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BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of	)	
	)	
GTE CORPORATION,	)	
Transferor,	)	
and	)	CC Docket No. 98-184
BELL ATLANTIC CORPORATION,	)	
Transferee,	)	
For Consent to Transfer of Control.	)	

DECLARATION OF
ROBERT W. CRANDALL AND J. GREGORY SIDAK

CONTENTS

Robert W. Crandall and J. Gregory Sidak, being duly sworn, depose and say:

1. We have been asked by Bell Atlantic Corporation and GTE Corporation to evaluate the claims, advanced by experts retained by AT&T, MCI WorldCom, and Sprint (companies that we shall collectively call "the IXCs"), that the proposed merger of Bell Atlantic and GTE will reduce competition in downstream markets—principally long-distance and Internet services—due to vertical foreclosure and price squeezes that could assertedly be employed profitably by the combined company.

QUALIFICATIONS

2. Our professional qualifications for submitting this expert declaration are as follows.

3. My name is Robert W. Crandall. I am a Senior Fellow in Economic Studies at the Brookings Institution in Washington, D.C., a position that I have held since 1978. My areas of economic research are antitrust, telecommunications, the automobile industry, competitiveness, deregulation, environmental policy, industrial organization, industrial policy, mergers, regulation, and the steel industry.

4. I have twice served in the federal government. I was Acting Director, Deputy Director, and Assistant Director of the Council on Wage and Price Stability in the Executive Office of the President. In 1974–75, I was an adviser to Commissioner Glen O. Robinson of the Federal Communications Commission (FCC).

5. I was an Assistant Professor and Associate Professor of Economics at the Massachusetts Institute of Technology between 1966 and 1974. I have also taught at George Washington University.

6. I have written widely on telecommunications policy, the economics of broadcasting, and the economics of cable television. I am the author or co-author of four books on communications policy published by the Brookings Institution since 1989: *Changing the Rules: Technological Change, International Competition, and Regulation in Communications*, with Kenneth Flamm (1989); *After the Breakup: U.S. Telecommunications in a More Competitive Era* (1991); *Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications*, with Leonard Waverman (1996); and *Cable TV: Regulation or Competition?*, with Harold Furchtgott-Roth

(1996). In addition, I have published four other books on regulation and industrial organization with the Brookings Institution: *The Extra Mile: Rethinking Energy Policy for Automotive Transportation*, with Pietro S. Nivola (1995); *Manufacturing on the Move* (1993); *Up from the Ashes: The U.S. Minimill Steel Industry*, with Donald F. Barnett (1986); and *Regulating the Automobile*, with Howard K. Gruenspecht, Theodore E. Keeler, and Lester B. Lave (1986). My work has been cited on numerous occasions by the federal judiciary and the FCC.

7. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice, to the Federal Trade Commission, to the Canadian Competition Bureau, and to more than twenty companies in the telecommunications, cable television, broadcasting, newspaper publishing, automobile, and steel industries. I have also been a consultant to the Environmental Protection Agency and the U.S. Department of the Treasury.

8. I received an A.B. (1962) from the University of Cincinnati and a Ph.D. in economics (1968) from Northwestern University.

9. My name is J. Gregory Sidak. I am the F. K. Weyerhaeuser Fellow in Law and Economics at the American Enterprise Institute for Public Policy Research (AEI) in Washington, D.C., where I direct AEI's Studies in Telecommunications Deregulation. I am also a senior lecturer at the Yale School of Management, where I teach a course on telecommunications regulation and strategy with Professor Paul W. MacAvoy. In addition to holding these two academic positions, I am a Principal in LECG, Inc., an economic consulting services firm that provides economic and financial analysis, expert testimony, litigation support, and strategic management consulting to a broad range of public and private enterprises.

10. I have previously worked in the federal government. From 1987 to 1989, I was

Deputy General Counsel of the FCC. From 1986 to 1987, I was Senior Counsel and Economist to the Council of Economic Advisers in the Executive Office of the President.

11. My academic research concerns regulation and strategy in telecommunications and other network industries, antitrust policy, and constitutional law issues concerning economic regulation. I have written four books concerning pricing, costing, competition, and investment in regulated network industries: *Deregulatory Takings and the Regulatory Contract: The Competitive Transformation of Network Industries in the United States* (Cambridge University Press 1997), co-authored with Daniel F. Spulber; *Toward Competition in Local Telephony* (MIT Press & AEI Press 1994), co-authored with William J. Baumol; *Transmission Pricing and Stranded Costs in the Electric Power Industry* (AEI Press 1995), also co-authored with Professor Baumol; and *Protecting Competition from the Postal Monopoly* (AEI Press 1996), also co-authored with Professor Spulber. I am also the author of a fifth book, *Foreign Investment in American Telecommunications* (University of Chicago Press 1997), and of more than thirty scholarly articles in law reviews and economics journals.

12. I have been a consultant on regulatory and antitrust matters to the Antitrust Division of the U.S. Department of Justice, to the Canadian Competition Bureau, and to more than thirty companies in the telecommunications, electric power, natural gas, mail delivery, broadcasting, newspaper publishing, and computer software industries in North America, Europe, Asia, and Australia.

13. From Stanford University, I earned A.B. (1977) and A.M. (1981) degrees in economics and a J.D. (1981) in law. I was a member of the *Stanford Law Review*.

14. We file this declaration in our individual capacities, and not on behalf of the Brookings Institution, the American Enterprise Institute, or the Yale School of Management.

SUMMARY OF CONCLUSIONS

15. The IXCs' economic experts argue that integrated incumbent local exchange companies (ILECs) have the incentive to employ a variety of discriminatory tactics and price squeezes in selling retail services that use their own access services (including unbundled network elements) as inputs. The IXCs' experts simply recite the fact that under certain assumptions ILECs may have the *incentive* to employ these tactics, but those experts do not demonstrate that these assumed conditions are realistic. Nor do they offer evidence that such tactics have been employed by either Bell Atlantic, GTE, or other ILECs. There is a lengthy history of ILEC integration into information services, wireless services, intraLATA long distance services and—in the case of Frontier, Sprint, and GTE—interLATA long distance services, but the IXCs' experts are unable to provide any evidence that discriminatory tactics have been employed by the ILECs in any of those markets. Contrary to their theoretical predictions, competition has flourished in those markets.

16. Even if the IXCs' experts were correct that vertical foreclosure is a feasible and profitable strategy for an ILEC, they do not provide evidence that the combination of two ILECs, such as GTE and Bell Atlantic, has an effect on such a strategy. They rely *in toto* on the allegation that the combination of Bell Atlantic and GTE will allow the merged company to capture "spillovers" from vertical foreclosure that neither company could capture alone. The IXCs' experts fail to show that such spillovers are currently captured by integrated ILECs in proportion

to their size.

17. In addition to arguing vertical foreclosure, the IXCs' experts argue that the merger exacerbates the dangers of a "price squeeze" by the combined company against its less integrated rivals, with anticompetitive results. Under the assumptions of the IXCs' experts, many ILECs currently have the ability and incentive to engage in such a price squeeze, yet the IXCs' experts fail to demonstrate that such squeezes are ever actually employed—and, if they are, that they result in anything other than lower prices for consumers. To our knowledge, no IXC has been driven from the market by any such purported "squeeze."

18. Finally, the IXCs' experts raise the specter of the combined company gaining monopoly control of Internet services through its position in offering intermediate access services and network elements. Were that possibility plausible, the largest ILECs would be moving in that direction today. Instead, the ILECs are paying large sums in reciprocal compensation to competitive local exchange carriers (CLECs) established by Internet service providers (ISPs) as the result of a regulatory distortion in pricing.

I. The Allegations of Vertical Foreclosure

19. The IXCs advance their arguments of potential vertical foreclosure caused by the merger in declarations or affidavits supplied by Stanley M. Besen, Padmanabhan Srinagesh, and John R. Woodbury,[1] by Kenneth C. Baseman and A. Daniel Kelley,[2] and by David L. Kaserman

1. Declaration of Stanley M. Besen, Padmanabhan Srinagesh, and John R. Woodbury: An Economic Analysis of the Proposed Bell Atlantic/GTE Merger (filed on behalf of Sprint Communications Company L.P., Nov. 23. 1998).

2. Declaration of Kenneth C. Baseman and A. Daniel Kelley (filed on behalf of MCI WorldCom, Inc., Nov. 23, 1998) [hereinafter *Baseman-Kelley Declaration*].

and John W. Mayo.[3] These commenters either simply assert that Bell Atlantic and GTE possess market power in the local exchange, or they rely on the incorrect analysis in the declaration of John B. Hayes.[4]

20. The Besen-Srinagesh-Woodbury declaration itself relies on a previous declaration submitted by Michael L. Katz and Steven C. Salop in the SBC-Ameritech merger proceeding before the Commission.[5] This latter declaration by Katz and Salop supplies the principal theoretical basis for the IXCs' contention that the current merger could reduce competition through the vertical foreclosure of access services and intermediate network elements supplied by Bell Atlantic and GTE. We therefore respond in this section primarily to the arguments advanced by Katz and Salop.

21. The Katz-Salop declaration argues that the larger "footprint" created by the SBC-Ameritech merger increases the incentive for the combined company to engage in various forms of vertical foreclosure. Because access services are still regulated by federal and state authorities, Katz and Salop are forced to concede that the merger does not enhance the *ability* of the combined company to raise the *price* of access.[6] Rather, they claim that the merger increases the *incentive*

3. Affidavit of David L. Kaserman and John W. Mayo (filed on behalf of AT&T Corp., Nov. 23, 1998).

4. Declaration of John B. Hayes: Market Power and the Bell Atlantic-GTE Merger (filed on behalf of Sprint Communications Company L.P., Nov. 23. 1998). As shown in Declaration of Professors Robert H. Gertner and John P. Gould (filed on behalf of Bell Atlantic Corp. and GTE Corp., Dec. 23, 1998), the Hayes analysis fails to account for cross-subsidization in the current ILEC rate structure and eschews any effort to conduct the rigorous market definition required for serious antitrust analysis.

5. Declaration of Michael L. Katz and Steven C. Salop: Using a Big Footprint to Step on Competition: Exclusionary Behavior and the SBC-Ameritech Merger, Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, to SBC Communications Inc., Transferee, CC Dkt. No. 98-141 (filed on behalf of Sprint Communications Company L.P., Oct. 14, 1998) [hereinafter *Katz-Salop Declaration*].

6. Katz and Salop speculate that "SBC may benefit [after its merger with Ameritech] from economies of scope in fighting regulatory battles in multiple state forums." *Katz-Salop Declaration* at 40–41 ¶ 65. Surely, it would be constitutionally

for the combined company to degrade the *quality* of its access services (or intermediate network elements) in a variety of hypothetical ways. If, however, a firm has an incentive, but not the means, to engage in anticompetitive behavior, then it necessarily follows that competitive harm cannot possibly occur.

22. Katz and Salop's hypothesis can be simply stated: If exclusionary behavior is subject to a positive spillover effect between markets, then the merger would increase the incentives of the companies to engage in exclusionary behavior. In short, the Katz-Salop declaration makes a number of arguments based on a purely theoretical and hypothetical analysis of "spillovers" of the benefits of asserted reductions in the quality of access services. Not only is their theoretical approach flawed and incomplete, but Katz and Salop fail to provide any evidence that such foreclosure has actually occurred and has harmed competition in any downstream market. Given that the ILECs have, for many years, been offering access services to firms that compete with them in a variety of downstream services, one must conclude that the Katz-Salop hypotheticals are just that–*hypothetical* cases without grounding in the reality of current market conditions. The Commission should disregard the Katz-Salop hypothesis—and, by extension, the arguments made by all of the IXCs' other experts who rely on the Katz-Salop hypothesis. The Katz-Salop model is incomplete, ignores the reality of the regulatory system, and is refuted by the

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impermissible for a regulator to block a merger in the belief that the combination would enhance one's ability to petition government, a right expressly protected by the First Amendment. Katz and Salop also argue that "regulators will no longer be able to monitor, detect and prove the existence of exclusionary conduct by SBC using Ameritech's conduct as a benchmark, or vice versa." *Id.* This argument is comprehensively analyzed and found wanting in Declaration of Kenneth Arrow (filed on behalf of Bell Atlantic Corp. and GTE Corp., Dec. 23, 1998). Finally, Katz and Salop allege that "by controlling both ends of access, the integrated company may be better able to evade regulatory oversight of the quality of the access it provides by better rationalizing its exclusionary tactics." *Id.* The Commission should dismiss this argument entirely, recognizing that it is nothing more than a speculative attempt to conjure up a new potential "problem" by recombining the "regulatory economies of scope" and "benchmarking" arguments.

facts.

23. The Telecommunications Act of 1996 requires ILECs to provide interconnection services to all carriers requesting them under terms to be negotiated and ultimately approved by regulatory authorities.[7] Both Bell Atlantic and GTE are currently subject to those provisions. Moreover, Bell Atlantic must satisfy a section 271 "competitive checklist" of those requirements to be permitted to provide in-region interLATA services.[8] The merger does not diminish those responsibilities, nor does it lessen regulatory oversight of the companies' interconnection activities.

24. Katz and Salop also make the crucial assumption that the externality in exclusionary behavior between the two ILECs is positive (for example, pre-merger discriminatory behavior by Bell Atlantic supposedly would increase GTE's profits by retarding CLEC entry in GTE's territories). The externality, however, is much more likely to be *negative*, in which case the discriminatory behavior by ILEC *A* in its territory leads the CLEC to concentrate its entry efforts in the territory of ILEC *B*.[9] If the externality is indeed negative, the merger is likely to *reduce* exclusionary behavior, as the negative externality is internalized. Put simply, before the merger the ILECs could be over-discriminating in a "beggar-thy-neighbor" effort to induce CLECs to enter somebody else's market instead. After the merger, such hypothetical discrimination is reduced as the ILEC realizes that exclusionary behavior in one of its markets is self-defeating

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7. 47 U.S.C. §§ 251, 252.

8. *Id.* § 271.

9. *See* Reply Affidavit of Richard Schmalensee and William Taylor, Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, to SBC Communications Inc., Transferee, CC Dkt. No. 98-141, at 23 ¶ 47 (filed on behalf of SBC Communications, Inc. and Ameritech Corporation, Nov. 12, 1998).

because it induces increased entry in another one of its markets. Katz and Salop make no empirical showing as to whether their theoretical externality is likely to be positive or negative. Consequently, the Commission should conclude that the Katz-Salop hypothesis cannot predict whether exclusionary behavior would increase or decrease as a result of the merger. It would be economic caprice for the Commission to use a model that cannot produce coherent predictions of exclusionary conduct to inform the agency's public interest determination under the Communications Act.

25. Contrary to the assertions by the IXCs' economic experts, the merger of Bell Atlantic and GTE will not induce the combined company deliberately to reduce the quality of its wholesale access services. Such reductions in quality would redound to the merged companies' *disadvantage* through adverse reputation effects with other customers. An ILEC's deliberate reduction in the quality of inputs supplied to customers that compete with it in downstream markets would thus have severe spillover effects of its own among other customers. Such a strategy would be short-sighted in an increasingly competitive market.

26. Katz and Salop, as well as the IXCs' other declarants cited above, advance what are by now very familiar arguments concerning the ILECs' potential to exercise vertical foreclosure of rivals. It is alleged that ILECs can engage in various exercises of quality degradation that are difficult to detect. Those actions are only broadly hinted at—delaying repair services on leased network elements; making collocation difficult; processing CLEC orders more slowly than their own; and even reducing the quality of the voice/data signal transmitted by their unintegrated rivals through the ILECs' facilities. Those arguments are never accompanied by *any* empirical measure of the extent of such alleged abuses or their effect on final service prices or

quality despite the fact that ILECs have for many years been offering access services to firms that compete with them in downstream markets.

27. The Katz-Salop declaration alleges that the ILECs have the *incentive* to engage in quality-degrading acts of vertical foreclosure because in so doing they protect high-margin retail services from competition while forgoing much less lucrative returns from wholesale services. But that assertion is no more than an obvious deduction: The CLECs will first attack the ILECs' high-margin services. Therefore, the ILECs have every incentive to defend their sales of such services by vigorously competing in any manner permitted by the regulators. That incentive to engage in commercial self-defense does not prove, however, that the ILECs could successfully degrade the quality of access to their rivals even if they desired to do so. The asserted incentive surely does not establish that such degradation would be a successful strategy.

28. For the ILECs to have the incentive to degrade their wholesale services, they must not suffer economic losses from such activities. By reducing the quality of their wholesale access services, the ILECs would induce their customers to search for alternatives (such as the services of competitive access providers) or even to construct their own facilities. If an ILEC in general, and Bell Atlantic-GTE in particular, could reduce competition through degradation of its access services, it would have to be surgically precise in such attempts. The ILEC surely would not wish to reduce the demand for these wholesale services that are purchased by firms serving other markets or even to reduce the quality of the ILEC's own downstream retail services. The Commission has reached a similar conclusion about allegations of ILEC discrimination against IXCs:

> [C]ommenters argue that the incumbent LEC will be able to . . . degrade the service of IXC competitors, by blocking calls at its own switch. Based on this record, we conclude that these concerns are not well-founded . . . . [I]ncumbent LECs have compelling incentives to deliver interstate calls to an IXC's POP. As competition develops for local service, it appears doubtful that an incumbent LEC would find it advantageous to block deliberately interstate calls placed by their end user customers. Such practices would encourage entry by new competitors and increase the interest of affected end users in finding a more reliable service provider. We also find it unlikely that either originating or terminating incumbent LECs would intentionally risk the collection of often significant per-minute access charge revenues on a completed long-distance call in order to collect additional, much smaller per-call setup charges. Finally, we know of no significant allegations of degraded service quality attributable to the very similar current regime. We are prepared, however, to investigate claims that an incumbent LEC is blocking calls in an intentional or discriminatory manner.[10]

29. Even if the contentions that the ILECs have the incentive and ability to degrade the quality of their access services were correct, it does not follow that those dangers would be heightened by the merger of Bell Atlantic and GTE. These same theoretical threats of vertical foreclosure would exist with *any* ILEC of *any* size. Katz and Salop are thus forced to make yet another set of heroic assumptions to try to link this merger to *increased* threats of vertical foreclosure. For this purpose they invoke a notion of "spillover" effects: the alleged vertical foreclosure benefits integrated ILECs *at each end* of any communication. To the extent that either GTE or Bell Atlantic has separately engaged in such activity, Katz and Salop theorize, each of the two companies may have created benefits of reduced competition for the other company when it is at the other end of the call. By combining their operations, the merger partners would

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10. Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure, Pricing End-User Common Line Charges, First Report and Order, CC Dkts. No. 96-262, 94-1, 91-213, 95-72, 12 F.C.C. Rcd. 15,982, 16,043 ¶ 142 (1997).

internalize these externalities, according to Katz and Salop, and the combined companies therefore would supposedly increase the profitability of the alleged vertical foreclosure.

30. Once again, the IXCs' experts submit their allegations of the potential profitability of anticompetitive actions without offering *any* empirical support. Were such degradations of quality possible and effective in preventing competition, one might expect that the largest ILECs would already be the most successful in foreclosing competition in downstream markets. Frontier, Sprint, and GTE are large carriers that have combined local and long-distance services for a number of years. Were vertical foreclosure through access degradation a successful anti-competitive strategy, one would expect those companies to have achieved greater market power than the scores of smaller ILECs that also offer long-distance services. There is, however, no evidence of successful foreclosure by Frontier, Sprint, and GTE that we have seen. Indeed, the available empirical evidence is inconsistent with the Katz-Salop foreclosure hypothesis.[11]

31. In addition, every wireless carrier requires interconnection with an ILEC in its region to operate successfully. In each local area, the ILEC was initially allocated one of the two initial cellular licenses, and most ILECs continue to offer wireless services and wireless-wireline interconnection to their wireless rivals. We know of no evidence that the ILECs have attempted to degrade the wireline interconnection of their local wireless competitors. Nor are we aware that the ILECs have been able to gain a competitive advantage over their unintegrated wireless rivals. In general, the wireline-owned cellar carrier (the "B" carrier) has not gained more market share than the non-wireline cellular carrier. Nor have the ILECs thwarted the competitive thrust of the

11. *See* Fred S. McChesney, *Empirical Tests of the Cross-Subsidy and Discriminatory-Access Hypotheses in Vertically Integrated Telephony*, 16 MANAGERIAL & DECISION ECON. 493 (1995).

new PCS and ESMR wireless services through vertical foreclosure of wireline access, despite the fact that these new wireless providers have succeeded in attracting customers from them and in severely reducing wireless rates. Surely, the wireless market provides the best possible test of the IXCs' experts' theories of foreclosure—and the theory fails decisively in that market.

32. If a competitive issue were to arise from the joint control of the originating and terminating ends of access, one would expect that such instances of exclusionary behavior would have been identified in the case of intraLATA toll. Bell Atlantic and GTE each historically carried a very large share of intraLATA toll traffic originating in their ILEC territories, until state regulators required 1+ equal access for intraLATA calls. In Bell Atlantic's case in particular, a very large proportion of intraLATA toll would both originate and terminate on its network, while the ratio for GTE would have been somewhat smaller. There has been no evidence of discrimination in the intraLATA market since the advent of 1+ preselection. For example, GTE's share of intraLATA toll traffic originating in its Florida territories dropped from 82 percent in December 1996 to less than 37 percent in December 1998.[12] Similar declines over the same period were recorded by GTE in Ohio (from 79 percent to 39 percent), Illinois (from 89 percent to 45 percent), Pennsylvania (from 78 percent to 38 percent), and Virginia (92 percent to 55 percent), a pattern which repeated itself across many GTE and Bell Atlantic territories.[13] Clearly, such share losses have occurred at a much faster rate than the erosion of AT&T's dominant position in interLATA toll since 1984, which indicates that ILECs have not excluded IXCs from intraLATA toll provision to any measurable extent. Consequently, there is little basis to fear that

12. Information provided by GTE.

13. Information provided by GTE and Bell Atlantic.

combination of the two companies should raise concerns based on the control of originating and terminating access.

33. We are forced to conclude that the theories of vertical foreclosure advanced by the IXCs' experts are just that—*theories*. The inapplicability of those theories to current market conditions is demonstrated by the conspicuous absence of empirical evidence to support them. Indeed, we believe that the wireless market and the long-distance operations of existing (non-RBOC) ILECs provide sufficient evidence to reject the applicability of those theories to current telecommunications markets.

II. THE ALLEGATIONS OF PRICE SQUEEZES

34. Baseman and Kelley raise the specter that the merger of Bell Atlantic and GTE would make possible "price squeezes" in long-distance and other downstream services that would use the combined firm's access services. In so doing, Baseman and Kelley reject the safeguards provided by imputation tests as too complicated for regulators to implement.

35. A price squeeze by an integrated seller of communications services would only make sense if the integrated ILEC could not obtain its maximum profits from the upstream market for access services alone and if such a squeeze were to allow it eventually to raise prices in the downstream market sufficiently to compensate it for losses caused by the squeeze. The first requirement—the inability to obtain maximum profits from the upstream access service—is obviously met because access services are regulated by federal and state regulators. The second requirement, however, is surely unlikely to be met.

36. For a price squeeze to be profitable, the ILEC would have to be able to raise prices

above current market levels at some future date. Those price increases would have to be large enough to compensate the ILEC for the profits forgone by holding prices artificially below current market levels to "squeeze" its unintegrated rivals. This strategy, in turn, would require that some current competitors—AT&T, Sprint, MCI WorldCom, Frontier, and others—be driven from the market. Otherwise, the new low-price equilibrium would simply persist to the great benefit of consumers. Even in the improbable event that an ILEC could drive one of the big IXCs into bankruptcy, the fiber-optic transmission capacity of that carrier would remain intact, ready for another firm to buy the capacity at a distress sale and immediately undercut the ILEC's noncompetitive prices. In 1996 the Commission embraced, with respect to newly enacted section 272, the logic of such skepticism toward hypothesized ILEC predation.[14] That skepticism accords with the conclusion of many respected regulatory economists.[15] The IXCs' experts ignore the weight of such analysis and utterly fail to explain how Bell Atlantic or GTE or the merged Bell Atlantic-GTE could successfully employ a squeeze that drives large IXCs from the market. Even if, *arguendo*, the ILECs flouted the imputation test, it is highly unlikely that rates would be driven below the IXCs' incremental costs of no more than 2 cents per minute plus access charges. We too are extremely skeptical that such a "squeeze" is even remotely possible.

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14. Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as Amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rulemaking, CC Dkt. No. 96-149, 11 F.C.C. Rcd. 18,877, 18,943 ¶ 137 (1996) (citing Daniel F. Spulber, *Deregulating Telecommunications*, 12 YALE J. ON REG. 25, 60 (1995); other citations omitted).

15. *E.g.*, PAUL W. MACAVOY, THE FAILURE OF ANTITRUST AND REGULATION TO ESTABLISH COMPETITION IN LONG-DISTANCE TELEPHONE SERVICES 186–90 (MIT Press & AEI Press 1996); Susan Gates, Paul Milgrom & John Roberts, *Deterring Predation in Telecommunications: Are Line-of-Business Restraints Needed?*, 16 MANAGERIAL & DECISION ECON. 427 (1995); Paul S. Brandon & Richard L. Schmalensee, *The Benefits of Releasing the Bell Companies from the Interexchange Restrictions*, 16 MANAGERIAL & DECISION ECON. 349 (1995); Jerry A. Hausman, *Competition in Long-Distance and Telecommunications Markets: Effects of the MFJ*, 16 MANAGERIAL & DECISION ECON. 365 (1995); Kenneth J. Arrow, Dennis W. Carlton & Hal S. Sider, *The Competitive Effects of Line-of-Business Restrictions in Telecommunications*, 16 MANAGERIAL & DECISION ECON. 301 (1995).

37. Baseman and Kelley argue that there is some evidence that New York Telephone and Southern New England Telephone (SNET) have engaged in price squeezes in the distant and recent past. Baseman and Kelley do not contend, however, that those alleged squeezes have been successful in driving any IXCs from New York or Connecticut. Indeed, a review of the experience in Connecticut suggests that competition is vigorous in the interexchange market and that all national competitors continue to operate there—albeit at lower prices than existed before SNET's entry.[16] That outcome demonstrates increased competition and would only be contrary to the public interest if lower long-distance prices reduce consumer welfare. This empirical evidence confirms the well-known theoretical proposition that even inefficient ILEC entry into long-distance markets will produce welfare gains to society that would more than offset the potential welfare losses from that inefficiency.[17] Finally, it is ironic that the IXCs would raise the specter of a price squeeze at a time when empirical analyses conclude that the IXCs have not passed through fully the recent and continuing ILECs' reduction in carrier access charges.[18]

III. ALLEGATIONS OF EXCLUSIONARY BEHAVIOR WITH RESPECT TO INTERNET SERVICES

38. Baseman and Kelley allege that ILECs in general, and GTE and Bell Atlantic in

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16. *See* PETER W. HUBER, LOCAL EXCHANGE COMPETITION UNDER THE 1996 TELECOM ACT: RED-LINING THE LOCAL EXCHANGE CUSTOMER (prepared for BellSouth Corp. and SBC Corp., Nov. 4, 1997).

17. *See* P.J. Hinton, J.D. Zona, R.L. Schmalensee & W.E. Taylor, *An Analysis of the Welfare Effects of Long-Distance Market Entry by an Integrated Access and Long-Distance Provider,* 13 J. REG. ECON. 183 (1998).

18. *See* MACAVOY, THE FAILURE OF REGULATION AND ANTITRUST, *supra* note 15; P.S. Brandon & W.E. Taylor, *AT&T, MCI and Sprint Failed to Pass Through the 1998 Interstate Access Charge Reductions to Consumers* (filed *ex parte* in CC Docket No. 96-262 on behalf of the United States Telephone Association, Oct. 22, 1998).

particular, control a bottleneck facility in the provision of Internet services.[19] Baseman and Kelley assert that Bell Atlantic and GTE "control the connection to the end-user,"[20] and they further speculate that this asserted "control" may afford opportunities for Bell Atlantic and GTE to discriminate against unaffiliated ISPs and monopolize the market for Internet service provision. The Baseman-Kelley theory, however, is logically flawed and fails on five independent grounds:

1. Bell Atlantic and GTE do not have unique means to discriminate against unaffiliated ISPs.

2. Bell Atlantic and GTE do not control a bottleneck facility in the provision of Internet services.

3. GTE is not a dominant firm in the provision of ISP services, and the transaction would not materially increase GTE's presence in the ISP arena. This distinction is critical, as the targeted-degradation argument of Professors Jacques Crémer, Patrick Rey, and Jean Tirole, which the IXCs' experts inappropriately cite, applies only to dominant firms.

4. Bell Atlantic and GTE have not discriminated against unaffiliated Internet service providers despite the allegation that they have both an incentive and the ability to do so.

5. Allegations that discrimination is more likely when new technologies are being introduced are sheer speculation that is contradicted by the facts, by the Commission's findings, and by the IXCs' experts themselves.

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19. *Baseman-Kelley Declaration* at ¶¶ 87–92 *et seq.*

20. *Id.* at ¶ 91.

We now discuss these five points in turn.

A. Bell Atlantic and GTE Do Not Have Unique Means to Discriminate Against ISPs

39. In making their allegations of potential discrimination against ISPs, Baseman and Kelley suggest that Bell Atlantic and GTE somehow have a novel and unique way to discriminate against ISPs. This alleged discrimination supposedly could take the form of either quality degradation or delayed provisioning of circuits. Again, a common sense examination of the relationship between ISPs and ILECs shows this allegation to be specious.

40. First, consider traditional dial-up access. As noted above, ISPs serve dial-up customers through multi-line business services, which the ISPs either purchase from the ILEC *or from a competing CLEC.* By definition, dial-up customers use standard voice circuits, and many customers use those circuits for other ILEC services. Therefore, to discriminate against dial-up ISPs using a strategy of quality degradation, an ILEC would need to degrade service on *all* its voice facilities. Surely such pervasive service degradation would be unprofitable. If an ILEC attempted to discriminate against ISPs in the manner that Baseman and Kelley hypothesize, then ISPs and other local exchange customers would switch to CLECs. The ILEC would suffer additional losses as residential users switched their local telephone service to other providers, and as regulators imposed quality-of-service penalties. Such discrimination clearly would not benefit Bell Atlantic and GTE.

41. Discriminating against ISPs through delayed provisioning would be equally futile. ISPs are large, lucrative business customers, whose premises are located in close proximity to existing central offices in high-density metropolitan areas. ISPs have their pick of competitive

local exchange providers.[21] If the ILEC were to give an ISP discriminatorily slow provision of the necessary inward trunks, the ISP would merely transfer its account to one of many CLECs offering more responsive service. As before, the ILEC would suffer a large reduction in its *own* cash flow as a result of the attempted discrimination.

42. In the case of high-speed Internet access service, ILECs would have even less to gain by discriminating against ISPs.[22] In the case of such service, the ILEC either provides the high-speed transport from the end user to the ISP (over a local DS-1 line or its own xDSL offering, for example) or supplies the unbundled loop to which the ISP adds its own central office and customer premises equipment to supply xDSL and similar offerings. The provisioning process for high-speed circuits and unbundled loops is already in place. Similarly, direct quality measurements are in place that would allow competitors and regulators to detect any delayed provisioning.[23]

43. Furthermore, Baseman and Kelley ignore the fact that Congress and the FCC imposed imputation safeguards. That is not to say that these requirements need to work perfectly. They need only work well enough to blunt the hypothesized incentives for upstream-downstream

21. *See* Merrill Lynch, *The Mysterious World of ISP-Related Reciprocal Compensation* (Telecom Services-Local Investment Report, Oct. 27, 1998).

22. The FCC explicitly "reject[ed] the argument that the possibility of a price squeeze warrants the Commission's transfer to the states of its ratemaking authority with respect to interstate DSL services." Investigation of New Access Offerings Filed by Bell Atlantic, BellSouth, GTE System Telephone Companies, and Pacific Bell Establishing Asymmetrical Digital Subscriber Line Service, Memorandum Opinion and Order, CC Dkts. Nos. 98-168, 98-161, 98-167, 98-103, ¶ 1 (released Nov. 30, 1998) (FCC 98-317).

23. The merger applicants have entered into specific time and quality-of-service commitments for the provision of collocation and interconnections services to their competitors. For example, Bell Atlantic commits in its southern region to provide competitors with physical collocation within 120 business days and virtual collocation within 60 business days, subject to the relevant central office not being declared exhausted *before* state regulators. *See* Bell Atlantic Network Services FCC Tariff #1 § 19, pp. 945-947 (13th rev. Dec. 3, 1998). The Bell Atlantic and GTE operating companies also make similar commitments through tariffs filed with state commissions.

coordination. If imputation requirements result in an inability of the ILEC to internalize fully the discriminatory effects being posited by the IXCs' experts, then the Katz-Salop results generally do not obtain.

B. Bell Atlantic and GTE Do Not Possess Bottleneck Control Over ISPs

44. The Baseman-Kelley allegation of "bottleneck control" is based on the trivial observation that most residential customers in GTE's and Bell Atlantic's territories currently gain access to the Internet through dial-up connections. Baseman and Kelley ignore, however, that customers seeking dial-up access to an unaffiliated ISP use the same circuits and technology as do customers for voice telephony. In other words, dial-up service is, by definition, simply traditional local service.[24] For example, ISPs unaffiliated with Bell Atlantic or GTE simply purchase multi-line business service, from either Bell Atlantic or GTE *or from a competing CLEC.* If the Baseman-Kelley theory were plausible, it would imply that GTE or Bell Atlantic has bottleneck control over services provided by any multi-line business customer whose business relies significantly on local telephony.

45. Furthermore, Baseman and Kelley completely ignore the fact that large volumes of end-user Internet traffic now move over other facilities, such as competitive access provider lines, cable modems, terrestrial wireless services (for example, Metricom's Ricochet), and satellite links. ILEC provision of high-speed circuits has been deemed a competitive service in many states, including Florida for GTE,[25] and Pennsylvania for Bell Atlantic,[26] as CLECs continue to

24. *See generally* J. Gregory Sidak & Daniel F. Spulber, *Cyberjam: The Law and Economics of Internet Congestion of the Telephone Network*, 21 HARV. J.L. & PUB. POL'Y 327 (1998).

25. *See* FLA. STAT. ch. 364.051 (1998). Large ILECs may elect price regulation under section 364.051, allowing limited

enter and expand their service provisions. Although relatively few end users may use high-speed facilities currently, that proportion is growing rapidly. An increasing number, however, use the services of carriers other than the ILECs. The growth of special access is accelerating. For example, the number of voice-grade equivalent special-access circuits provided by Bell Atlantic and GTE in their territories jumped 40 percent in 1997, almost doubling their historic growth rate.[27] The CLECs are currently extremely competitive with ILECs in the provision of high-speed access, and the CLECs are capturing a substantial and growing share of that segment. In 1996, for example, a leading competitive access provider described its corporate strategy as follows:

> The Company's strategy is to become the primary provider of telecommunications services to business and government end users. The Company believes business and government users have distinct telecommunications service requirements, including maximum reliability, consistent high quality, capacity for high-speed data transmission, responsive customer service and continuous attention to service enhancement and new service development. The Company believes it has significant advantages over its competitors as a result of the Company's . . . expertise in developing highly reliable, advanced digital fiber optic networks which offer substantial transmission capacity.[28]

Now, nearly three years later, data-focused CLECs such as MFS/Brooks (owned by MCI WorldCom), TCG (owned by AT&T), WinStar, Teligent, and Internet specialists such as

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upwards flexibility for all services other than basic services (flat-rate voice-grade residential or single-line business local exchange service), voice-grade flat-rate multi-line business local exchange service, and network access services.

26. *See* Emergency Ratification Order, Petition of Bell Atlantic-Pennsylvania Inc. For a Determination of Whether Digital Data Services and High Capacity Services Are Competitive, Dkt. No. P-00950929, AT&T Communications of Pennsylvania Inc. *v.* Bell Atlantic-Pennsylvania, Inc., Dkt. No. P-00950929C0001, at 3, ordering clause 3 (Pa. Pub. Util. Comm'n, Oct. 13, 1995) ("Bell's HICAP service is hereby classified as competitive").

27. *See* FCC, 1997–98 STATISTICS OF COMMON COMMUNICATIONS CARRIERS at table 2.10.

28. MFS COMMUNICATIONS CO., 1995 SEC FORM 10-K at 1 (1996). "Because MFS believes it has certain advantages relative to quality control . . . resulting from its use of the Company's existing fiber optic networks, MFS Intelenet believes that it may enjoy certain advantages with respect to certain of its competitors." *Id.* at 6.

Metricom indeed enjoy phenomenal growth in lines that far exceeds the rate of growth in lines for either Bell Atlantic or GTE.[29] Finally, cable modems are poised to become an important means of residential Internet access, with projected growth rates of over 100 percent per annum—"surging from 350,000 subscribers in mid-1998 to more than 2 million by end of 1999"[30]—and are expected to account for 80 percent of residential Internet access connections by 2002.[31] That projected growth in Internet access over the cable infrastructure is, of course, a principal justification that AT&T has offered for its acquisition of TCI.[32] In short, by focusing only on dial-up access to the Internet, Baseman and Kelley erroneously exclude many actual and potential competitors from consideration.

C. The Transaction Would Not Enable Bell Atlantic-GTE to Dominate the Internet

46. GTE is not a dominant firm in the provision of ISP services, and the transaction would not materially increase GTE's presence in the ISP arena. Bell Atlantic currently has relatively few ISP customers, and even after the merger the combined firm would rank far behind America Online, the largest ISP in the nation.[33] The combined GTE/Bell Atlantic ISP operation

29. *See* FCC, 1997–98 STATISTICS OF COMMON CARRIERS, at table 2.10.; Salomon Smith Barney, *CLECs Surpass Bells In Net Business Line Additions For First Time*, May 6, 1998.

30. *See* Forrester Research Press Release, *High-Speed Internet Access,* Sept. 1, 1998.

31. *See* Paul Kagan Associates, Inc., *U.S. High-Speed Access Cable & ADSL Projection Model, 1997-2006,* in CABLE TV TECHNOLOGY (Feb. 28, 1998).

32. *See* AT&T Press Release, *AT&T, TCI to Merge, Create New AT&T Consumer Services Unit,* June 24, 1998. "Today we are beginning to answer a big part of the question about how we will provide local service to U.S. consumers," said C. Michael Armstrong, chairman and CEO of AT&T. "Through its own systems and in partnership with affiliates, AT&T will bring to people's homes the first fully integrated package of communications, electronic commerce, and video entertainment services."

33. Estimated AOL and AT&T subscriber counts from *AT&T Changes Internet Service, Fees,* L.A. TIMES, Dec. 16, 1998 (quoting AT&T's projected customer base pending the acquisition of IBM Corp.'s network business).

would be less than half the size of the next largest competitor and less than one-fourteenth the size of the largest ISP, AOL.[34]

47. This distinction is critical because the network-dominance strategy that the IXCs' experts hypothesize relies on the existence of a *dominant* firm. Baseman and Kelley, for example, quote the Crémer-Rey-Tirole result.[35] But Baseman and Kelley fail to observe that Professors Crémer, Rey, and Tirole actually stated:

> *In the absence of a dominant backbone, the unilateral degradation strategy is much riskier*[,] . . . encourag[ing] migration of [part] of its installed base and new customers to other networks. We would expect interconnectivity to continue prevailing in the Internet industry as long as a dominant player does not emerge.[36]

Thus, Baseman and Kelley quote the Crémer-Rey-Tirole result out of context, as the targeted-degradation argument applies only to dominant firms. Crémer, Rey, and Tirole examined the specific case in which a merger would create a dominant firm with a share of more than 50 percent, at least three times the size of the second largest firm.[37] Such assumed conditions clearly do not accurately describe the merger of Bell Atlantic and GTE.

48. Finally, the combined Bell Atlantic-GTE will still be several times smaller than the ISP and telecommunications providers against which the merged company will compete, such as America Online and MCI WorldCom. Earthlink, one of the largest ISPs, is controlled by Sprint

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34. GTE subscribers from BOARDWATCH, 1998 ISP DIRECTORY. Bell Atlantic subscribers from internal company data.

35. *Baseman-Kelley Declaration* at 54 ¶ 95 (discussing Jacques Crémer, Patrick Rey & Jean Tirole, *The Degradation of Quality and the Domination of the Internet* (Apr. 8, 1998) (prepared for GTE Communications Corporation)).

36. Crémer, Rey & Tirole, *supra* note 35, at ¶ 9 (emphasis added).

37. *Id.*

and may soon be a wholly owned subsidiary.[38] Meanwhile, the largest IXC, AT&T, has already acquired one of the largest CLECs, TCG. AT&T is also acquiring the largest provider of alternative residential broadband access, TCI, by virtue of its ownership of and marketing relationship with @Home. (Previously, AT&T offered to acquire America Online.[39]) And AT&T is acquiring a large data network unit from IBM.[40] Finally, AT&T is entering into a local telephone venture with Time-Warner.[41]

D. Bell Atlantic and GTE Have Not Discriminated Against Unaffiliated ISPs

49. If GTE and Bell Atlantic actually had both the incentive and the opportunity to discriminate against unaffiliated ISPs, then one would expect to find evidence of such behavior in the ISP market. Because of the enormously inefficient pricing of ILEC provision of dial-up Internet access, ILECs experience substantial cost increases for every dial-up customer that is

38. *See* Inside Wall Street, *Sprint: Sauntering After Earthlink?*, BUS. WK., Dec. 7, 1998, at 134. Sprint currently owns 27 percent on a fully diluted basis, received in consideration for the transfer to Earthlink of approximately 130,000 Sprint Internet passport subscribers, $24 million in cash, and the exclusive right to use certain ports in Sprint's high-speed network. Sprint also agreed to deliver a minimum of 150,000 new subscribers per year for five years to Earthlink, and to give Earthlink the right to be Sprint's exclusive provider of consumer Internet access service and to use Sprint's brand and distribution network for at least ten years. *See* EARTHLINK NETWORK INC., SEC FORM 10-Q, at 8 (Aug. 14, 1998).

39. *See* CNNfn, *Ma Bell to Log On To AOL?*, CNNfn, June 17, 1998 (available at http://cnnfn.com/hotstories/deals/980617/index.htm).

40. *See AT&T Changes Internet Service, Fees,* L.A. TIMES, Dec. 16, 1998.

41. *See* Associated Press Online—Dec. 9, 1998. "CNBC reported AT&T and Time Warner had nearly agreed on the terms of a joint venture, of which AT&T would control 75 percent and Time Warner 25 percent. AT&T would pay three-quarters of the cost of upgrading Time Warner's cable systems to handle voice transmissions. AT&T, in turn, would get three-quarters of the revenues from selling the local phone service. A Time Warner Inc. pact would cap a unprecedented deal-making spree by AT&T Corp., including an agreement Tuesday to buy IBM's data-networking business for $5 billion. This fall, AT&T agreed to buy cable giant Tele-Communications Inc., for $31.7 billion, but TCI's cable TV lines are able to reach only about one-third of U.S. homes."

added by an ISP served by a CLEC.[42] Moreover, the customer probably orders a second line only for Internet traffic (which therefore does not recover its loop and switching costs assigned to the interstate jurisdiction, as it does not generate interLATA access charges). Consequently, if the opportunity and incentive for discrimination were truly to exist, one would expect them to be relatively stronger concerning dial-up service to ISP-CLEC combinations.

50. The evidence, however, all points in the opposite direction. To our knowledge, no regulatory body or court has found discrimination by Bell Atlantic or GTE against ISP-CLEC combinations. The market for ISPs in the Bell Atlantic and GTE territories is vibrant, with 180 ISPs operating in Maryland's 301 area code alone.[43] If anything, the efforts of some Bell operating companies, including Bell Atlantic, in Internet service provision "seem to be faltering" despite "high-profile marketing campaigns."[44] Industry observers note that "oligopoly is not on the horizon," and that "BOCs should buy up regional ISPs as a means to gain expertise and [market] share."[45] Such evidence indicates an *absence* of discrimination.

E. Allegations of Potential Discrimination Have Never Risen Above Sheer Speculation

51. It is worth reviewing the long-run evidence surrounding previous allegations that the Bell operating companies would interfere with a new and emerging market. The experience in information services is particularly illustrative because it is the predecessor of today's ISP

42. *See* Sidak & Spulber, *supra* note 24, at 379–80.

43. *See* http://boardwatch.internet.com/isp/ac/ac301.html (Dec. 1, 1998).

44. *See Online Services Reach 20.3M Users*, MULTIMEDIA DAILY, Apr. 25, 1997.

45. *See* Forrester Research, *Consolidation in the Business ISP Marketplace*, Press Release, July 16, 1997 (downloaded Dec. 2, 1998, http://www.forrester.com/press/pressrel/970716TS.htm).

service. Eight years ago, Professor Carl Shapiro (a former expert witness for Sprint before the FCC and founder of the Tilden Group, with whom Sprint's experts in this proceeding—Katz, Farrell, and Hayes—are affiliated) predicted dire consequences if the Modification of Final Judgment were amended to allow the BOCs to enter the information services arena.[46] Shapiro alleged at that time many of the arguments now being alleged by the IXCs' experts in this proceeding. He argued that the risk of discrimination was too great to allow the BOCs to participate in information services. In particular, Shapiro alleged that the BOCs would engage in the familiar litany of bad acts, including raising the price, reducing the quality, and restricting the availability of essential inputs to competing information services providers.[47] Shapiro also alleged that the BOCs would have the incentive to bias their systems in their own favor and against their most threatening rivals.[48] "Lifting the information services restriction at this time," he concluded in 1990, "would predictably result in anticompetitive consequences."[49] Eight years later, it is clear that Shapiro's predictions were demonstrably wrong. As has been observed repeatedly, after the BOCs were given limited permission in 1988 to offer consumers voice mail as an information service, the price of such services fell dramatically and the demand for voice mail equipment grew

46. Affidavit of Carl Shapiro, attached to Joint Opposition to Motions for Removal of the Section II(D)(1) Restriction on the Provision of Information Services in *United States* v. *Western Elec. Co.*, Civil Action No. 82-0192 (HHG), (D.D.C. Oct. 17, 1990), submitted by Commerce Clearing House, Inc., Dialog Information Services, Inc., Dun & Bradstreet Corporation, Knight-Ridder, Inc., MacMillan, Inc., Times Mirror, the Washington Post Company, and West Publishing Company.

47. *Id.* at ¶¶ 33–41.

48. *Id.* at ¶ 39.

49. *Id.* at ¶ 103.

threefold.[50] And, of course, since 1990 the Bell operating companies have hardly succeeded in monopolizing information services.

52. Now, nearly a decade after Shapiro's faulty prediction about information services, Baseman and Kelley similarly allege that the potential for ILEC discrimination will be enhanced by the introduction of new technologies and non-standard interfaces.[51] They are wrong for at least five reasons, just as Shapiro was wrong.

53. First, to the extent that ISPs and their customers wish to use the ILEC's plant in lieu of the ILEC's dial-up service, they can and will simply unbundle the loop and install their own CPE and collocated equipment. Attempts to degrade such interconnection are easy to detect, remedy, and punish.[52]

54. Second, Baseman and Kelley concede that the problems they identify, "of course, are likely to occur *with or without the merger*."[53] By itself, this admission renders the entire Baseman-Kelley declaration irrelevant to this proceeding.

55. Third, Baseman and Kelley concede that "[t]he problem is ameliorated if other technologies emerge to provide broadband access for ISPs,"[54] such as cable modem access, which

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50. *See* WILLIAM J. BAUMOL & J. GREGORY SIDAK, TOWARD COMPETITION IN LOCAL TELEPHONY 132 (MIT Press & AEI Press 1994).

51. *Baseman-Kelley Declaration* at ¶ 88.

52. These observations about detection, punishment, and deterrence have been well understood for years. *See* Affidavit of Michael K. Block, *attached to* Motion of Bell Atlantic Corp., BellSouth Corp., NYNEX Corp., and Southwestern Bell Corp. to Vacate the Consent Decree, United States *v.* Western Electric Co., Civil Action No. 82-0192 (May 23, 1994; filed D.D.C. July 6, 1994).

53. *Baseman-Kelley Declaration* at ¶ 94 (emphasis added).

54. *Id.* at ¶ 54.

is rapidly being deployed today and is, as noted earlier, the centerpiece of AT&T's high-profile investment strategy encompassing its acquisition of TCI.

56. Fourth, Baseman and Kelley acknowledge "that the Commission is addressing these issues in its Broadband Rulemaking"[55] and has the ability in that separate proceeding to address those concerns fully.

57. Fifth, the notion that the merger of Bell Atlantic and GTE can somehow "tip" the ISP market is truly fanciful. Unlike the case of Internet backbone services, ILEC access is fully subject to FCC oversight and regulation. The ISP market is atomized and fully competitive with thousands of participants.[56] Unlike backbones, ISPs do not generally interconnect directly with each other. Rather, they interconnect through backbones, although direct connections exist in some cases.[57] Each ISP is a paying customer of one or more backbones for Internet transport service. The ISP access marketplace therefore does not operate on the basis of the same delicate system of competitive peering that exists between rival, unregulated backbone networks. Moreover, Bell Atlantic's share of the ISP access market is minuscule.[58]

58. Seen in that light, the Baseman-Kelley allegations of potential discrimination by Bell Atlantic-GTE against unaffiliated ISPs are nothing more than a reprise of the erroneous predictions that Shapiro offered nearly a decade ago. Since then, the facts have compelled any

55. *Id.* ¶¶ 56–57.

56. *See* BOARDWATCH, 1998 ISP DIRECTORY, which lists over 5,000 ISPs.

57. See Internet Affidavit of Robert G. Harris on behalf of GTE Corp. in WorldCom Inc. and MCI Communications Corp. Proposed Transfer of Control, CC Dkt. No. 97-211, ¶¶ 17-25 (filed March 13, 1998); Internet Affidavit of Robert G. Harris on behalf of GTE Corp. in WorldCom Inc. and MCI Communications Corp. Proposed Transfer of Control, CC Dkt. No. 97-211, ¶¶ 2-4 (filed June 8, 1998).

58. *See* Forrester Research, *Consolidation in the Business ISP Marketplace, supra* note 45 .

objective observer to reject as false the prediction by Shapiro and others that the Bell operating companies would monopolize information services. The Commission should reject the use of that same flawed logic here to predict that the merger of Bell Atlantic and GTE would dominate unaffiliated ISPs.

CONCLUSION

59. The arguments advanced by the IXCs' economic experts are unpersuasive. They allege that integrated ILECs have the incentive and ability to employ a variety of discriminatory tactics and price squeezes to harm IXCs and CLECs, yet the IXCs' experts thoroughly fail to demonstrate that the factual assumptions necessary for their theories to hold are indeed realistic. The IXCs' experts are no more believable when they predict monopolization of Internet services. Moreover, the IXCs' experts fail to provide any credible argument that the merger of Bell Atlantic and GTE would increase the likelihood that these predictions of anticompetitive doom would actually occur. The Commission should evaluate this merger on the basis of logic and fact, not on the basis of far-fetched theoretical predictions that bear no relationship to observed market conditions.

I hereby swear, under penalty of perjury, that the foregoing is true and correct.

J. Gregory Sidak

J. Gregory Sidak

Executed on this 21st day of December, 1998.

I hereby swear, under penalty of perjury, that the foregoing is true and correct.

Robert W. Crandall

Executed on this 21st day of December, 1998.

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