public interest benefits and weigh them against the public interest harms posed by a potential merger.

Just as the Commission has been specific that applicants bear the burden to include any claimed efficiencies and synergies in their public interest showing, it has been clear that applicants will fail to satisfy that burden of proof if their claims are "vague or speculative, and cannot be verified by reasonable means."[239] There is no room within this language for lump sum approximations or "bottom line" guesses. The standard is a demand for an accounting by merger applicants, a requisite as elementary and understandable as a junior high school math teacher's rule that students must "show their work." The Commission gives no credit for generalized or speculative claims.

Even applicants who describe the size, scope and detailed origins of their claimed efficiencies will nevertheless fail to meet their burden of proof if they cannot also demonstrate that those efficiencies and synergies "would not be available but for the proposed merger."[240] By demanding proof of "merger specific" efficiencies, the Commission forces applicants to distinguish their claims from efficiencies that could be achieved through means less harmful to competition than the proposed merger. To this end, the Commission has delineated three areas in which applicants might demonstrate the benefits of their merger. First, applicants can show that efficiencies and synergies generated through a merger will "enhance the merged firm's ability to compete and

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[239] *Id.* at ¶ 158.

[240] *Id* at ¶¶ 158, 169

therefore result in lower prices. . . ."[241] Second, applicants may prove that the efficiencies and synergies generated through a merger will "result in . . . improved quality, [and] enhanced service."[242] Third, applicants can demonstrate that the efficiencies and synergies generated through a merger will "result in . . . new products."[243]

As discussed below, WorldCom and MCI have not even attempted to comply with their obligations under *Bell Atlantic/NYNEX*. Their asserted efficiencies and synergies are undocumented, unverified, and quite possibly unattainable, and their claims that the combined company will be a more effective local and long distance competitor rely more on rhetorical flourishes than reasoned analysis.

B. The Applicants Fail To Substantiate Their Efficiency Claims as Required by the *Bell Atlantic/NYNEX* Standard, and a Preliminary Analysis of Those Claims Raises Serious Questions As to Their Accuracy.

1. The Applications and Joint Reply Provide No Documentation for the Asserted Efficiencies and Synergies.

The Applicants propose that during the four years after their proposed merger, the combined company will achieve savings in excess of $23 billion[244] from network synergies, "core sales, general and administrative expenses," and "capital expenditure

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[241] *Id.* at ¶158.

[242] *Id.* and at ¶ 174.

[243] *Id.* at ¶ 158.

[244] WorldCom, Inc. S-4, at 41-44.

savings."[245] Specifically, the companies contend that their combination will result in "reduced domestic network costs," "reduced costs in MCI's local activities," and "avoided duplicative capital expenditures."[246] Yet the specific origins of these multibillion dollar efficiencies and synergies are unexplained, the data on which they are based are unavailable (apparently even to WorldCom and MCI's own financial advisors), and the savings that they claim are not independently verifiable. Accordingly, there is no basis for crediting these claims, given the absence of any record evidence.

While the *Bell Atlantic/NYNEX* standard requires specificity from applicants who claim their merger will create efficiencies and synergies, WorldCom and MCI offer only a naked conclusion, not evidence. There are no underlying data in their applications, Joint Reply, or SEC filings to explain the source of the purported savings. Nor do the companies reveal the assumptions explaining how they will recognize multiple billions of dollars in savings in category after category of expenses and investment. Instead, their economic experts, when opining that the merger will be pro-competitive, take as a given the assertions made by the companies' financial advisors in their SEC filings.[247]

Following the paper trail to the SEC, though, makes it clear that the synergy and efficiency claims presented by the Applicants' financial advisors are simply lump sum predictions based entirely on figures furnished by WorldCom on a "trust me" basis.

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[245] Joint Reply at 11-12.

[246] *Id.*

[247] *See* Carlton/Sider Declaration at 8 ("While we have not independently reviewed these calculations, it is important to note that investment analysts generally appear to attach credibility to these estimates.").

That is, by the Applicants' own account, the data underlying the efficiency and synergy claims were "not examined, reviewed or compiled by independent accountants."[248] Moreover, the analysts' generalized conclusions regarding synergies and efficiencies were "not prepared with a view toward compliance with general accounting principles." And, to further confirm that the asserted efficiencies are "pie in the sky," the SEC filing cautions that "there can be no assurance that the synergies will be realized."[249] In short, the Applicants' efficiency claims are incapable of being verified and thus cannot be credited.

2. There Is Substantial Cause For Questioning Whether the Merger Can Truly Produce Billions and Billions of Dollars in Savings.

Based on the extremely limited information contained in the Applicants' SEC filings, the claimed efficiencies appear to be grossly overstated. For example, WorldCom and MCI claim that access charge savings will account for approximately one-third of the total efficiencies to be realized from the merger. However, examination of the purported sources of those savings demonstrates that, in all likelihood, they are almost entirely unattainable.

As an initial matter, the Applicants appear to be counting the full amount of expected savings from self-provisioning access, without offsetting those savings by the revenues that an independent WorldCom would have received from MCI. Those foregone revenues represent a clear opportunity cost of the merger. As Dr. Harris

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[248] WorldCom, Inc. S-4, at 41.

[249] *Id.* at 41.

explains, the Applicants should have examined the access charge savings (that is, the avoided access charge less the company's internal cost of providing access) resulting from *additional* MCI traffic routed over WorldCom's access facilities *as a result of the merger.*[250]

Similarly, Dr. Harris concludes that the parties have greatly overestimated the available access savings resulting from more efficient trunking of traffic exchanged with incumbent LECs. As he points out, the vast majority of access charges – including the CCL, PICC, and end office switching-related charges – cannot be minimized through more efficient trunking. It is only the charges for entrance facilities and direct-trunked transport (which together represent only *three percent* of total access charges) that can be minimized.[251] Consequently, the asserted access charge reductions are at best completely undocumented and at worst largely fictional.

Another major source of claimed efficiencies, representing approximately one-fourth of expected savings, is WorldCom's ability to use MCI's assertedly more favorable international settlement arrangements. This source, too, however, appears to dematerialize once scrutinized. Dr. Harris explains that: (1) a merger is not required to reap any available savings, since the parties could achieve the same result through a mutually beneficial contract; (2) it is not clear that MCI truly has superior arrangements; and (3) even if it does, those arrangements either violate Commission policy (if the

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[250] *See* Harris LD Affidavit at 42.

[251] *Id.* at 39-40.

foreign market is not open to competition) or would not be sustainable (if the foreign market is effectively open).[252]

Finally, Dr. Harris notes that the Applicants' rosy financial projections are inconsistent with their economic experts' claims that the interexchange market is competitive. In this regard, he shows in Exhibit 34 to his Affidavit that MCI and WorldCom expect their joint revenue to more than double by 2001, their cost savings to widen as a proportion of operating expenditure from 8 percent to 12 percent by 2002, and their profit margin to expand to an "astonishing" 33 percent by 2002. The Applicants, of course, have not explained how these figures are achievable in a vigorously competitive market, and they would be hard-pressed to do so.[253]

Finally, Dr. Harris shows that the stock market seems to have substantially discounted the claimed efficiencies. While the market apparently believes the merger will go through (since MCI's current share price is close to the $51 offered by WorldCom), the combined stock value of the companies is well below the valuation that would be expected even if the low end of the expected synergy range were realized. As Dr. Harris concludes:

> [if] traders were to believe the synergy estimates, they would bid up the price of WorldCom's stock until these synergies were fully built into the market capitalization. . . . [I]t appears that the market has discounted . . . over 50% of MCI-

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[252] *Id.* at 43. In the latter case, which should apply more frequently following implementation of the WTO Agreement, "any advantages which MCI has should be rapidly eliminated as WorldCom bargains for better terminating rates in those countries." *Id.* at 43.

[253] *Id.*

> WorldCom's synergy estimates. . . . Therefore, one must conclude that the WorldCom and MCI efficiency estimates are not persuasive.[254]

C. There Is No Basis For Believing the Applicants' Assertion That the Merger Will Enhance Local and Long Distance Competition.

1. Claims That the Combined Company Will Be a More Effective Local Competitor Are Unsupported by Facts or Analysis, and any "Efficiencies" Likely Result from Reduced Investment and Less Robust Competition.

The basic premise underlying the Applicants' public interest claims is that the merged entity will be a strengthened competitor to the ILECs because of MCI's and WorldCom's complementary skills.[255] However, as highlighted in GTE's Petition, they merely state this claim as a seemingly undeniable fact, and present no data or other evidence to confirm that their operations are complementary or capable of being integrated effectively. Indeed, most of their discussion regarding local entry is framed as a diatribe against the alleged anticompetitive conduct of incumbent LECs, rather than an affirmative, reasoned showing that the merger can be expected to strengthen local competition.

In reality, there appears to be good reason to believe that any cost savings or increased revenues flowing to the merged entity will result from reduced investment and

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[254] *Id.* at 44; *see also id.* at Exhibit 35.

[255] Joint Reply at 8-11. For example, Applicants assert that "the two companies bring complementary strengths to the merger" and that "[t]he combination of MCI's reputation and customer recognition, with WorldCom's more extensive network of local exchange facilities, presents a unique opportunity to provide facilities-based local exchange competition." Joint Reply at 9.

less robust competition – factors that certainly cannot be considered to advance the public interest. In this regard, Wall Street analysts have concluded that the merger of WorldCom and MCI will produce efficiencies and synergies through a "significant cut back in the aggressive local market entry plans at MCIMetro which are now redundant to existing and planned MFDS and Brooks CLEC assets."[256] Therefore, while the Applicants claim that their merger is "fundamentally different from a merger of, for example, two steel plants that will result in the closing of one of them,"[257] the analogy actually rings all too true. Notably, these analysts also predict that savings will accrue to the companies because "local pricing will feel slightly less pressure" from a combined WorldCom/MCI.[258]

2. The Applicants Have Failed To Demonstrate That any Synergies in the Long Distance Market Will Benefit Consumers.

The Applicants also claim that the combination of their long distance businesses will result in efficiencies and synergies, supposedly stemming from more productive use

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[256] Merrill Lynch In-depth Report, "United States Telecommunications/Services," at 2, Feb 4, 1998 ("Merrill Lynch"). Additional support for the financial analysts' position is found in the conclusions of the Communications Workers of America, who noted that "the only logical explanation for the reduction of $5.3 billion in expenses in the local market is that the merged entity will shift focus from MCI's pre-merger plans to compete in the residential and small business markets to WorldCom's exclusive focus on large and medium-sized business customers." Reply Comments of the Communications Workers of America, CC Docket No. 97-221, at 14 (filed Jan. 26, 1998).

[257] Joint Reply at 17.

[258] Merrill Lynch at 2.

of their network assets.[259] There are two problems with this assertion. First, assuming for the sake of argument that the claimed efficiencies are real and would flow through to long distance consumers, WorldCom and MCI offer no explanation how they will optimize their networks and what it will cost to do so. For example, they provide no evidence that their disparate switches, network management systems and operations support systems are readily capable of integration. Such evidence is crucial to determining whether efficiencies truly result from network consolidation; WorldCom elected not to consolidate the LDDS and WilTel networks primarily due to the difficulty of integrating the different switching platforms. If MCI's and WorldCom's networks are not compatible, then no efficiencies will be gained.[260] Even if they can be integrated with some effort, there will be potentially substantial costs associated with doing so, which may well offset in large part the resulting efficiencies.

The second problem with the Applicants' claim is that the real source of any benefits to the combined company may well be reduced competition. In this regard, the Wall Street analysts have reached the same conclusion as in the local market: the merger will "reduce . . . the level of intra-industry competition in . . . the US LD . . . market via the reduction in the number of major competitors."[261] Accordingly, as Dr.

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[259] WorldCom, Inc. S-4, at 42.

[260] *See* Harris LD Affidavit at 44.

[261] Merrill Lynch WorldCom Report at 2; *see also* the discussion in Section II.E above regarding the stock prices of facilities-based interexchange carriers following announcement of the merger.

Harris recommends, the "Commission should discount any defense of this merger based on the claimed 'efficiencies' that this transaction would generate":

> Production efficiencies can only mitigate the negative impact on consumers of an anticompetitive transaction if they are passed on to consumers. However, in the case of the interexchange industry, not even an industry-wide cost reduction that was observable by regulators (that is, a mandated reduction in access charges) was passed on to consumers. This makes it all the less likely that consumers would benefit from the efficiencies claimed by MCI and WorldCom.[262]

* * *

The Applicants have failed, by any measure, to meet the *Bell Atlantic/NYNEX* requirement that their efficiency claims be stated with specificity, in a verifiable manner and with assurances that they would not arise "but for" the merger. Nor have they shown that any efficiencies and synergies that do occur as a result of the merger would redound to the public's benefit. Indeed, just the opposite appears true: whatever efficiencies are gained through this merger almost certainly will come at the expense of cuts in local service and degradation of competition in the local and long distance markets.

VII. CONCLUSION

WorldCom and MCI have fallen far short of meeting the *Bell Atlantic/NYNEX* showing. Their product and geographic market definitions are either altogether absent or self-servingly inconsistent with Commission precedent. Their identification of

[262] Harris LD Affidavit at 45.

significant market participants is in some cases indefensibly narrow and in others plainly overbroad, with the transparent goal of understating the adverse effects of the merger. Their discussion of entry barriers and their competitive impact analysis rest on unsubstantiated allegations, devoid of factual development and reasoned argument. And, their enormous efficiency and synergy claims lack any factual or analytical foundation and have not been critically examined by the Applicants' own economic experts and financial advisors. Based on the record now before the Commission, the only proper alternative is to dismiss the applications as patently insufficient to demonstrate compliance with the applicable standards or at a minimum, to designate the applications for a formal hearing.

Respectfully submitted,

GTE SERVICE CORPORATION

By: William P. Barr

William P. Barr, Executive Vice President & General Counsel
and
Ward W. Wueste, Vice President - Deputy General Counsel

GTE SERVICE CORPORATION
One Stamford Forum
Stamford, CT 06904

By: R. Michael Senkowski

Richard E. Wiley
R. Michael Senkowski
Jeffrey S. Linder
Robert J. Butler

WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000

March 13, 1998

CERTIFICATE OF SERVICE

I hereby certify that on this 13th day of March, 1998, I caused copies of the foregoing Comments of GTE Service Corporation to be delivered by first class U.S. mail to the following:

Michael H. Salsbury
Mary L. Brown
Larry A. Blosser
MCI COMMUNICATIONS CORPORATION
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006-3606

Andrew D. Lipman
Jean L. Kiddoo
SWIDLER & BERLIN, CHTD.
3000 K Street, N.W., Suite 300
Washington, D.C. 20007

Catherine R. Sloan
Robert S. Koppel
WORLDCOM, INC.
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036

Sue Ashdown
Coalition of Utah Independent Internet
Service Providers
X Mission
51 E. 400 S. Suite 200
Salt Lake City, Utah 84111

George Kohl
Debbie Goldman
Communications Workers of America
501 Third Street, N.W.
Washington, D.C. 20001

Ramsey L. Woodworth
Robert M. Gurss
Rudolph J. Geist
Simply Internet, Inc.
Wilkes, Artis, Hedrick & Lane, Chtd.
1666 K Street, N.W.
Suite 1100
Washington, D.C. 20006

Thomas A Hart, Jr.
Amy E. Weissman
M. Tamber Christian
TMB Communications, Inc.
Ginsburg, Feldman and Bress, Chtd.
1250 Connecticut Avenue, N.W.
Washington, D.C. 20036

Andrew Jay Schwartzman
Gigi B. Sohn
Joseph S. Paykel
Media Access Project
Suite 400
1707 L Street, N.W.
Washington, D.C. 20036

James Love
Consumer Project on Technology
P.O. Box 19367
Washington, D.C. 20036

Barbara O'Connor
Donald Vial
Maureen Lewis
The Alliance for Public Technology
901 Fifteenth Street, N.W., Suite 230
Washington, D.C. 20005

John Thorne
Bell Atlantic
1320 N. Court House Rd.
8th Floor
Arlington, VA 22201

William B. Barfield
Jonathan Banks
BellSouth Corporation
Suite 1800
1155 Peachtree Street, N.E.
Atlanta, GA 30309

Alan Y. Naftalin
Koteen & Naftalin, L.L.P.
1150 Connecticut Avenue, N.W.
Suite 1000
Washington, D.C. 20036

Janice Mathis
Rainbow/PUSH Coalition
Thurmond, Mathis & Patrick
1127 W. Hancock Avenue
Athens, GA 30603

David Honig
Rainbow/PUSH Coalition
3636 16th Street, N.W., #B-366
Washington, D.C. 20010

Matthew R. Lee
Inner City Press/Community on the Move
1919 Washington Avenue
Bronx, N.Y. 10457

John J. Sweeney
American Federation of Labor and
Congress of Industrial Organizations
815 16th Street, N.W.
Washington, D.C. 20006

*Chief, Network Services Division
Federal Communications Commission
2000 M St., N.W., Room 235
Washington, D.C. 20554
(2 copies)

*International Reference Room
International Bureau
Federal Communications Commission
2000 M St., N.W., Room 102
Washington, D.C. 20554
(2 copies)

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Wireless Telecommunications Bureau
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2025 M St., N.W., Room 5608
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(2 copies)

*John Nakahata
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*Chairman William F. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*Regina Keeney
Federal Communications Commission
2000 M Street, N.W., 8th Floor
Washington, D.C. 20554

*Commissioner Harold Furchtgott-Roth
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

*Paul Misener
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

*Jane Mago
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

*Helgi Walker
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

*James Casserly
Federal Communications Commission
1919 M Street, N.W., Room 832
Washington, D.C. 20554

*Commissioner Gloria Tristani
Federal Communications Commission
1919 M Street, N.W., Room 826
Washington, D.C. 20554

*Rick Chessen
Federal Communications Commission
1919 M Street, N.W., Room 826
Washington, D.C. 20554

*Richard Metzger
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

*Karen Gulick
Federal Communications Commission
1919 M Street, N.W., Room 826
Washington, D.C. 20554

*Paul Gallant
Federal Communications Commission
1919 M Street, N.W., Room 826
Washington, D.C. 20554

*Susan Fox
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*Ari Fitzgerald
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*Commissioner Michael Powell
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

*Peter E. Tenhula
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

*Kyle D. Dixon
Federal Communications Commission
1919 M Street, N.W., Room 844
Washington, D.C. 20554

*Commissioner Susan Ness
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*James L. Casserly
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

*John Muleta
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

*Richard Welch
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

*Larry Strickling
Federal Communications Commission
1919 M Street, N.W., Room 650L
Washington, D.C. 20554

*Christopher Wright
Federal Communications Commission
1919 M Street, N.W., Room 614
Washington, D.C. 20554

*Daniel Phythyon
Federal Communications Commission
1919 M Street, N.W., Room
Washington, D.C. 20554

*Ruth Milkman
Federal Communications Commission
1919 M Street, N.W., Room 500
Washington, D.C. 20554

*Diane Cornell
Federal Communications Commission
2000 M Street, N.W., 8th Floor
Washington, D.C. 20554

*David Solomon
Federal Communications Commission
1919 M Street, N.W., Room 614
Washington, D.C. 20554

*Paula Michele Ellison
Federal Communications Commission
1919 M Street, N.W., Room 614
Washington, D.C. 20554

*Kevin Martin
Federal Communications Commission
1919 M Street, N.W., Room 802
Washington, D.C. 20554

*Gregory Cooke
Federal Communications Commission
2000 M Street, N.W., Room 210R
Washington, D.C. 20554

*Carol Mattey
Federal Communications Commission
1919 M Street, N.W., Room 544
Washington, D.C. 20554

*Rebecca Dorch
Federal Communications Commission
1919 M Street, N.W., Room 658
Washington, D.C. 20554

*International Transcription Service, Inc.
1231 20th Street, N.W.
Washington, D.C. 20036

Gina M. Stuart

Gina M. Stuart

* via hand delivery

APPENDIX 1

Chart of Competitive Effects of Merger

SUMMARY OF THE COMPETITIVE EFFECTS OF THE WORLDCOM/MCI MERGER

	BELL ATLANTIC/NYNEX STANDARD	APPLICANTS' CLAIMS	PETITIONERS' AND COMME SUBMISSIONS
LONG DISTANCE SERVICES	Identify the relevant product markets	• Interexchange retail and wholesale services are part of a single market	• There are two relevant produ (1) retail long distance and (2 long distance (e.g., bulk capa advanced features)
	Identify the relevant geographic markets	• No discussion	• In *LEC In-Region Interexch* FCC found that each point-t geographic market constitut separate geographic marke markets may be grouped w customers face the same c conditions

	BELL ATLANTIC/NYNEX STANDARD	APPLICANTS' CLAIMS	PETITIONERS' AND COMMEN SUBMISSIONS
LONG DISTANCE SERVICES (continued)	Identify impact on customer groups: (1) residential customers and small businesses; and (2) medium-sized businesses; and (3) large businesses/government users	• Applicants have supplied no information to assess impact on the different customer groups • Resellers have access to wholesale capacity from other sources	• Competition for residential and businesses will be harmed by WorldCom/MCI abandoning lo market to concentrate on high customers (namely businesse • All classes of customers will s because resellers serving the market will pay higher rates fc wholesale capacity • Resellers will be denied acce advanced capabilities neede compete
	Identify the most significant market participants	• All IXC carriers, including small IXCs	• AT&T, MCI, Sprint, WorldCo

	BELL ATLANTIC/NYNEX STANDARD	APPLICANTS' CLAIMS	PETITIONERS' AND COMMEN SUBMISSIONS
LONG DISTANCE SERVICES (continued)	Evaluate the competitive effects of the merger	• Merger will have no anticompetitive effects b/c Applicants hold no bottlenecks and the interexchange market has virtually no barriers to entry • Coordinated action is unlikely • Merged company will remain committed to serving residential markets; residential customers are important users of network capacity that would remain idle	*Retail Long Distance* • Combines the 2nd and 4th large distance providers • Increases likelihood of price co • Under DOJ Guidelines, marke "highly concentrated" • HHI analysis shows that merg to increase market power *Wholesale Long Distance* • Absent WorldCom, the three will pursue less vigorous who market strategies
INTERNATIONAL SERVICES	Identify the relevant product markets	• Seamless global services market (i.e., IMTS and private line services constitute a single product market)	• There are two end-user prod (1) private line services and • Transport capacity is an inpu market
	Identify the relevant geographic markets	• World-wide market	• The FCC defines geographi the international context on specific basis

	BELL ATLANTIC/NYNEX STANDARD	APPLICANTS' CLAIMS	PETITIONERS' AND COMMEN SUBMISSIONS
INTERNATIONAL SERVICES (continued)	Identify impact on customer groups: (1) residential customers and small businesses; and (2) medium-sized businesses; and (3) large businesses/government users	• No discussion	• The merger will adversely affe businesses and residential cus diminishing competition in the of IMTS services • Large businesses and reseller typically use private line servic likely to be affected by increas concentration in the private lin
	Identify the most significant market participants	• All domestic and foreign IXCs	*Private Line Services* • AT&T, MCI, Sprint, WorldCor *IMTS* • AT&T, MCI, Sprint, WorldCon *Transport* • AT&T, MCI, Sprint, WorldCor

	BELL ATLANTIC/NYNEX STANDARD	APPLICANTS' CLAIMS	PETITIONERS' AND COMME SUBMISSIONS
INTERNATIONAL SERVICES (continued)	Evaluate the competitive effects of the merger	*Combined Private Line and IMTS* • Merger will not have anticompetitive effects because market is growing and prices are declining • Market entry is easy *Transport* • Substantial capacity exists; new cables are being planned	*Private Line Services* • Combines 2nd (MCI) and 3rd (ranked carriers by revenue tc AT&T as the market leader • Under the DOJ's merger guic market is already highly conc • HHI analysis shows that the likely to create or enhance m *IMTS* • Combines 2nd (MCI) and 4th (ranked carriers by revenue • Creates incentive for collusic • Under the DOJ's merger gui market is already highly conc • HHI analysis shows that the likely to create or enhance m *Transport* • Under the DOJ's merger gui market is already highly con • Capacity shortage will be ex even though new cables are line • Increased incentive to raise this input • Increased incentive to restri prevent competition in the r