A

US OFFICE PRODUCTS

## APPENDIX A

**AT&T's Claims Regarding The Elimination of Potential Competition Between Bell Atlantic and GTE in Local Exchange Markets are Baseless and Do Not Constitute a Reason to Oppose the Merger**

In its Opposition and the "Confidential Appendix" ("Conf. Apdx.") attached to it, AT&T repeats the claim it first made 18 months ago that the merger will harm local competition by eliminating the local exchange competition that AT&T says ***would*** have taken place between Bell Atlantic and GTE in the absence of the merger, especially in Pennsylvania and Virginia.[1] AT&T has now had ample opportunity to litigate this assertion in evidentiary hearings around the country, before more than a dozen state commissions which have reviewed the merger. Every state with approval authority has now approved the merger; none has concluded the merger should be blocked on the grounds of the alleged anti-competitive effects in the local exchange market.[2]

[1] AT&T tries to gloss over the fact that Bell Atlantic and GTE do not currently compete with one another through general local exchange service offerings, even though AT&T argued that a similar lack of competition was virtually dispositive in asking for approval of its MediaOne acquisition. In its initial filing to the Commission in support of that transaction, AT&T stated the merger should not cause any competitive concern because "AT&T and MediaOne do not currently serve the same service areas or compete with each other in the provision of facilities-based local telephone service in any service area. ***As a consequence, the proposed Merger will not result in the diminution of competition for local telephone service in the areas served by AT&T and MediaOne.***" *Transfer of Control Applications submitted by AT&T and MediaOne Corp., In the Matter of Transfer of Control of FCC License MediaOne Group Inc. to AT&T Corp.*, CS Docket No. 99-251, July 7, 1999, at p. 34 (footnotes quoting FCC decisions omitted)(emphasis added)("*AT&T/MediaOne FCC Application*").

[2] All states with authority to approve the merger (27, plus Puerto Rico) have now approved the merger. The approvals issued in Pennsylvania, Virginia, Vermont, Ohio, Kentucky, Illinois, California, Arkansas and Iowa all followed contested evidentiary hearings; many of the other approvals followed extensive discovery and briefing.

Both the Virginia State Corporation Commission and the Pennsylvania Public Utility Commission rejected AT&T's request that the merger between Bell Atlantic and GTE should not be allowed to go forward. To the contrary, following more than 10 days of evidentiary hearings in these two states -- during which AT&T made exactly the same arguments based on the same discovery materials they include in their Confidential Appendix here -- both Commissions issued orders approving the merger in November 1999.[3] As the Chairman of the Pennsylvania Commission explained in his separate statement concurring in his Commission's approval, "[w]e are cognizant of those concerns [regarding local competition] but confident that this merger, as approved, is not anti-competitive and is in the public interest . . . ."[4] AT&T's warmed-over arguments are equally unpersuasive here, and form no basis to reject the merger, especially in light of the substantial market-opening commitments made here by the Joint Applicants.

As discussed in detail in the Joint Applicants' prior filings, the "potential competition" doctrine depends on a well-grounded finding that one of the merging firms in the near future would, but for the merger, supply significant competition against the other that would not be forthcoming from other present or potential market participants. *See generally* Public Int. St. at pp. 25-28; Joint Reply at 30-32. The arguments AT&T sets out in the Confidential Appendix to it Opposition, focused principally on the issue of

[3]Opinion and Order, *Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger*, Pennsylvania Public Utility Commission, Docket Nos. A-310200F0002, et al., issued Nov. 4, 1999 (appeals pending)("Pennsylvania Order"); Order Approving Petition, *Joint Petition of Bell Atlantic Corporation and GTE Corporation For Approval of agreement and plan of merger*, Virginia State Corporation Commission, Case No. PUC990100, issued Nov. 29, 1999. In both proceedings, AT&T vigorously exercised its right to discovery, to present fact and expert witnesses, and to cross examine witnesses from Bell Atlantic and GTE.

[4] Statement of Chairman John M. Quain accompanying Pennsylvania Order, at 1.

whether Bell Atlantic or GTE would have competed against one another in Virginia and Pennsylvania, fail to support such a well-grounded finding. While the entire "potential competition" issue has already been exhaustively covered in the Joint Applicant's prior filings, three points bear particular emphasis.

**No Plans to Compete.** ***First***, neither Bell Atlantic nor GTE had plans to become significant competitors in the local exchange market against one another in the absence of the merger. *See generally* Pub. Int. St. at 29-33; Joint Reply at 31-32. In its Confidential Appendix, AT&T nonetheless argues that both Bell Atlantic and GTE planned to compete with the other for local exchange customers in Virginia and Pennsylvania. This argument, created primarily from AT&T's selective quotation of various internal documents and preliminary analyses, is baseless.

Virtually all of AT&T's support for the assertion that Bell Atlantic intended to compete in GTE territories is based on the fact that "***in late 1995 and 1996***" a small group within Bell Atlantic analyzed the possibility of competing out-of-franchise, including in some GTE territory in Virginia and Pennsylvania. Conf. Apx. at 1-2 (emphasis added). In the more than four years since the small team compiled these preliminary analyses, however, Bell Atlantic never pursued this option and never even sought certification as a CLEC. Pub. Int. St. at 33-34. These dated analyses, commissioned and primarily conducted even prior to the passage of the 1996 Telecommunications Act, are meaningless.

Moreover, the speculation in these dated analyses concerning Bell Atlantic's prospects for success outside its traditional service area has been disproved by subsequent events. For example, in close out-of-region areas where Bell Atlantic offered resold long distance service, expecting to capitalize on at least some brand awareness, the results

were dismal. Pub. Int. St. at 33. This harsh real-world experience destroyed any business rationale for competing with a local service offering in GTE's predominantly rural territory:[5] there have been and remain simply too many other, more profitable opportunities to pursue nationwide (and worldwide). *See generally* Stallard Decl. ¶¶ 9-16 (noting, for example, that GTE South territory in Virginia does not contain even one Fortune 1000 company headquarters); Whelan Decl. ¶¶ 4-6.[6] Indeed, Bell Atlantic has not considered or analyzed the possibility of competing in GTE's local exchange territory in Virginia or Pennsylvania against GTE since the 1995-1996 period. Stallard Decl. ¶ 5; Whelan Decl. ¶ 3.[7] It cannot plausibly be claimed or assumed that Bell Atlantic would, in the absence of the merger, choose to invest the resources required to compete against GTE in its local exchange markets.

As to plans by GTE to compete in Bell Atlantic's territory, AT&T similarly claims that GTE had "specific and definite plans" to do so, again emphasizing the prospects for such competition in Pennsylvania and Virginia. Conf. Apdx. at 7-9. Once again, however, AT&T relies on GTE's initial optimistic hopes for its efforts rather than

[5] *See* Reply Declaration of Robert W. Crandall and Robert H. Gertner, March 16, 2000 (filed with this Reply as Appendix B), at ¶ 16 (noting that population density of GTE franchise territory in Virginia and Pennsylvania is only about half to one-third the population density of Bell Atlantic's service areas)("Crandall/Gertner Reply Decl.").

[6] The Declarations of Messrs. Stallard and Whelan, the presidents of Bell Atlantic-Virginia and Bell Atlantic-Pennsylvania, respectively, were attached to the Joint Applicants' initial Public Interest Statement filed Oct. 2, 1998. Both Mr. Stallard and Mr. Whelan testified in his state's merger approval proceeding, and both were exhaustively cross examined by AT&T and other competitors.

[7] AT&T tries to claim that Bell Atlantic's decision not to pursue these out-of-region expansion effort was as a result of its decision to merge with NYNEX. Conf. Apdx. at 6. If competition against GTE remained an attractive option, however, Bell Atlantic had ample time to pursue it following the close of the Bell Atlantic/NYNEX merger. It did not do so, nor did it again analyze that option.

the cold business reality that essentially killed those efforts at the start. In fact, GTE's business plan for competing out of franchise in Virginia and Pennsylvania was limited from the outset, and even that focused effort quickly foundered due to substantially higher costs and much lower revenue than anticipated. Indeed, in its Confidential Appendix AT&T does not even try to respond to the detailed explanation of these efforts provided by GTE executives Jeffrey C. Kissell and Scott M. Zimmerman in their prior declarations.

Messrs. Kissell and Zimmerman explained that GTE (through GTE Communications Company, or "GTECC") had entered into what essentially were "pro forma" interconnection agreements with Bell Atlantic in Virginia and Pennsylvania (agreements whose content was borrowed from other agreements). *See generally* Kissell Decl. ¶¶ 3-5 (attached to Pub. Int. St.); Zimmerman/Kissell Decl. ¶¶ 9-13 (attached to Joint Reply).[8] GTECC intended to offer a bundle of services to GTE's ***in-franchise*** customers, with a targeted attempt out-of-franchise to gain nearby small business customers. Zimmerman/Kissell Decl. ¶ 9. There was no plan to try to attract out-of-franchise residential or large business customers, in view of the likely high costs and low return on any such effort. Zimmerman/Kissell Decl. ¶¶ 9-12.

Even the limited out-of-franchise attempt to gain small business customers, however, turned out to be more than twice as expensive and barely one-quarter as successful in generating revenue as originally expected. Zimmerman/Kissell Decl. ¶ 10-11. Rather than a profit of between 17 and 53% (depending on the product), GTECC was facing a "profit" margin of negative 73.92% in trying to capture small business customers

[8] Mr. Zimmerman testified before both the Virginia and Pennsylvania commissions on these issues.

out-of-franchise. Zimmerman/Kissell Decl. ¶ 11. As a result, GTECC dramatically scaled back its out-of-franchise efforts from coast to coast and, ***prior to*** the merger, had placed any further expansion plans on hold in Virginia, Pennsylvania and elsewhere. Zimmerman/Kissell Decl. ¶ 10-12. As Messrs. Zimmerman and Kissell explain, the GTECC experience simply underscored the need to acquire economies of scale and the large business customer base of a Bell Atlantic to successfully compete outside its franchise service areas for local exchange customers. Zimmerman/Kissell Decl. ¶ 14.

**Numerous Other Competitors.** ***Second***, AT&T cannot (and does not) even pretend to claim that there will not be a substantial number of competitors (both actual and potential) remaining in the local exchange markets for Bell Atlantic and GTE following the merger. AT&T's silence on this point is understandable, since the presence of these myriad of other competitors is fatal to its claim that the merger will remove any competitive discipline from the local exchange market. *See generally* Pub. Int. St. at 29-30; Jt. Reply at 33-35.[9] With respect to competition in the Pennsylvania local exchange markets, for example, the Pennsylvania Commission found that "several significant competitors in these [Bell Atlantic-Pennsylvania and GTE North Pennsylvania] markets following the merger" would remain.[10] Indeed, AT&T itself has emphasized -- when it is in its interest to do so -- that a robustly competitive local

[9] The Declarations by Mr. Stallard (¶ 18) and Mr. Whelan (¶ 7) set forth in detail the competitive statistics within their respective territories. As the Commission is well aware, by virtually any measure during the 18 months since these declarations were submitted local competitive activity has increased substantially.

[10] Pennsylvania Order at 15. Similarly, the New York Commission rejected the potential competition argument, finding in doing so that "there are several current and potential competitors to BA-NY in the local market, including AT&T, MCI/WorldCom, and Sprint." Order Granting Approval of Merger, *Petition of Bell Atlantic Corporation for Approval of Agreement and Plan of Merger with GTE Corporation*, Case No. 98-C-1443, New York Public Service Commission, issued Aug. 12, 1999, at 4.

exchange market will continue to develop, telling this Commission in seeking approval of its acquisition of MediaOne that:

> [E]ven beyond the dominant ILECs, 'numerous new entrants are rapidly entering this [local exchange market for business telephone services], especially in central business districts in urban areas, and . . . any number of these other new entrants have both the capabilities and the incentives to compete effectively.' These other new entrants will be 'at least as significant a competitive force as either of the merging parties [referring to Bell Atlantic and NYNEX].' The merger therefore will not significantly affect competition in the provision of local business exchange and exchange access services.[11]

**No Unique Competitive Advantages.** ***Third***, Bell Atlantic and GTE do not possess any unique advantages in competing against one another, in Pennsylvania, Virginia or elsewhere, contrary to the claims AT&T continues to press based upon the dated documents it cites in the Confidential Appendix (at pp. 3-6). Whatever once may have been thought by Bell Atlantic to be its advantages as an ILEC in competing outside its franchise territories have been lost through the development of the industry or simply disproved in actual practice (as shown by both Bell Atlantic's and GTE's actual experiences). Drs. Gertner and Gould examined each of the claimed ILEC advantages of Bell Atlantic and GTE (including proximity), and concluded that none constitutes a competitive advantage today.[12] For example, everyone within GTE's Virginia and Pennsylvania territory that is within 125 miles of a Bell Atlantic switch (the distance AT&T says a switch with digital loop carrier can serve) is also within 125 miles of the switch of at least ***10 other firms***. Gertner/Gould Decl. ¶¶ 31-32.

[11] *AT&T/MediaOne FCC Application* at p. 37.

[12] Declaration of Robert H. Gertner and John P. Gould (attached to Joint Reply, Dec. 23, 1998), ¶¶ 17-36 ("Gertner/Gould Decl."); *see also* Crandall/Gertner Reply Decl. ¶ ¶18-20.

Drs. Gertner and Gould's analysis, as well as the analysis of the Pennsylvania and Virginia markets by Messrs. Stallard, Whelan, Kissell and Zimmerman and the approvals of the merger by those Commissions, is particularly important in light of the peculiar demographics of GTE's service territories in those two states. The GTE franchise areas are small islands spread throughout each state which, as indicated above, are predominantly rural in nature. Virginia and Pennsylvania thus are not markets in which large RBOCs have adjacent urban territories and for which facile assumptions concerning brand awareness or customer and facility proximity can safely be made. The characteristics of the merging parties in this case, and any alleged advantages of proximity even in Virginia and Pennsylvania, thus are far different than were present with SBC and Ameritech. Crandall/Gertner Reply Decl. ¶ 17.

Market evidence also confirms that experience as an ILEC or proximity between Bell Atlantic and GTE properties in some locations does not provide any special competitive advantages in Virginia or Pennsylvania. Entry into local exchange markets typically has come ***not*** from adjacent ILECs and facilities, but rather from a variety of other competitors using various approaches. Gertner/Gould Decl. ¶¶ 24-26. Most telling is the experience of Sprint. While it has sought interconnection agreements and made plans to compete with Bell Atlantic in Virginia and Pennsylvania, it has not chosen to do so by expanding its United and Centel ILEC operations, even though it has such properties adjacent to both Bell Atlantic and GTE ILEC properties in those states. Crandall/Gertner Reply Decl. ¶ 20. This is consistent with Sprint's approach nationally: despite its announced plans to compete in Chicago, for example, Sprint sold its adjacent ILEC property rather than use it to launch a competitive attack against Ameritech. Gertner/Gould Decl. ¶¶ 24-25.

Moreover, while AT&T repeats its superficial claims that adjacent ILECs have unique competitive advantages, it refuses to address the critical issue of how those alleged competitive advantages compare to AT&T's (and other competitors') ***own*** package of competitive attributes.[13] Having facilities and customers ***near*** a target market is, by any measure, no substitute for having facilities and customers already ***in*** that market -- which is exactly the situation which the IXCs, cable companies, and a plethora of other CLECs occupy today in Virginia and Pennsylvania. So, too, having some brand recognition is no match for being "the company that [consumers] were most likely to use as their primary provider of telecommunications services (including local, long distance, and wireless)", as AT&T boasted of its own brand when seeking permission to acquire MediaOne.[14] Indeed, AT&T is so confident in its brand strength and extensive experience in serving residential customers that it is investing more than $100 billion to

[13] The Commission, of course, has recently reaffirmed the significant capabilities of the interexchange carriers in competing in the local exchange market. "We also reaffirm our finding in prior decisions that the three largest interexchange carriers, AT&T, MCI (now MCI WorldCom), and Sprint are among the most significant participants in the mass market for local exchange and exchange access services." *In re Application of Ameritech Corp. and SBC Communications for Consent to Transfer Control of Corporations Holding Licenses and Lines Pursuant to Section 214 and 310(d) of the Communications Act and Part 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, Memorandum Opinion and Order, Oct. 8, 1999, at p. 43.

[14] *AT&T/MediaOne FCC Application* at p. 24. AT&T as well as the other IXCs are even more candid and confident about their own substantial strengths – in terms of brand, expertise, facilities and customer relationships – when talking to their shareholders and the investment community. For example, Sprint told its shareholders in its 1998 Annual Report that "[t]he difference between the capabilities of our competitors and *Sprint ION* is like the difference between a roomful of pocket calculators and a multimedia computer." Sprint 1998 Summary Annual Report at p. 20.. Most telling is AT&T's claim in its 1998 Annual Report that in its view there are "only a handful of 'super carriers' positioned to serve the needs of multinational customers," and AT&T believes it will "come out on top" because it "should have a ***competitive advantage across the board – on scope, product depth, quality, cost structure and service capabilities***." (AT&T 1998 Annual Report at 22 (emphasis added)).

acquire cable companies, convinced that these strengths will allow it to "reach its goal of selling phone service via cable lines to 30% of potential customers by 2004" in the residential market.[15] In light of the capabilities of the IXCs and the plethora of other market competitors, the absence of either Bell Atlantic or GTE from the local exchange market has no competitive significance.[16]

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**The Merger will create a stronger national competitor.** The theoretical "potential competition" arguments AT&T cobbles together are no match for the tangible competitive benefits which the merger will provide in local exchange markets. The combination of Bell Atlantic's national, large business customer base with the GTE CLEC operations already in place nationwide will allow the combined company to more quickly, effectively enter into these other local markets than could have been possible individually. Kissell Decl. ¶¶ 7-13; Zimmerman/Kissell Decl. ¶¶ 16-20; *see also* Supplemental Filing of Bell Atlantic and GTE, Jan. 27, 2000, at 9-11. The combination will be the kind of melding of assets and customer relationships coast to coast which will allow the companies to compete with the likes of AT&T for national customers -- such as CVS Pharmacy, which AT&T recently announced it had signed to a four year, $125

[15] AT&T Chairman Michael Armstrong, quoted in "AT&T Wireless Unit Introduces Plan for Unlimited-Use Calls by Business," Wall Street Journal, June 10, 1999.

[16] For example, both Mr. Stallard and Mr. Whelan explained in their declarations that the presence or absence of GTE in the local market makes no difference in their efforts to compete for customers. Stallard Decl. ¶ 20; Whelan Decl. ¶ 7-8. While AT&T cites documents 3 to 4 years old to argue Bell Atlantic viewed GTE's possible competitive entry as uniquely significant (Conf. Apdx. at 12-13), the documents it relies on do not take that position nor do they remain relevant today, in view of the subsequent entry into Bell Atlantic's markets by dozens of other competitors.

million contract in order to provide CVS's 4100 nationwide stores with "domestic and international long distance services, plus local service via AT&T Digital Link . . ."[17]

There is no significance to the fact that the companies have not yet produced detailed plans as to how to carry out their out-of-region initiatives to better compete for customers, despite AT&T's assertions to the contrary (Conf. Apdx. at 14-16.) It should scarcely be surprising in the rapidly evolving market that the companies have chosen to wait until personnel decisions are finalized and the merger consummated before engaging in detailed planning. In any event, the companies have already committed to spend $500 million competing with incumbent local exchange companies in the three years following closing to provide further assurance that the companies will capitalize on the combined strengths of the two companies in competing in local markets.[18]

[17] AT&T News Release, *"AT&T Wins $125 Million Contract from CVS For Voice, Data, and Managed Networking Services,"* Nov. 9, 1999, at 1 (available on AT&T website at www.att.com/press/item/0,1354,2243,00.html). The day following this announcement, AT&T also announced the formation of "AT&T Business Network," which it described as a business unit which will offer a "fully integrated range of communications services -- local, long distance, international, wireless, data and IP -- all from one company, with one contract, one bill and one point of contact for customer care . . . AT&T Business Network will leverage the local service assets of the former TCG, the company's far-reaching wireless network, and, in the future, broadband cable and Digital Subscriber Line (DSL) services. This will allow all of a customer's services to ride over AT&T's own worldwide network, eliminating handoffs of calls between multiple communications carriers and ensuring that customers get AT&T network quality and reliability from beginning to end." AT&T News Release, *"AT&T Business Network Gives High-Growth Companies Integrated Services, Web-Based Virtual Telecom Department,"* November 10, 1999, at pp. 1, 2 (available on AT&T website at www.att.com/press/item/0,1354,2245,00.html).

[18] AT&T's assertion that the competitive advantages of the merger could be achieved through a joint venture is a makeweight. Conf. Apdx. at 14-15. The same kind of managerial, marketing and financial issues that have lead AT&T to conclude that it could not simply engage in a joint venture with TCI or MediaOne in order to compete nationally apply here as well.

B

US OFFICE PRODUCTS

**Before the**
**FEDERAL COMMUNICATIONS COMMISSION**
**Washington, D.C. 20554**

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

**REPLY DECLARATION OF**
**ROBERT W. CRANDALL AND ROBERT H. GERTNER**

## I. INTRODUCTION

### A. Qualifications

1. 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. I am the chairman of Criterion Economics, LLC, an economic consulting firm in Washington, D.C. that specializes in antitrust and regulatory issues concerning telecommunications, the Internet, and other network industries.

2. 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").

3. 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.

4. 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.

5. 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.

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

7. I, Robert H. Gertner, am Professor of Economics and Strategy at the Graduate School of Business of The University of Chicago. I received an A.B., summa cum laude, from Princeton University in 1981, where I majored in Economics, and a Ph.D. from the Massachusetts Institute of Technology in 1986, also in Economics. I am a Research Fellow at the National Bureau of Economic Research. In 1990-1991 I was a John Olin Fellow in Law and Economics at The University of Chicago's Law School. I specialize in the economics of industrial organization (the study of individual markets which includes the study of antitrust, regulation, and business strategy), game theory (the formal study of strategic interdependence), law and economics, and corporate finance. I am co-author of *Game Theory and the Law*, a book that applies the modern tools of game theory and information economics to legal issues. I have published numerous articles in academic journals including the *Journal of Law and Economics*, the *Rand Journal of Economics*, the *Quarterly Journal of Economics*, and the *Journal of Finance*. I am Co-Editor of the *Journal of Business*, a leading journal that publishes academic research applying economics to business problems, and Associate Editor of the *Journal of Industrial Economics*. I have taught courses at The University of Chicago in competitive strategy, industrial organization, financial economics, corporate law, and antitrust law.

8. In addition to my academic experience, I am Principal and Vice President of Lexecon Inc., an economics consulting firm that specializes in the application of economic analysis to legal and regulatory matters. I have worked as a consultant on antitrust and other litigation issues as well as business strategy problems with major telecommunications firms.

**Summary and Conclusions**

9. We have been asked by counsel for Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") to review the comments filed by a variety of parties in response to conditions proposed by Bell Atlantic and GTE to alleviate any potential concerns that the proposed Bell Atlantic/GTE merger will reduce competition and harm consumers. Several commenters claim that the conditions proposed by the merging firms are not sufficient to prevent a reduction in competition. In particular, they claim that:

1) The merger will remove a significant potential entrant in each firm's territories;

2) The merger will reduce the number of "benchmarks" that can be relied upon by regulators; and

3) The merger will increase the merged firm's incentive and ability to discriminate against its rivals.

10. As we explain in this statement, we find that these claims are without merit. First, we find that Bell Atlantic and GTE have no substantial advantages over many other potential entrants, including in those limited areas where Bell Atlantic and GTE service territories are physically contiguous. Second, we find that GTE is a relatively poor benchmark for RBOCs, so that its loss as a benchmark is less important than the loss of SBC or Ameritech. Also, an examination of the FCC's historical use of benchmarking suggests that the FCC has gained new benchmarks over time and otherwise compensated for the loss of some benchmarks to mergers. Finally, we find that the empirical evidence is inconsistent with a concern that the merged firm will discriminate against its rivals.

11. Several commenters cite the FCC's Order in the SBC/Ameritech matter to support their claims. However, we find that the proposed Bell Atlantic/GTE merger

raises substantially fewer competitive concerns than the SBC/Ameritech merger. Thus, Bell Atlantic and GTE's proposed conditions, which are substantially the same as those adopted by SBC and Ameritech, should address any competitive concerns.

## II. BELL ATLANTIC AND GTE ARE NOT AMONG THE MOST SIGNIFICANT POTENTIAL ENTRANTS INTO ONE ANOTHER'S TERRITORIES.

12. Several commenters, citing the FCC's potential entrant analysis in Bell Atlantic/NYNEX and SBC/Ameritech, argue that each company is one of only a few potential entrants with the systems and expertise needed to provide competing local services. However, Bell Atlantic and GTE only have contiguous territories in two states, Pennsylvania and Virginia, and have no substantial advantages over other potential entrants in those areas. GTE's competitive local exchange carrier ("CLEC") activities are focused on areas removed from Bell Atlantic's service areas, and Bell Atlantic has little incentive to enter GTE's low density rural territories. For this reason, Bell Atlantic and GTE are not among the most significant potential entrants into one another's territories.

### A. GTE's local service facilities provide a springboard for national expansion but are focused in areas removed from Bell Atlantic.

13. GTE has substantial local exchange facilities and operations in states that are served by other RBOCs such as California, Florida, Washington and Texas. The local exchange operations in these states include major metropolitan areas where they are adjacent to the local exchange operations of other RBOCs such as Los Angeles, Tampa, Seattle and Dallas. While GTE has an active CLEC operation, it has focused its activity in areas close to its existing local exchange operations in these other RBOCs'

regions (California, Florida, Washington and Texas).[1] In each of these areas, GTE's service areas are far from Bell Atlantic's.

14. Bell Atlantic and GTE do not have physically contiguous service areas in any major metropolitan market, and for the most part their respective local exchange operations are not contiguous. In fact, GTE and Bell Atlantic service areas are only contiguous in two states, Pennsylvania and Virginia. In these states, GTE provides service in largely rural, low-density areas.

**B. Bell Atlantic and GTE's geographic proximity to each other is not an advantage in Pennsylvania and Virginia.**

15. Bell Atlantic's customer base in Virginia and Pennsylvania is concentrated in urban areas, while GTE operates primarily in rural areas. In Virginia, Bell Atlantic's service area is concentrated in the densely populated areas in eastern Virginia around Washington, Richmond and Norfolk. In addition, Bell Atlantic serves the areas around Roanoke in the western part of the state. In Pennsylvania, Bell Atlantic's service areas are concentrated around Pittsburgh, Philadelphia, Allentown, Harrisburg and Scranton.

16. In contrast, GTE services a small area of Northern Virginia, part of Norfolk, and the less densely populated areas along the Western shore of the Chesapeake Bay, south of Richmond, around Harrisonburg and Lynchburg, and along the West Virginia border. The total population of these areas is 885,369 with a density of 89 people per square mile, as compared to the total population of Bell Atlantic's Virginia service areas of 4,370,720 with a density of 284 people per square mile. Similarly, in Pennsylvania, GTE's service areas cover less densely populated areas around Erie, Greensburg, York, Lebanon and Lewisburg. The total population of GTE's service areas in

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1. http://www.gte.com/AboutGTE/NewsCenter/FactSheets/communications.html. The FCC has found that potential entry into business markets is not a significant issue since there are many more firms competing for business customers than for mass market customers.

Pennsylvania is 1,030,084 with a density of 190 people per square mile, as compared to the total population of 8,771,251 and a density of 487 people per square mile in Bell Atlantic's Pennsylvania service areas.

17. Unlike SBC and Ameritech, which had large adjacent territories, GTE is much more geographically diffuse. Even in the two states where it is adjacent to Bell Atlantic the two firms serve areas with substantially different characteristics. GTE's low density rural areas make relatively unattractive targets for Bell Atlantic. Even if some entry by Bell Atlantic may have occurred in one or a few GTE service areas, the potential competition issue is less significant than it was in the analysis of the SBC and Ameritech merger where the merging companies benefited from adjacency and the presence of significant relevant facilities in major metropolitan markets.

18. Several commenters claim that Bell Atlantic and GTE, as incumbent local exchange carriers ("ILECs"), are among only a few potential entrants with the special expertise, systems and operational capabilities needed to provide competing local service. As discussed in the Gertner/Gould Declaration submitted previously in this proceeding, the evidence is inconsistent with this claim.[2]

19. With respect to back office and operations support systems ("OSS"), GTE chose to invest in new back office systems for its CLEC subsidiary rather than relying on legacy systems (and has not deployed those new systems in Bell Atlantic states). Other companies such as AT&T, Sprint, Unitel and Frontier have also purchased billing systems from third parties rather than expanding their own systems. Furthermore, companies such as MCI WorldCom and AT&T have entered local markets by purchasing CLECs or cable companies. In contrast, we understand that neither firm has purchased any ILECs. Thus, their actions are inconsistent with the claims that

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2. Declaration of Robert H. Gertner and John P. Gould on Behalf of GTE Corporation and Bell Atlantic Corporation, December 22, 1998.

ILEC experience provides a substantial advantage for potential entrants into the local telephone business.

20. With respect to proximity of facilities, Sprint's actions are telling. We understand that Sprint has ILEC properties in both Virginia and Pennsylvania, some of which are adjacent to both GTE and Bell Atlantic territories. Despite this adjacency, however, Sprint has not chosen to extend and use those ILEC facilities in order to compete for local exchange customers in either state. This is further market evidence that having proximate independent ILEC facilities offers no substantial advantage over other potential entrants in competing in these states. Moreover, we have found that many other companies have facilities within reach of the contiguous Bell Atlantic and GTE territories and many other companies also have existing operations, marketing presence and customer relationships in Bell Atlantic and GTE territories.[3] Indeed, many of these firms, such as AT&T and MCI WorldCom, have already entered Bell Atlantic's territories.

21. The FCC found that SBC and Ameritech had extensive plans to enter one another's territories, and that they had advantages in doing so where the companies were adjacent or had relevant facilities (in that case, cellular).[4] Bell Atlantic and GTE, on the other hand, have shown little sign of entering one another's territories and do not have any particular advantages over many other potential entrants in Virginia and Pennsylvania. Although any ILEC or CLEC could, in theory, be considered a potential entrant, Bell Atlantic and GTE are less significant to each other than SBC and Ameritech were to one another.

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3. See Gertner/Gould Declaration, paragraphs 31-34.
4. *SBC/Ameritech Memorandum and Order,* CC Docket No. 98-141, October 6, 1999, paragraphs 85-86.

## III. COMMENTERS EXAGGERATE THE IMPACT OF THIS MERGER ON THE ABILITY OF REGULATORS TO ESTABLISH BENCHMARKS FOR *EVALUATING ILEC PERFORMANCE.*

22. A number of commenters argue that the proposed merger should be blocked because it will reduce the ability of the FCC to monitor the behavior of incumbent local exchange carriers. Several commenters cite the FCC's SBC/Ameritech Order. In that case the FCC was concerned that a reduction in the number of available benchmarks would have negative effects on three levels.

1) Holding company level – reducing the likelihood of a "maverick" in strategic or management decisions;

2) Operating company level – tying operating company policies more closely with those of the holding company; and

3) Industry level – facilitating coordination to thwart benchmarking.

However, we find that GTE is a relatively poor benchmark for RBOCs, so that its loss as a benchmark likely is less important than the loss of SBC or Ameritech. An examination of the FCC's historical use of benchmarking also suggests that the FCC has gained new benchmarks and otherwise compensated for the loss of some benchmarks to mergers.

### A. GTE is a poor benchmark for RBOCs.

23. The FCC has stated that companies sharing "similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance."[5] GTE, while of similar size in the aggregate, evolved differently than the RBOCs, is subject to different regulatory concerns, and is more geographically diffuse.

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5. *Bell Atlantic/NYNEX Memorandum Opinion and Order*, CC Docket No. 97-286, August 14, 1997, paragraph 16.

24. Historically, GTE grew to its present form by purchasing a series of other ILECs, while the RBOCs were created as monolithic entities by the breakup of AT&T. As a result, the RBOCs were subject to regulatory concerns such as the Modification of Final Judgment and Section 271 that GTE has never been subject to. Furthermore, the RBOCs' networks evolved as monolithic entities, while GTE's, being created from a series of geographically diverse ILECs, has always had more of a patchwork quality.

25. The networks themselves also are fundamentally different. The comparison of GTE and Bell Atlantic's operating companies in Pennsylvania and Virginia is true at the holding company level as well. Since GTE grew by absorbing mostly rural incumbent LECs, its network is far less dense than the RBOCs'. Figure 1 illustrates the contrast. GTE has over half of its network services' lines in low density areas (less than 650 lines per square mile), while SBC, Ameritech and Bell Atlantic all have at least three quarters of their lines in higher density areas (more than 650 lines per square mile). These differences limit the usefulness of GTE's network as a benchmark for the RBOCs.

26. In its SBC/Ameritech Order, the FCC provides an extensive discussion of the types of benchmarks it uses. In these examples companies are considered based on a common regulatory background: MFJ issues, Section 271 proceedings, Section 251 proceedings, companies subject to price caps, and incumbent LECs. In none of these cases does the group consist of only the RBOCs and GTE.

- Comparative practices under the MFJ exclude GTE.
- Section 251 issues cover all incumbent LECs, not just GTE and the RBOCs. In one example on determining technically feasible interconnection points, the FCC explicitly refused to exempt small

incumbent LECs from the benchmark.[6] In another case on cost estimation for collocation, the FCC took an average of the costs of 14 LECs.[7]

- ARMIS data, which is designed to facilitate benchmarking, tracks all "large" ILECs. However, this group includes all ILECs subject to price cap regulation or earning over $112 million a year. Many companies other than the RBOCs and GTE meet these requirements, including Alltel, Aliant, and Citizens.
- Carriers subject to price cap regulation were used in an example on presubscribed interexchange carrier charges. This group included the RBOCs, Sprint, GTE, Aliant, Frontier, Citizens and CBT.[8] ARMIS data also tracks carriers subject to price cap regulation.

27. In each case the groups were examined based on their regulatory obligations, not on their size, except for the ARMIS data, which set a threshold that includes many companies besides the RBOCs and GTE. GTE's regulatory status has more in common with non-RBOC ILECs, and the FCC's history of benchmarking reflects this.

28. This merger presents less of a concern for benchmarking than the SBC/Ameritech merger simply because GTE is a relatively poor benchmark for the RBOCs.

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6. *Local Competition Order*, 11 FCC Rcd. at 15606, para. 206.
7. *In the Matter of Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, CC Docket No. 93-162, Second Report and Order, 12 FCC Rcd. 18730, paragraphs 142-146.
8. *In the Matter of Tariffs Implementing Access Charge Reform*, CC Docket No. 97-250, Memorandum Opinion and Order, 13 FCC Rcd 14683, Figures 1-4.

### B. At the operating company level, Bell Atlantic and GTE are particularly dissimilar in their contiguous areas.

29. As we have discussed, GTE serves predominantly low-density rural areas in Pennsylvania and Virginia while Bell Atlantic serves higher density urban areas. GTE's average population density in these states is 125 people per square mile, while Bell Atlantic's is 393 people per square mile.

30. The FCC noted the difficulties this may cause for benchmarking in its SBC/Ameritech Order.

> Moreover, different market structures may result in different network configurations that limit the usefulness of comparisons. For example, the loop costs of an RBOC may not be comparable to those of a small rural incumbent LEC with longer average loops or less densely concentrated customers.[9]

While Bell Atlantic's networks may be relatively uniform because of their historical presence in AT&T's monopoly, GTE's networks are derived from a number of smaller ILECs.

### C. Commenters fail to recognize the creation of new benchmarks.

31. ILEC-to-ILEC comparisons have become less important as the regulatory focus has shifted to how BOCs treat competitors in markets in comparison to the way the BOC treats itself. These "parity" requirements provide benchmarks that are unaffected by the merger. The FCC agrees that "an incumbent LEC's treatment of its retail operations or its affiliates as compared with its treatment of competitors can provide useful benchmarks for regulators and competitors."[10] Indeed, some commenters argue that parity rules are superior to other benchmarks. AT&T, in their comments, for example, states that a parity standard "is generally simpler and more

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9. *SBC/Ameritech Order*, paragraph 168.
10. *SBC/Ameritech Order*, paragraph 175.

rigorous than attempting to devise a performance benchmark."[11] Parity requirements cannot substitute for all forms of benchmarking, but their increasing importance means that the FCC's overall benchmarking ability is not affected as much by a merger as it might have been prior to the 1996 Telecommunications Act.

32. The entry of numerous CLECs into local markets also creates a variety of alternative benchmarks for evaluating an ILEC's performance, both through comparisons of the ILEC's interactions with the CLECs, and through the CLECs' interactions with other CLECs, IXCs, data service providers and other customers.

### D. Regulators may modify their practices to counteract any attempts at collusion or manipulation.

33. Regulators are not passive recipients of information. As the telecommunications industry evolves, the FCC and other regulators have adapted as well. For example, the FCC expressed concern in its SBC/Ameritech Order that new services such as xDSL may be particularly hard to benchmark because ILECs may not be providing the service themselves. However, the FCC has responded to this problem by increasing the focus on such services in rulemaking proceedings (recently adopting new rules imposing line sharing and other requirements), in 271 proceedings and through conditions such as forming advanced services affiliates.

34. These conditions were sufficient to address the issue in SBC/Ameritech and should be more than sufficient in this case. The loss in benchmarking capability is less than in SBC/Ameritech since GTE is a relatively poor benchmark for the RBOCs.

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11. Opposition of AT&T Corp. to Applicants' Supplemental Filing and Renewal of AT&T's Petition to Deny, March 1, 2000, p.36.

## IV. RESPONDENTS' CLAIM THAT THE PROPOSED MERGER WILL INCREASE THE MERGED FIRM'S ABILITY AND INCENTIVE TO DISCRIMINATE AGAINST RIVALS IS WITHOUT MERIT.

35. Several commenters claim that the discrimination theory articulated in the SBC/Ameritech Order applies equally to Bell Atlantic and GTE. In that Order the FCC expressed concern that the merger would increase the incentive and ability to discriminate "against competitors in the provision of advanced services, interexchange services, and circuit-switched local exchange services."[12] According to the FCC, the increased incentive to discriminate stemmed from the ability of the merged firm to internalize more of the "spill-over effects" from successful discrimination. The increased ability to discriminate allegedly is due to the reduction in the number of benchmarks available to regulators; sharing of "worst practices" in discriminatory conduct by the merging firms; and economies of scope from sharing strategies and arguments in regulatory battles.[13]

36. We find that even if the FCC's discrimination theory is applicable in other contexts, this theory raises substantially fewer concerns on both empirical and theoretical grounds with respect to the Bell Atlantic and GTE merger.

### A. To the extent that discrimination was a concern with SBC/Ameritech, it is less so for Bell Atlantic/GTE.

#### 1. Few CLECs operate in both territories.

37. According to the FCC's discrimination theory, the proposed merger would increase the incentive to discriminate against rival CLECs only if they operate in both companies' service areas (thus allowing the combined firm to capture more of the "spill-

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12. *SBC/Ameritech Order,* paragraph 186.
13. *SBC/Ameritech Order,* paragraph 209.

overs" from discrimination). Any incremental incentive to discriminate due to CLECs operating in both service areas is likely to be small because many of GTE's territories are sparsely populated and have thus faced considerably less CLEC entry than Bell Atlantic.[14] We understand that few CLECs have substantial operations in both Bell Atlantic's and GTE's territories.

38. Even in those cases where CLECs operate in both Bell Atlantic and GTE territories, they will in general share fewer common costs between the regions than would be expected if the territories were adjacent. For example, operations in New York and Los Angeles are likely to share fewer common costs than operations in Dallas and Austin. The geographic dispersion of the Bell Atlantic and GTE service areas thus reduces the magnitude of any spill-over effects. Discriminating against the New York branch of a firm likely will have less impact on its Los Angeles branch than on an adjacent branch.

**2. The change in the percentage of calls originating and terminating within region is likely to be lower than in SBC/Ameritech.**

39. In the SBC/Ameritech Order, the FCC found that the merged firm would "have an increased incentive to discriminate in terminating the calls of competing interexchange carriers, stemming from the fact that benefits will flow from controlling both ends of a higher percentage of interexchange calls."[15] However, the merger was permitted because the conditions would "provide the one sure remedy for the incumbent LEC's threat of discrimination: the competitive LEC's promise of an alternative access provider."[16]

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14. See various measures of local competition presented in USTA's December 9, 1998 letter to The Honorable Thomas Bliley, Chairman of the House Committee on Commerce. GTE, for example, has considerably fewer resold lines than any of the RBOCs.
15. *SBC/Ameritech Order*, paragraph 226.
16. *SBC/Ameritech Order*, paragraph 230.

40. Unlike SBC/Ameritech, GTE's territories are both largely rural and dispersed. Both factors combine to suggest that GTE has a particularly low percentage of calls terminating and originating in region. Since there is no reason to believe that GTE calls are terminating disproportionately in the geographically distant Bell Atlantic territories, the merged company may well have a lower percentage of terminating and originating calls than Bell Atlantic alone.

### 3. Bell Atlantic and GTE's desire to obtain 271 authority provides strong incentives not to discriminate.

41. Unlike SBC and Ameritech, GTE will be giving up its interexchange services in Bell Atlantic's region as part of the merger, and will transfer ownership and control of its extensive Internet backbone infrastructure and interLATA data operations to third party shareholders. This divestiture will provide the merged company with a powerful incentive to obtain 271 authority as quickly as possible in order to regain the assets and resume service. Furthermore, Bell Atlantic is the only RBOC to have actually obtained 271 authority, demonstrating that it is serious about addressing the competition issues necessary to satisfy the 271 competitive checklist. Bell Atlantic agreed to significant penalties in New York should any discrimination problems arise, creating even more incentive not to discriminate.

### B. The FCC's Discrimination Theory is Not Supported by the Available Empirical Evidence or Economic Theory.

#### 1. Empirical evidence indicates that ILECs do not have the ability and/or incentive to discriminate in providing local access to rivals.

##### a. Evidence in wireless telecommunications and other services indicates that ILECs do not have the ability and/or incentive to discriminate in providing local access to rivals.

42. ILECs provide critical inputs to competing cellular carriers. However, a review of the evidence in the wireless telecommunications industry contradicts claims that ILECs can successfully discriminate against their rivals.

43. From the introduction of cellular telephone service in the mid-1980s, to the introduction of ESMR and PCS services in the last few years, virtually all areas in the country were served by two cellular providers. One of the cellular licenses in each area was originally given to the ILEC in that area, and the second license was awarded to a "non-wireline" carrier. Both cellular providers relied on the ILEC to provide local access services (e.g., to connect a cellular call to a landline phone). That is, the ILEC provided local access services to a firm with which it competed.

44. If discrimination concerns were valid, we would expect that the non-wireline carriers would have been substantially disadvantaged as they competed with the ILEC-owned cellular carrier. However, non-wireline carriers have for many years competed on an equal footing against ILEC-owned cellular providers. The FCC, for example, noted in 1996 that "the market shares in each cellular service area have been divided on a roughly equal basis between wireline and nonwireline carriers."[17] Furthermore, the actions of Pacific Telesis and U S WEST in divesting their cellular

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17. *Amendment of the Commission's Rules to Establish Competitive Service Safeguards for Local Exchange Carrier Provision of Commercial Mobile Radio Services, Notice of Proposed Rulemaking, Order Remand, and Waiver Order*, 11 FCC Rcd 16,639, 16,664, paragraph 47 (1996).

interests in 1994 and 1998, respectively, are inconsistent with commenters' claim that an ILEC can disadvantage rivals that rely on the ILEC for local exchange access.

45. We have also reviewed evidence in markets served by Bell Atlantic Mobile ("BAM") and conclude that there has been no effective anticompetitive activity by Bell Atlantic in the wireless markets in which it operates. BAM has provided us with historical data on wireless market shares in markets in which it operates. These data provide a picture that is contrary to the theory of anticompetitive abuse by ILECs against non-wireline CMRS providers. The BAM estimates of market shares in 49 MSAs and RSAs in the Bell Atlantic region provide evidence that Bell Atlantic has not used its interconnection facilities to enhance BAM's market shares. In the 15 of these 49 markets in which BAM's market share is greater than that of its non-wireline cellular competitor, it has a market share that averages only 1.7 percentage points more than its non-wireline rival. In the 20 markets in which BAM has a lower market share than its non-wireline cellular rival, it has an average of 2.5 percentage points less market share than its rival. Finally, in 15 of the 49 markets the shares are identical.[18] Thus, in Bell Atlantic's territory, BAM has a slightly lower average market share than its non-wireline cellular rivals. Indeed, BAM's market share in the 31 markets in which Bell Atlantic is not the principal ILEC is generally about 1 percentage point higher than that of its wireline-owned competitor.

46. We also are not aware of any claims of harm to competition resulting from RBOC provision of information services and customer premises equipment ("CPE") in competition with others. For example, information services (including the Internet) have grown at extraordinary rates in recent years. RBOCs are small players among a very

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18. These data were provided by Bell Atlantic. All data were rounded to the nearest percentage point.

large number of Internet Service Providers. Similarly, Bell companies have achieved only a modest share of industry sales of CPE.[19]

47. The ability of wireless, CPE and information service providers to compete successfully with ILECs is inconsistent with a claim that ILECs abuse their position as suppliers of local access to discriminate against their unintegrated rivals.

**b. Available evidence fails to support the hypothesis that ILEC mergers adversely affect CLEC activity.**

48. The FCC's SBC/Ameritech Order cites testimony submitted by Katz and Salop and Hayes, Jayaratne and Katz in support of its discrimination theory.[20] Hayes, Jayaratne & Katz (hereafter, "HJK") attempted to show that CLEC entry was slowed by the SBC/PacTel merger and that smaller ILECs have seen more competitive entry into their markets than have the larger ILECs.

49. Dennis Carlton and Hal Sider have undertaken a much more complete multivariate regression analysis, including a variety of other variables such as market size, population, and population growth, and they find no evidence of a statistically-significant difference between entry into local markets in the SBC region and entry into other regions since the SBC/PacTel merger.[21] Nor do they find evidence that the growth of entry in the Bell Atlantic/NYNEX region was any lower after their merger than entry in other markets. Carlton and Sider also found no statistically significant difference between CLEC entry into markets served by "small" ILECs, such as Sprint, Frontier, Cincinnati Bell, and SNET, and entry into markets served by the large RBOCs.

50. Furthermore, New York state has been the only area in the nation which has received Section 271 approval, having been found to have substantial and

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19. NATA, 1995 Telecommunications Review and Forecast, p.128 (1995).
20. *SBC/Ameritech Order*, footnote 350.
21. Dennis Carlton and Hal Sider. *Report to the FCC on Supplemental Analysis of the Katz/Salop Hypothesis*, April 5, 1999.

irreversible local competition, and this has occurred after the Bell Atlantic/NYNEX merger. This fact suggests that the merger did not lead to anticompetitive activities in New York.

51. Although the FCC found that "it is difficult to reach a conclusion regarding the level of competitive LEC activity, and ultimately the corresponding amount of discrimination, in the regions of the merged RBOCs [using the Carlton and Sider data]," the Carlton/Sider analysis still rebuts HJK leaving no evidence that previous mergers have affected the level of CLEC activity.

**2. The theory fails to address an important theoretical objection.**

52. As we have explained, the so-called "spill-over" theory is inconsistent with the available empirical evidence. The theory also fails to address an important theoretical objection. In particular, the theory presumes that consumers will be able to detect the effects of discrimination and service degradation by an ILEC. If this were not the case, consumers would have no reason to purchase service from the ILEC. However, the theory also implicitly assumes that regulators and rivals (including large sophisticated firms like several of the commenters) will not be able to respond to discrimination effectively. If discrimination is detectable then there are mechanisms in place to address it.

53. The FCC's SBC/Ameritech Order states that some areas such as xDSL provisioning already have required regulatory intervention. If this is the case, this example demonstrates that regulatory mechanisms are working and can be used to prevent successful discrimination.[22] In any case, the FCC found that the conditions

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22. *SBC/Ameritech Order,* paragraph 197.

imposed on SBC and Ameritech to prevent discrimination were adequate to prevent discrimination after that merger.

### 3. The FCC has repeatedly found that the risk of discrimination does not justify blocking mergers.

54. Discrimination arguments in various guises have been made in all of the major telecommunications mergers since Bell Atlantic/NYNEX. They have never been found to justify blocking a merger. In the SBC/SNET decision, the Commission explained that "MCI made the identical argument [concerning price squeezes] in opposing the merger of Bell Atlantic and NYNEX. In the Bell Atlantic/NYNEX Order, the Commission concluded that this concern did not justify blocking the merger, and MCI does not challenge the Commission's analysis in this proceeding."[23] These arguments centered on the regulatory safeguards in place and the corresponding ease with which this type of discrimination could be detected.

55. GTE is a different case than Ameritech. Since the discrimination theory is speculative to begin with, and the available empirical evidence does not support any significant effects on competing firms from discrimination, the FCC should be cautious about applying it in the same manner as in SBC/Ameritech.

56. The Commission permitted the SBC/Ameritech merger despite finding that the risk of discrimination would increase because the companies adopted "a number of conditions, initially proposed by SBC, that both guard specifically against the discrimination harms identified above and do so in a deregulatory manner..."[24] Not only are Bell Atlantic and GTE prepared to accept substantially the same conditions

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23. *SBC/SNET Memorandum Opinion and Order*, CC Docket No. 98-25, October 15, 1998, paragraph 24.
24. *SBC/Ameritech Order*, paragraph 254.

addressed at discrimination, but the discrimination concerns themselves, following the FCC's logic, are less serious in this merger.

## V. SUMMARY OF CONCLUSIONS.

57. We find that Bell Atlantic and GTE are not among the most significant potential entrants into one another's territories. GTE's local service facilities generally are not located near Bell Atlantic territories, and in the two states where the companies are contiguous in limited areas, many other companies have entered or could enter drawing on facilities and customer bases to compete in Bell Atlantic and GTE territories.

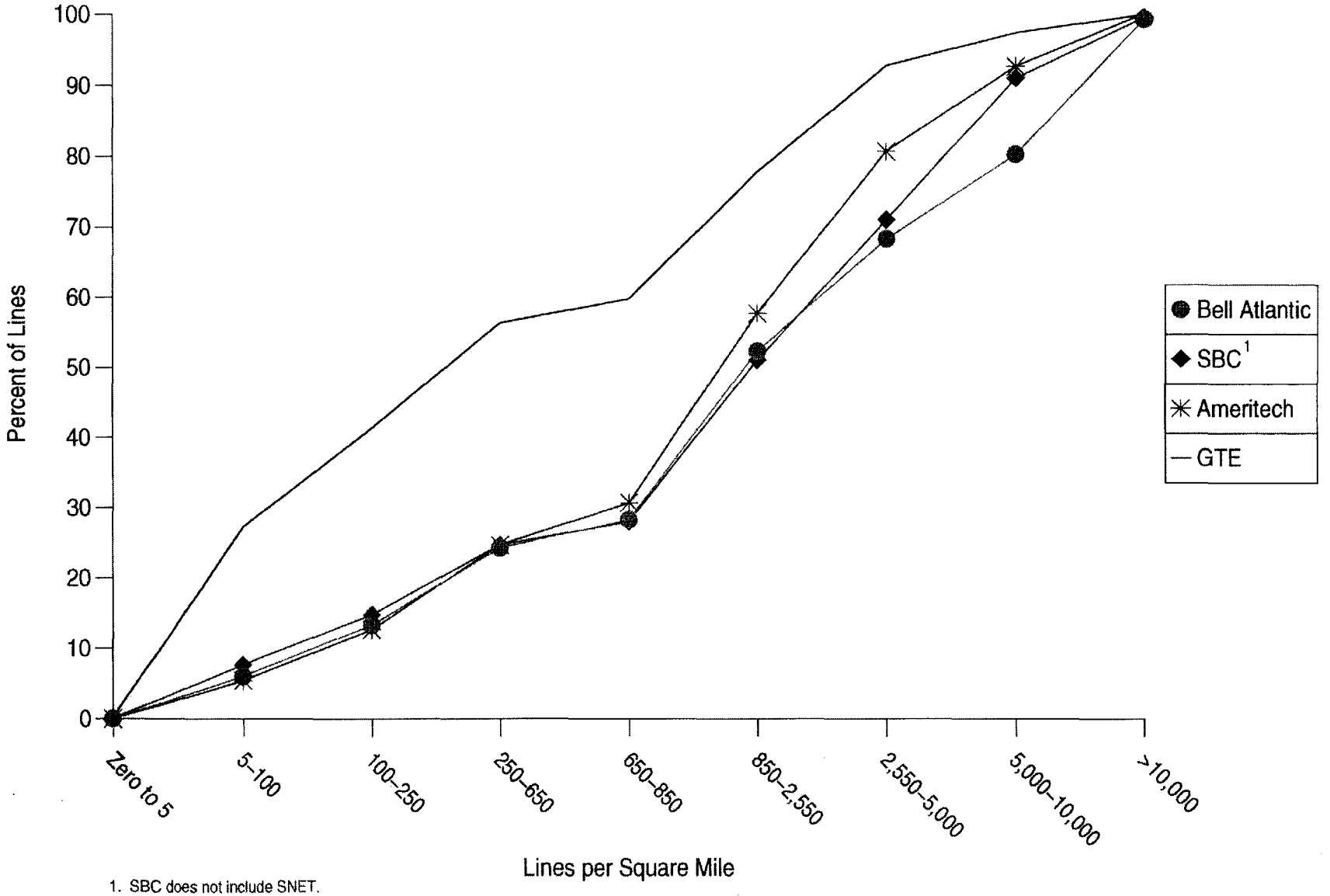
58. We also find that the merger of Bell Atlantic and GTE does not pose a significant danger to regulators' ability to benchmark. Unlike SBC and Ameritech, GTE is a relatively poor benchmark for RBOCs. GTE is not subject to Section 271 requirements, has a different network structure than the RBOCs, and was created through the agglomeration of numerous small ILECs. It has more in common with the other non-RBOC ILECs that also are subject to Section 251 requirements. Furthermore, an examination of the FCC's historical use of benchmarking suggests that the FCC has gained new benchmarks over time and otherwise compensated for the loss of some benchmarks to mergers.

59. Discrimination is not as significant an issue for Bell Atlantic and GTE as it was for SBC and Ameritech. Also, evidence in a variety of markets suggests that discrimination has not had a significant effect on competing firms. In addition, the discrimination theory still fails to address the question of how the effects of discrimination can be detected by consumers but not by sophisticated rivals and regulators.

60. We find that the proposed Bell Atlantic/GTE merger raises substantially fewer competitive concerns than the SBC/Ameritech merger. Since Bell Atlantic and

GTE have agreed to accept substantially the same conditions as did SBC and Ameritech, we believe that this merger should also be approved.

## Figure 1
## Network Density for GTE, Bell Atlantic, Ameritech and SBC




1. SBC does not include SNET.
Source: GTE.

I declare, under the penalty of perjury, that the foregoing is true and correct to the best of my knowledge and belief.

3/16/00

Robert W. Crandall

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge and belief. Respectively submitted this day, March 15, 2000.

Robert H. Gertner