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May 12, 2000

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 – 12th Street, S.W.
Washington, DC 20554

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OFFICE OF THE SECRETARY

Re: CC Docket No. 99-333

Dear Ms. Salas:

On February 18, 2000, SBC Communications Inc. ("SBC") filed comments in the above-referenced docket establishing that the MCI WorldCom/Sprint merger would adversely affect competition in several telecommunications markets. In their reply comments filed March 20, 2000, MCI WorldCom and Sprint attempted to cast doubt on the showing made by SBC. Pursuant to 47 C.F.R. § 1.1206, enclosed are two copies of an *ex parte* paper that addresses particular aspects of the Applicants' reply, where MCI WorldCom and Sprint have mischaracterized SBC's opposition, or where they have offered new evidence that they claim justifies the merger.

Any questions regarding this submission or SBC's opposition to the proposed MCI WorldCom/Sprint merger can be directed to my attention.

Yours truly,

Sandy Wagner
Vice President for Regulatory Matters
SBC Telecommunications Inc.

cc: Larry Strickling, Chief, Common Carrier Bureau
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SUPPLEMENTAL SUBMISSION OF SBC COMMUNICATIONS INC.
CC Docket No. 99-333

The merger of MCI WorldCom and Sprint should be unthinkable. As SBC demonstrated in its Opposition, filed February 18, 2000, the merger would cause concrete harms in long distance voice and data, Internet, and local exchange services, and its purported efficiencies are neither specific enough nor substantial enough to outweigh these competitive harms.

Despite the obvious anticompetitive potential of the merger, MCI WorldCom and Sprint persist in the argument that the proposal is in fact procompetitive (or at least not as anticompetitive as most people think). The only way they can make this argument is to distort the arguments made in opposition to the merger, and to mischaracterize the evidence that supports those arguments. SBC therefore provides this submission to correct and clarify the record on three specific propositions addressed in SBC's Opposition. *First*, the merger will reduce long distance competition. *Second*, new entry will not constrain long distance pricing post-merger. *Third*, the Applicants' claimed efficiencies are insufficient to justify the merger.

DISCUSSION

I. The Merger Will Lead to Higher Prices in Long Distance Markets

MCI WorldCom and Sprint's economists do not deny that the merger will have anticompetitive effects in long distance market segments. Their claim, rather, is that SBC's concerns about the "likely competitive effects" of the merger are "overstated."[1] But even that qualified response rests in large part on misunderstanding – and mischaracterization – of the evidence set out in SBC's Opposition.

[1] Declaration of Stanley M. Besen and Steven R. Brenner ¶ 1 (Mar. 20, 2000) ("Besen & Brenner Second Decl.").

A. The Merger Would Adversely Affect Mass Market Long Distance Competition

No one disputes that the merger would create concentration levels in the mass market not seen in more than a decade. SBC's Opposition explained that, if anything, these concentration levels *understate* the merger's likely effect on consumers, because MCI WorldCom and Sprint are one another's next closest substitutes. SBC Opposition at 8-11. MCI WorldCom and Sprint object to this characterization, and to the predictions of a post-merger price increase that flow from it. These objections are misplaced. Moreover, even if one assumed that MCI WorldCom's and Sprint's criticisms were on-target, which they are not, the merger would *still* result in demonstrable harm to consumers of more than $14 billion in net present value.

1. The Applicants acknowledge that SBC has presented statistically meaningful evidence that "a disproportionate number of MCI WorldCom's customers switch to Sprint." Reply at 24. The Applicants claim, however, that "SBC's own economists" do not support the other half of that equation – *i.e.,* that "a disproportionate number" of Sprint customers switch to MCI WorldCom. *Id.* The Applicants are wrong. The Declaration of Dr. Hausman included with SBC's Opposition includes an econometric model of cross-elasticities and own-price elasticities of the Big Three, as well as of the second-tier interexchange carriers. *See* Declaration of Professor Jerry A. Hausman ¶ 22 & Table 1 (Feb. 16, 2000) ("Hausman Decl."). As Dr. Hausman states, this model, which is based on an analysis of 20,000 customer bills, shows quite clearly that not only is "Sprint . . . the closest competitor to MCI WorldCom," but "*MCI WorldCom is also the closest competitor to Sprint.*" *Id.* (emphasis added).[2]

[2] Moreover, the Applicants themselves admit that MCI WorldCom and Sprint are closer competitors to each other than either is to AT&T. Table 5 of the Besen & Brenner Second Declaration shows that the ratio of actual to expected customer switches from MCI WorldCom to Sprint is greater than the ratio from MCI WorldCom to AT&T. Similarly, the ratio of actual to expected customer switches from Sprint to MCI WorldCom is greater than the ratio from Sprint to AT&T.

More to the point, the Applicants claim that the closest competition faced by MCI WorldCom and Sprint comes from the second-tier interexchange carriers. Reply at 24-26. The evidence upon which they base this claim, however, is flawed.

The Applicants' claims regarding their next closest substitutes are based on a churn study that tracks changes in customers' so-called "main vendors," as measured only by the volume of minutes carried during a given month. Reply at 24-26; Besen & Brenner Second Decl. ¶¶ 49-55. Under this "main vendor" approach, a customer "switches" carriers in a month in which she makes dial-around calls that last longer, in the aggregate, than her 1+ calls. That customer switches *again* when she reverts back to the practice of making all her calls on her presubscribed carrier. Thus, a customer's decision to experiment with a dial-around carrier for a single call can be reflected in the Applicants' study as a decision to "switch" carriers twice.[3]

The Applicants' narrow emphasis on the volume of minutes carried – to the exclusion of both revenue and presubscribed interexchange carriers – almost certainly overstates the extent of switching by consumers. *See* Ex Parte Declaration of Dennis W. Carlton and Hall S. Sider ¶¶ 28-31 (May 10, 2000) ("Carlton & Sider Supp. Decl."). As the Commission has recognized, the more standard, reliable approach is to analyze the extent of customer switching based on *all*

[3] Take, for example, a customer who has presubscribed to MCI, pays MCI a minimum monthly fee of approximately $5 per month, and typically makes the majority of her calls using 1+ dialing. In one particular month, however, the customer uses a dial-around carrier (perhaps MCI itself) to make one fairly long call. In the same month, the customer has made a number of calls using 1+ dialing, but those calls are shorter in total length than the single dial-around call. In the subsequent month, the customer reverts to using 1+ dialing exclusively. While in fact the customer has always retained MCI as her presubscribed carrier, while in fact she has made the overwhelming majority of her calls on MCI, and while in fact she has paid the overwhelming majority (or even all) of her long distance fees to MCI, the Applicants' study shows her as having "switched" long distance carriers -- not just once, but *twice*. This scenario is extremely plausible: according to one recent estimate, "well over half of all consumers make less than an hour of long distance calls in a given month." Initial Comments of Consumer Federation of America, Consumers Union, and the Texas Office of Public Utility Counsel, CC Docket No. 99-249, at 9 (FCC filed Sept. 22, 1999) ("*Consumers Union Comments*"). Thus, one lengthy dial-around call will often result in two so-called "switches."

the relevant measures: PIC lines, revenue, and volume.[4] And as documented in SBC's Opposition, that approach plainly shows that MCI WorldCom and Sprint are one another's closest competitors. SBC Opposition at 8; Hausman Decl. ¶ 22 & Table 1 (analyzing cross-elasticity through changes in PICs and "minutes called per month"); Declaration of Dennis W. Carlton and Hal S. Sider ¶¶ 32-38 (Feb. 18, 2000) ("Carlton & Sider Decl.") (analyzing cross-elasticity through changes in "long distance purchasing patterns"); *see also* Carlton & Sider Supp. Decl. ¶ 24. Thus, notwithstanding the Applicants' gerry-rigged study, the truth of the matter is that MCI WorldCom and Sprint must compete for new customers more vigorously than, say, AT&T, just to maintain their existing market shares.[5] As SBC explained in its

[4] *See, e.g.*, FCC Common Carrier Bureau, Industry Analysis Div., *Long Distance Market Shares: Fourth Quarter 1998* (Mar. 1999) (measuring long distance market shares based on revenues, minutes, and presubscribed lines); FCC Common Carrier Bureau, Industry Analysis Div., *Historical Patterns of Entry into Long Distance by Local Exchange Carriers*, at 2 (Sept. 1998) (measuring market share by presubscribed lines); *see generally* Memorandum Opinion and Order, *Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor to AT&T Corp., Transferee*, 14 FCC Rcd 3160, 3162 n.5 (1999) (measuring share by presubscribed access lines); Memorandum Opinion and Order, *Application of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control of MCI Communications Corp. to WorldCom, Inc.*, 13 FCC Rcd 18025, 18044, ¶ 32 (1998) ("*MCI/WorldCom*") (measuring share by revenues); *id.* at 18044-45, ¶ 33 & n.85 (citing shares based on volume of toll minutes); Memorandum Opinion and Order, *Applications of Teleport Communications Group Inc., Transferor, and AT&T Corp., Transferee, for Consent to Transfer of Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities-Based Resold Communications Services*, 13 FCC Rcd 15236, 15328 n.7 (1998) (measuring share by presubscribed access lines); *id.* at 15252, ¶ 28 & n.95 (citing AT&T's share of long-distance carrier operating revenues and volume of switched-access minutes); Order, *Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, 11 FCC Rcd 3271, 3294, ¶ 40 (1995) (noting AT&T's share of toll minutes); *id.* at 3307, ¶ 67 (tracking AT&T's share of revenues).

[5] As MCI WorldCom's own official testified, given high churn rates, MCI WorldCom "ha[s] to win customers every day just to stay even." Direct Testimony of David N. Porter, MCI WorldCom Vice President of Government Affairs, *Request of MCI WorldCom, Inc., and Sprint Corp. for Approval to Transfer Control of Sprint Corp.'s California Operating Subsidiaries to MCI WorldCom, Inc.*, Application No. 99-12-012, at 32 (Cal. Pub. Utils. Comm'n filed Apr. 14, 2000).

Opposition, market share statistics alone – however damning – actually understate the threat posed by the merger.

2. MCI WorldCom and Sprint next take issue with Professor Hausman's prediction that the merger would lead to price increases of 5.4% for MCI WorldCom and 8.9% for Sprint. It is telling that the Applicants do not make any attempt to quantify the merger's likely impact on long distance prices.[6] But in any event, the substance of their criticism of Dr. Hausman's analysis reveals a profound misunderstanding of the model upon which that analysis is based. *See* Hausman Supp. Decl. ¶¶ 8-14. For example, the Applicants claim that Dr. Hausman's model "assumes that consumers will react to new prices set by a carrier instantaneously, rather than over a number of months." Reply at 26 (citing Besen & Brenner Second Decl. ¶¶ 69-71). In fact, however, Dr. Hausman's model "predicts a gradual response as more consumers switch to the new price offerings." Hausman Supp. Decl. ¶¶ 9-11. Similarly, MCI WorldCom and Sprint are simply wrong to suggest that Dr. Hausman's pricing information does not take into consideration monthly recurring charges. Reply at 26 (citing Besen & Brenner Second Decl. ¶¶ 73, 76-77 & n.62). The model does take into account "[m]onthly fixed charges as well as separate prices for peak and off-peak calls." Hausman Supp. Decl. ¶ 12.[7]

Perhaps most importantly, Besen & Brenner criticize Dr. Hausman's estimated demand elasticity for AT&T. Besen & Brenner Second Decl. ¶¶ 82-85. Since, in their view, that estimate is too low, and "since [Dr. Hausman's] estimates of the post-merger price changes depend directly on his demand estimates, [those estimates of post-merger price changes] should not be accepted as reliable." *Id.* ¶ 86. In fact, Dr. Hausman's price-change estimates are not

[6] *See* Ex Parte Declaration of Jerry A. Hausman ¶ 3 (May 10, 2000) ("Hausman Supp. Decl."); *see also* Declaration of Paul W. MacAvoy at iv-v (May 10, 2000) ("MacAvoy Decl.").

[7] Moreover, any failure to include promotional discounts, *see* Reply at 26, would only *underestimate* the price effects of the merger. *See* Hausman Supp. Decl. ¶ 12.

particularly sensitive to the estimated demand elasticity for AT&T. *See* Hausman Supp. Decl. ¶ 8. Rather, those estimates turn largely on the estimated demand elasticities of MCI WorldCom and Sprint, *which are not questioned by Drs. Besen and Brenner. See id.*[8] To illustrate the point, Dr. Hausman increased the AT&T price elasticity to match that estimated for MCI WorldCom, and found a post-merger price increase of 7.3% for Sprint. *Id.* Thus, even taking the view of Drs. Besen and Brenner that AT&T customers are more inclined to switch carriers than Dr. Hausman initially estimated, the merger would still cause substantial consumer harm.

Indeed, this is exactly the conclusion reached by Dr. MacAvoy. *See* MacAvoy Decl. ¶¶ 47-52. Dr. MacAvoy has analyzed the long distance market without using explicit elasticity estimates for individual carriers (and without assuming that carriers offer highly differentiated services), as suggested by Drs. Besen and Brenner. *See id.* ¶ 45. Nonetheless, Dr. MacAvoy concludes that the merger of MCI WorldCom and Sprint would lead to classic oligopolistic behavior in the long distance market, and would cost consumers at least $14.3 billion, net present value. *Id.* ¶¶ 51-52 & Table 9. Thus, even if the Besen and Brenner criticisms of Dr. Hausman's assumptions had merit, which they do not, one thing still would be clear: if MCI WorldCom and Sprint were to merge, consumers would pay more for long distance service than they would absent the merger.[9]

4. Although the anticompetitive effects of the merger will be felt most acutely by the high-volume residential customers for whom MCI WorldCom and Sprint actively compete, *see* SBC Opposition at 10, low- and middle-volume long distance callers would suffer as well.

[8] Drs. Besen and Brenner presumably have access to MCI WorldCom's and Sprint's elasticity information, making their acceptance of Dr. Hausman's elasticity estimates all the more significant.

[9] The likelihood of a post-merger price increase is confirmed by Carlton and Sider's analysis of stock prices following the merger. *See* SBC Opposition at 11; Carlton & Sider Decl. ¶¶ 49-58. MCI WorldCom and Sprint's attempts to cast doubt on that analysis are without merit. *See* Carlton & Sider Supp. Decl. ¶¶ 32-46.

Many of these callers pay well over half of their long distance charges through monthly minimum charges, which makes for especially easy price coordination among the leading carriers.[10] Indeed, as Dr. MacAvoy explains, these monthly charges mean that millions of low- and middle-volume callers have actually seen price increases in recent years.[11] MCI WorldCom and Sprint appear to take the view that because many of these customers are served by AT&T, they are "unaffected by the merger." Reply at 17. But AT&T customers would be hurt as much as any others, for AT&T, like MCI WorldCom/Sprint, would raise prices post-merger in response to the decrease in competitive pressure resulting from the merger. *See* MacAvoy Decl. ¶ 38. The Commission has already expressed concern about the "lack of competition among carriers to serve low volume long distance customers."[12] This merger would only make that situation worse.

B. The Merger Would Adversely Affect Competition in the Larger Business Market

With respect to the larger business voice market, SBC's Opposition pointed out the proposed merger's massive potential impact on market concentration, more than eight times the increase necessary to establish a presumption of unlawfulness. SBC Opposition at 29. MCI WorldCom and Sprint leave that analysis essentially unrebutted. The Applicants do, however,

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[10] *See Consumers Union Comments* at 9-10; Hausman Supp. Decl. ¶¶ 15-16.

[11] MacAvoy Decl. Appendix ¶¶ 34-43; *see also* Carlton & Sider Supp. Decl. ¶¶ 17-21; *Consumers Union Comments* at 8 ("residential long distance customers making 30 minutes or less in calls in a month have faced almost a 300% increase in per minute rates and total bills since July 1997"). The Applicants' claim that "the competitiveness of the mass long distance market is proven by its performance," Reply at 30-31, is not supported by the data which they cite. *See* Carlton & Sider Supp. Decl. ¶ 16.

[12] Memorandum Opinion and Order, *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services in Michigan*, 12 FCC Rcd 20543, 20552-53, ¶ 16 (1997) (footnote omitted).

take issue with SBC's analysis of the distinct larger business market for packet-switched data services. Again, their complaints are misguided.

The Applicants do not challenge SBC's market share statistics for packet-switched services.[13] Rather, they criticize SBC's definition of the market. But contrary to the Applicants' claims, the Commission did not reject a similar effort to define a separate market for switched data services in *MCI/WorldCom*[14]; indeed, if anything, the Commission endorsed the existence of such a market in *SBC/Ameritech*. There, the Commission expressly identified the existence of a "data market" distinct from the "long distance voice market," and it relied upon a report that includes within that data market enhanced services such as frame relay, ATM, and X.25.[15]

MCI WorldCom and Sprint's criticism of SBC's market definition – which focuses on SBC's decision to exclude IP-based VPN – reflects a basic misconception of today's market for data services.[16] Reply at 35-36. In the first place, unlike ATM, frame relay, X.25, and SMDS,

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[13] They refer to these documented shares as a "historical snapshot," apparently to contrast them with the parties' hypothetical "snapshots" of the future. Reply at 38.

[14] Contrary to the Applicants' suggestion (Reply at 34-35), the *MCI/WorldCom* order nowhere suggests the express rejection of a data services market. To the contrary, that order notes that "it may be possible to identify . . . narrower product markets within" the larger business market. *MCI/WorldCom*, 13 FCC Rcd at 18041, ¶ 27. Moreover, to the extent the Commission determined that "production substitution among . . . services" rendered such market segmentation unnecessary, it also noted an exception to that conclusion for certain "advanced business services." *Id.*

[15] *See* Memorandum Opinion and Order, *Application of Ameritech Corp. and SBC Communications Inc., for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, 14 FCC Rcd 14712, 14841, ¶ 298 (1999) ("*SBC/Ameritech*") (citing Jack B. Grubman & Christine Gochuico, *Review of Our Position on RBOCs*, Salomon Smith Barney Equity Research, at 4-5 (Mar. 11, 1999)).

[16] It also reflects a misreading of the report on which the Applicants rely. *See* Frost & Sullivan, *U.S. ATM, Frame Relay, SMDS, and X.25 Data Service Markets* (Report 2687-63) ("*Frost & Sullivan*"). The Frost & Sullivan report confirms much of the analysis set out in SBC's Opposition. It notes, for example, that MCI WorldCom and Sprint alone accounted for 86% of interLATA ATM revenues in 1998. *Id.* at 8-26. "Emerging carriers" such as Frontier, GTE, Intermedia, and Williams accounted for less than 3%. *Id.* at 8-27.

VPN is not a protocol; rather, it is a service that must run on top of other protocols (such as ATM). As SBC described in its Opposition, the Big Three provide the overwhelming majority of services offered over the significant protocols. More importantly, even if IP VPN were a technological substitute for the data services SBC identified, there is no reason to believe that it is *currently* providing any meaningful competition, or that it will do so within the relevant two-year timeframe.[17] Indeed, the very same report on which the Applicants rely downplays the prospects for new technologies such as IP VPNs over the next two years.[18] And, to the extent the Applicants rely on RBOCs to constrain their pricing of data services, Reply at 53-54, they are again misguided. As the Commission has recognized, RBOCs can be effective data service providers only when they obtain the interLATA relief needed to provide "long-haul services."[19]

II. New Entry Would Not Constrain Long Distance Pricing Post-Merger

MCI WorldCom and Sprint's filings are dedicated largely to the proposition that entry into long distance is easy. SBC's Opposition pointed out two major flaws in this theory: (1) there are insufficient *facilities-based* long-distance providers to ensure competition post-merger; and (2) even assuming there were enough facilities, brand is a substantial barrier to entry in the mass market. MCI WorldCom and Sprint's responses to these points are unconvincing, for a few very simple reasons. Before turning to those reasons, however, SBC makes two preliminary observations:

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[17] *See, e.g.*, International Data Corp., *U.S. Frame Relay Services: Market Share and Assessment, 1999-2004*, at 2 (Nov. 1999) ("IP VPNs have not yet evolved sufficiently to move into the mission-critical applications space."); *see generally* SBC Opposition at 30 n.56.

[18] *Frost & Sullivan* at 4-4. MCI WorldCom and Sprint's economists can bring themselves to say only that SBC's market definition "appears to have excluded a set of switched data services that *will be* increasingly important." Besen & Brenner Second Decl. ¶ 92 (emphasis added).

[19] *SBC/Ameritech*, 14 FCC Rcd at 14841, ¶ 298; *cf.* International Data Corp., *U.S. Packet/Cell-Based Services: Market Share and Forecast, 1998-2003*, at 91 (Feb. 1999) (Packet-switched data service pricing "is considerably higher than its local equivalent, in large part because of the long distance components factored into the national service pricing structure.").

First, MCI WorldCom and Sprint's ease-of-entry argument is, doctrinally speaking, an effort to rebut the presumption of unlawfulness that results from the unprecedented HHI increases this merger would cause. *See* SBC Opposition at 7, 29, 31.[20] Rebutting that presumption is not as easy as MCI WorldCom and Sprint would have the Commission believe. *See* Reply at 5-12. Where market share statistics raise a presumption of unlawfulness, the burden is on the applicants "to show that [those] statistics [give] an inaccurate account of the acquisitions' probable effects on competition."[21] And where the market shares are as high as they are in this case, "absent *really extraordinary circumstances*," the Commission is obliged to intervene.[22]

Second, MCI WorldCom and Sprint's attempt to meet this burden – the burden to show that "really extraordinary circumstances" exist in the long distance market – has led them to

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[20] The Commission has recently reiterated the usefulness of the HHI to analyze the competitive effects of market concentration. *See* Report & Order, *1998 Biennial Regulatory Review of Spectrum Aggregation Limits for Wireless Telecommunications Carriers*, WT Docket Nos. 98-205, *et al.*, FCC 99-244, ¶ 35 (rel. Sept. 22, 1999); *see also, e.g., SBC/Ameritech*, 14 FCC Rcd at 14769-70, ¶¶ 122-124 nn.239-40 (noting that in a highly concentrated market, "a merger that reduces the number of competing firms from six to five is . . . likely to be challenged as raising serious concern regarding unilateral and coordinated effects").

[21] *United States v. Citizen & S. Nat'l Bank*, 422 U.S. 86, 120 (1975); *see also FTC v. University Health, Inc.*, 938 F.2d 1206, 1218 (11th Cir. 1991) (where market shares yield presumption of unlawfulness, applicants must show "unique economic circumstances that undermine the predictive value of [market share] statistics") (citing *United States v. General Dynamics Corp.*, 415 U.S. 486, 501 (1974)).

[22] *FTC v. PPG Indus., Inc.*, 798 F.2d 1500, 1503 (D.C. Cir. 1986) (emphasis added). The cases relied on by MCI WorldCom and Sprint are largely inapposite. *See United States v. Waste Management, Inc.*, 743 F.2d 976 (2d Cir. 1984) (no barriers to entry); *United States v. Baker Hughes Inc.*, 908 F.2d 981 (D.C. Cir. 1990) (market for hardrock hydraulic underground drilling rigs was too small to make market share analysis meaningful); *HTI Health Servs., Inc. v. Quorum Health Group, Inc.*, 960 F. Supp. 1104 (S.D. Miss. 1997) (entry could be accomplished simply by primary care physicians' moving to the relevant area); *United States v. Calmar Inc.*, 612 F. Supp. 1298 (D.N.J. 1985) (customers could respond to price increase by self-provisioning); *In re The Echelin Mfg. Co.*, 105 F.T.C. 410 (1985) (no barriers to entry); *United States v. Country Lake Foods, Inc.*, 754 F. Supp. 669 (D. Minn. 1990) (brand not a barrier to entry, and market disciplined by large buyers).

make a "really extraordinary" claim. Boiled down to its essence, MCI WorldCom and Sprint's contention is that any attempt to exercise market power in long distance will be impossible, because the fringe, consisting of second-tier facilities-based carriers, will expand.[23] If that were so, it is difficult to see what long distance merger would *not* be approved. Perhaps MCI WorldCom's next target is AT&T. The absence of a "stopping point to the logic of [the] argument" is a sure sign that it is "unpersuasive." *Marquez v. Screen Actors Guild, Inc.*, 525 U.S. 33, 47 (1998).

A. There Is Insufficient Nationwide Capacity to Constrain Post-Merger Long Distance Prices

Even looking narrowly at this proposed merger, the Applicants' reliance on second-tier capacity is unconvincing. MCI WorldCom and Sprint do not dispute that their merger would eliminate one of only three ubiquitous, nationwide networks. *See* SBC Opposition at 17-20, 35-37. Their claim is that ubiquity is unnecessary. In their view, just about anyone can establish a national footprint, simply by purchasing capacity from the many carriers that "sell[] capacity on a wholesale basis." Reply at 15. But the wholesale capacity upon which the Applicants rely is not sufficiently ubiquitous to bear the weight of the application.

1. Sprint elsewhere has stressed that "[r]esale by itself . . . cannot assure full competition."[24] Competition in long distance requires competition among facilities-based

[23] *E.g.*, Reply at 10 ("Plainly, then, the key to understanding the competitive significance of the merger for long distance services is understanding the substantial and growing role of a significant number of national facilities-based carriers."); Reply at 12-13 ("expanding fiber transmission capacity and share growth by emerging carriers" will constrain any post-merger "attempt to raise prices for . . . mass market . . . customers.").

[24] Comments of Sprint Communications Co., LP, *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, CC Docket No. 79-252, at 11 (FCC filed Nov. 12, 1993) ("Resale by itself cannot prevent market power abuse by the dominant carrier and cannot assure full competition."); *see also* MCI's Motion to Compel Compliance, Docket Nos. 9608336-TP & 960846-TP, at 6 (Florida Pub. Serv. Comm'n filed Oct. 27, 1997) (resale is insufficient to create competition because "one company . . . control[s] the costs of all the other companies").

carriers, and unless there is sufficient capacity *nationwide* to constrain MCI WorldCom/Sprint and AT&T, the merger will be bad for competition. As SBC's Opposition pointed out, there is not enough capacity to perform this task, at least in the many areas that are served primarily if not exclusively by the Big Three. *See* SBC Opposition at 17-18, 36-37.

MCI WorldCom appears to agree with SBC on this point. According to Bernard Ebbers, MCI WorldCom's Chief Executive Officer, "a majority of [MCI WorldCom's private line] revenue base is intact because it is on . . . *regional lines . . . where emerging competitors . . . do not have facilities*."[25] And MCI WorldCom obviously intends to keep it that way. Mr. Ebbers has "strongly suggested that he would *never* sell such regional capacity" to other carriers.[26]

Of course, in their filings with this Commission, MCI WorldCom and Sprint do not mention the views of Mr. Ebbers. Instead, the Applicants point to the dozens of small, regional carriers that they claim (at least for purposes of this proceeding) provide facilities-based competition in areas underserved by second-tier carriers. Reply at 13-14. But it is simply folly to consider these regional carriers as equivalent to national carriers. *See* Hausman Supp. Decl. ¶¶ 19-22. It is not feasible to create a national footprint by cobbling together the facilities of numerous regional carriers. Multiple carriers means "multiple bills . . . , troubleshooting problems, regulatory issues, long installation times, and lack of service features."[27] Similarly, carriers who rely on numerous regional wholesalers are largely unable to match the "reliability"

[25] Bruce Roberts, Kirk Boodry, James Powers, *WorldCom: Takeaways From Our One-on-One Meeting With CEO Bernie Ebbers and CFO Scott Sullivan*, Dresdner Kleinwort Benson Research, at 1 (Mar. 24, 2000) ("*WorldCom Takeaways*") (emphasis added).

[26] *Id.* (emphasis added).

[27] Bob Wallace, *The Next Frontier: AT&T and MCI WorldCom Are Trying to Turn from Long-Distance Pipe Peddlers Into One-Stop Shops*, InformationWeek (Feb. 21, 2000) <http://www.informationweek.com/774/carrier.htm> (visited May 3, 2000).

and "enhanced flexibility" of ubiquitous carriers.[28] By contrast, as MCI WorldCom itself has stressed, a "single-network approach eliminates the inefficiencies of interconnecting with multiple carriers for traffic hand-offs and gives users a single access method for their voice and data needs."[29]

The Applicants attempt to shore up their reliance on the availability of wholesale capacity by describing so-called "bandwidth exchanges." Reply at 41-42. Because these exchanges do not themselves increase the number of available, ubiquitous networks, they do not lessen the extent to which resellers would have to deal with multiple carriers to establish a national footprint. And in any event, the participants necessary to make these exchanges work do not yet believe that they are viable. According to Williams Communications, "'[t]his is a market that may not be at a maturity level that others would like to think it is in terms of ability to trade.'"[30] And according to Global Crossing, "bandwidth isn't 'commoditized' yet," in large part because of "differences in quality of service from one network to another."[31]

2. Specifically with regard to the ability of second-tier carriers to serve the larger business market, moreover, MCI WorldCom and Sprint completely fail to address the fact that their vast networks give them a substantial cost advantage over second-tier carriers in providing private line service. *See* SBC Opposition at 37-38.

Contrary to the Applicants' misguided contention, this cost advantage has nothing to do with whether special access rates are "competitive," or whether incumbent LECs have pricing

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[28] Telecommunications (Online), *MCI WorldCom – On-Net* (Feb. 1999) <http://www.telecoms-mag.com/products/199902/19990202.html> (visited May 3, 2000).

[29] *Id.*

[30] Michael Rieke, *Williams Communications Forms Bandwidth Trading Group*, Dow Jones (Feb. 11, 2000) (internal quotation marks omitted).

[31] Michael Rieke, *Enron Says 1st Bandwidth Commodity Trade Executed*, Dow Jones (Dec. 2, 1999).

flexibility. Reply at 44-45. Rather, the cost advantage is based on the simple fact that special access rates vary based on distance. SBC Opposition at 38 & n.73. MCI WorldCom and Sprint have substantially more points of presence per LATA than second-tier carriers. *See id.* at 37-38. Accordingly, MCI WorldCom and Sprint are more likely to have a point of presence located close to a potential business customer, and are therefore more likely to have lower costs when providing private line service to that customer.

B. Brand Is a Barrier to Entry in the Mass Market

SBC's Opposition included evidence to support the Commission's oft-stated premise that "brand name recognition is a 'critical' asset for offering services in the mass market." SBC Opposition at 12-16; Carlton & Sider Decl. ¶¶ 27-28 & Table 5.[32] In response, the Applicants contend that "consumers respond to price, not brand." Reply at 17. The Applicants' criticisms of SBC's evidence are without merit, and the evidence they offer to support their claim of the primacy of price is unpersuasive.

1. As SBC demonstrated in its Opposition, consumers will stay with a brand-named long distance carrier even in the presence of lower-priced and equal-quality alternatives. SBC Opposition at 12-14; Carlton & Sider Decl. ¶ 28. MCI WorldCom and Sprint's efforts to undermine that showing fall flat. *See* Carlton & Sider Supp. Decl. ¶¶ 12-21. First, contrary to the Applicants' suggestion, MCI WorldCom and Sprint customers – like AT&T customers – are willing to pay a premium for service from MCI WorldCom as compared to what they are willing to pay to second-tier carriers. *Id.* ¶ 13. Second, the Applicants are wrong to criticize SBC's evidence for failing to take account of "promotions or special offers." Reply at 20. The Carlton & Sider study excluded from the sample individuals who received *extraordinary* charges or

[32] *MCI/WorldCom*, 13 FCC Rcd at 18122, ¶ 171 & n.470; *SBC/Ameritech*, 14 FCC Rcd at 14754-55, ¶¶ 87-88; Memorandum Opinion and Order, *Applications of NYNEX Corp. and Bell Atlantic Corp., for Consent to Transfer Control of NYNEX Corp. and Its* Subsidiaries, 12 FCC Rcd 19985, 20021, ¶ 62, 20031, ¶ 84 (1997) ("*Bell Atlantic/NYNEX*").

adjustments in a particular month, but it included "widely promoted" calling plans. *See* Carlton & Sider Decl. ¶ 29 & nn.21-22; *see also* Carlton & Sider Supp. Decl. ¶ 14 n.10. Finally, again contrary to the Applicants' suggestion, the period of time over which Carlton & Sider analyzed calling patterns was more than sufficient to account for (potential) variability. Carlton & Sider Supp. Decl. ¶ 14. Indeed, as reflected in the Carlton & Sider Supplemental Declaration, analysis over a longer time period only confirms that many consumers will stay with a branded carrier even though they "could obtain lower prices under another plan." *Id.* Moreover, Drs. Besen and Brenner do not themselves document variability in calling patterns over time. Their failure to do so itself confirms that there is no merit to the claim that the initial Carlton & Sider study should have sampled a longer time horizon.

2. The Applicants claim that consumers readily switch their "main vendors" based on price, and without regard to brand. But their "main vendor" evidence is no more convincing in this context than it is with respect to customer churn. As described above, *see infra* pp. 3-4, the Applicants' approach overstates the extent of switching by consumers. *See* Carlton & Sider Supp. Decl. ¶¶ 22-27. Moreover, although price may be important to consumers when choosing among the well-known Big Three, the Applicants have utterly failed to show that brand is not a barrier to entry for second-tier carriers.[33]

Indeed, if second-tier carriers could attract share based solely on price, why haven't they done so already? "In most situations, of course, the unstated assumption is that a company that has maintained a certain share of a market in the recent past will . . . do so in the immediate

[33] The unreliability of the Applicants' study is pointed up by the fact that it proves far too much. The MCI WorldCom/Sprint data show that 53% of consumers switched to nonbranded carriers over an eighteen-month period. Reply at 19. But the aggregate market share of second-tier carriers has never exceeded 18%. The necessary conclusion is that either (a) the study is simply incorrect, or (b) the people who switch to second-tier carriers overwhelmingly switch back to one of the Big Three within a short period of time. *See* Carlton & Sider Supp. Decl. ¶¶ 30-31.

future."[34] Second-tier carriers have for years had the cost structure, capitalization, and capacity to compete with the Big Three, and they have for years offered lower prices.[35] Yet none of these carriers has ever gained more than a miniscule share of the mass market.[36] There must be reasons for this, and, in SBC's view, the primary reason is that the second-tier carriers lack the brand names necessary to compete with the Big Three. The Commission appears to have adopted that same view.[37] Even the Applicants appear to recognize that *something* is "impeding the marketing success of emerging carriers." Reply at 17. If not brand, then what?[38]

III. The Applicants' Claimed Efficiencies Are Insufficient to Justify the Merger

In its Opposition, SBC explained that the Commission's recent merger decisions set a high bar for the showing of efficiencies necessary to justify a merger of this magnitude. SBC Opposition at 47. SBC then identified the flaws in the Applicants' claimed efficiencies in light of these precedents, noting that each was either not merger-specific, not "sufficiently likely and verifiable," or the "result of anti-competitive reductions in output or increases in price."[39] MCI WorldCom and Sprint's rebuttal requires only a brief response.

A. The Applicants' Analysis of Local Competition is Misleading

SBC pointed out in its Opposition that MCI WorldCom's CLEC facilities overlap Sprint ILEC territory in 13 separate MSAs. SBC Opposition at 48. MCI WorldCom and Sprint now

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[34] *United States v. General Dynamics Corp.*, 415 U.S. 486, 501 (1974).

[35] *See* SBC Opposition at 13; Hausman Supp. Decl. ¶ 3; Carlton & Sider Supp. Decl. ¶¶ 22-24; Hausman Decl. ¶ 13; Carlton & Sider Decl. ¶ 27 & Table 5; MacAvoy Decl. ¶¶ 31-32.

[36] FCC Common Carrier Bureau, Industry Analysis Div., *Trends In Telephone Service*, Table 11.5 (Sept. 1999).

[37] *MCI/WorldCom*, 13 FCC Rcd at 18122, ¶ 171 & n.470; *SBC/Ameritech*, 14 FCC Rcd at 14754-55, ¶¶ 87-88; *Bell Atlantic/NYNEX*, 12 FCC Rcd at 20021, ¶ 62, 20031, ¶ 84.

[38] The Applicants do not contend that service quality disparity explains the low market share of second-tier carriers. Indeed, any such argument would only underscore the point that second-tier carriers are not viable substitutes for the Big Three in the mass market.

[39] *SBC/Ameritech* 14 FCC Rcd at 14825, ¶ 255; SBC Opposition at 47-59.

claim that "the *only* area in which MCI WorldCom local facilities extend into a Sprint ILEC serving area is in suburban Orlando, Florida." Reply at 67 (emphasis added). MCI WorldCom and Sprint are apparently taking the view that "horizontal overlap" occurs only where MCI WorldCom and Sprint serve the same street. But that approach is contrary to the Commission's recent practice of examining local competition on an MSA-basis,[40] as well as to MCI WorldCom's own advocacy.[41]

B. MMDS Is Not Sufficiently Likely or Verifiable To Justify the Merger, Nor Is It Merger Specific

SBC previously explained that, as a technological matter, the prospect of two-way MMDS is far from the "sufficiently likely and verifiable" efficiency necessary to justify a merger. MCI WorldCom and Sprint provide nothing by way of actual commitment to market entry that would cast doubt on that proposition.

Instead, the Applicants complain that SBC fails to appreciate the value of combining the *separate* coverages of their respective properties. MCI WorldCom and Sprint's claim is not, therefore, that the merger would allow the companies to better address, say, line-of-sight

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[40] Third Report and Order and Fourth Further Notice of Proposed Rulemaking, *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, ¶ 80 (rel. Nov. 5, 1999) ("*UNE Remand Order*") ("a competitive LEC, at a minimum, would want to serve a substantial number of business and/or residential customers within a particular ... MSA") (footnotes omitted); Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform*, 14 FCC Rcd 14221, 14235, ¶ 25 (1999) ("To obtain Phase II relief, price cap LECs must demonstrate that . . . competition for a particular service within the MSA is sufficient to preclude the incumbent from exploiting any individual market power over a sustained period . . . ."); *UNE Remand Order*, ¶ 80 n.140 ("An MSA is [] a reasonable entry market because number portability is deployed on an MSA basis, and available to serve a requesting carrier's customers within these areas.") (citing *Telephone Number Portability*, 11 FCC Rcd 8352, ¶ 3 (1997)).

[41] *See* Letter from Chuck Goldfarb, WorldCom, to Larry Strickling, FCC, CC Docket Nos. 96-98 & 95-185, at 3 (Aug. 9, 1999) ("The decision by a CLEC to deploy a switch is based on potential traffic in geographic areas more expansive than the individual serving wire center or central office. *The more relevant geographic area is the MSA or county.*") (footnote omitted) (emphasis added); *id.* at 3 n.1 ("[M]ost areas within MSAs can be served reasonably efficiently by a centrally located switch and extended link priced at TELRIC.").

problems in markets where they overlap. Rather, "[t]he two companies' MMDS properties are in fact located in *different* areas, enabling the two, when combined, to achieve considerably greater geographic coverage than either could on its own." Reply at 77 (emphasis added).

If that is the substance of the Applicants' argument on MMDS efficiencies, there can be no serious claim that it is merger-specific. As the wireless industry has proved time and again, MCI WorldCom and Sprint could easily gain this exact same benefit by forming a joint venture, or by the purchase of one company's MMDS assets by the other.[42]

IV. MCI WorldCom and Sprint Do Not Believe Their Own Rhetoric Regarding BOC Entry

MCI WorldCom and Sprint continue to claim that their merger is necessary to allow them to respond to "rapid, dramatic and pervasive change" – *i.e.*, to RBOC "Section 271 approvals [to] offer interLATA service." Reply at 2, 53-62. This claim is as disingenuous now as it was when first made.

MCI WorldCom and Sprint continue to oppose SBC's 271 entry in every possible forum. For example, MCI WorldCom recently characterized SBC's Texas 271 application – more than four years in the making and recently delayed once again – as "premature."[43] And while it

[42] SBC and BellSouth have recently announced a joint venture under which they will join their wireless ventures. *See* SBC News Release, *BellSouth, SBC Create 2nd Largest Wireless Company* (Apr. 5, 2000) <http://www.sbc.com/News_center/article.html?query_type+article&query=20000405-01>. Bell Atlantic and NYNEX had a successful joint venture in mobile operations before their companies merged. *See* D. Leibowitz, *et al.*, Donaldson, Lufkin & Jenrette Securities, Investext Rpt. No. 1875854, *The Wireless Communications Industry – Industry Report*, at *23 (Mar. 7, 1997) (ranking Bell Atlantic/NYNEX Mobile second among U.S. cellular operators with 4.4 million subscribers as of year-end 1996). Vodafone AirTouch and Verizon are currently co-owners of PrimeCo PCS, a leading regional provider of PCS/wireless service. *See* Fourth Report, *Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993*, FCC 99-136, App. B at Tables 4 & 6 (rel. June 24, 1999) (ranking PrimeCo second among PCS providers (13th among mobile telephone operators) with 902,000 subscribers as of year-end 1998).

[43] Comments of MCI WorldCom, Inc., *Application by SBC Communications, Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Servs., Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Texas*, CC Docket No. 00-65, at 43

continues to rely on BOC entry to justify this proposed merger, MCI WorldCom now publicly proclaims that it "doesn't view the RBOCs as the key threat to the [long distance] business."[44] Two months ago, the Applicants jointly characterized the prospect of SBC's sale of long distance as an "event that . . . may never in fact occur."[45]

Either BOC interLATA entry is certain and imminent, or it is not. The Applicants cannot have it both ways.

CONCLUSION

To approve this merger, the Commission must "be convinced that it will *enhance* competition."[46] MCI WorldCom and Sprint's filings fail to satisfy that standard. For the reasons set forth in SBC's Opposition, and as elaborated herein, the Commission should deny the merger.

SBC Communications Inc.
May 12, 2000

(FCC filed Apr. 26, 2000); *see also* Petition To Deny of Sprint Communications Co. L.P., *Application by SBC Communications, Inc., Southwestern Bell Tel. Co., and Southwestern Bell Communications Servs., Inc. d/b/a Southwestern Bell Long Distance for Provision of In-Region, InterLATA Services in Texas*, CC Docket No. 00-65, at 2 (FCC filed Apr. 26, 2000).

[44] *WorldCom Takeaways* at 2. MCI WorldCom and Sprint appear to believe that SBC's Texas 271 application is the only BOC 271 application that "can reasonably be expected" to receive approval "within the next two years." *See* Attachment to Ex parte Letter of Bradley Stillman, MCI WorldCom, to Magalie Salas, FCC, CC Docket No. 99-333, at 11 (FCC filed Apr. 19, 2000).

[45] MCI WorldCom, Inc. and Sprint Corp. Joint Motion To Deny SBC Communications, Inc.'s Petition for Leave To Intervene, or in the Alternative To Deny in Part this Intervention, *Application of MCI WorldCom, Inc. and Central Tel. Co.-Nevada, d/b/a Sprint of Nevada, and Other Sprint Entities Certificated to Provide Telecommunications Services in Nevada, for Approval of Transfer of Control Pursuant to NRS 704.329*, Docket No. 99-12029, at 5 (Nev. Pub. Utils. Comm'n filed Feb. 25, 2000).

[46] *Bell Atlantic/NYNEX*, 12 FCC Rcd at 19987, ¶ 2 (emphasis added).

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US OFFICE PRODUCTS

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of Joint Applications of MCI WorldCom, Inc., and Sprint Corporation for Consent to Transfer Control	)	CC Docket No. 99-333

EX PARTE DECLARATION OF DENNIS W. CARLTON AND HAL S. SIDER

May 10, 2000

I. INTRODUCTION

1. We previously submitted a declaration in this matter on behalf of SBC in which we concluded that the proposed merger of MCI WorldCom and Sprint is likely to adversely affect residential consumers of long distance services.[1] On March 20, 2000, Sprint and MCI WorldCom filed their reply to comments on the proposed merger submitted by SBC and others and attached declarations from economists that took issue with various aspects of the analysis presented in our earlier statement. These include a declaration by Stanley M. Besen and Steven Brenner, and another by Frederick R. Warren-Boulton and Serdar Dalkir.

2. Our February declaration addressed the potential impact of the merger of two of only three "brand name" providers of long distance service. We concluded that the transaction is likely to adversely affect residential or "mass market" consumers of long distance service.[2] This, in turn, would adversely affect SBC since a restriction in the output of long distance services would adversely affect demand for access services provided by SBC. More specifically, we concluded in our February declaration that:

- Residential long distance consumers face complex price schedules in which rates can vary by time of day, day of week and call destination, with rates varying for interstate, intrastate and international calls.
- The economic literature shows that brand names serve an important economic function when consumers have imperfect information about complex products. Consistent with this view, available data on long distance consumer calling patterns

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1. Declaration of Dennis W. Carlton and Hal S. Sider in CC Docket 99-333, in the matter of Joint Applications of MCI WorldCom, Inc. and Sprint Corporation for Consent to Transfer Control, February 18, 2000. That declaration presents our qualifications and attaches our curriculum vitae.
2. Although we recognize that the FCC includes small businesses in its definition of mass market consumers, we use the terms "residential" and "mass market" interchangeably in this report.

indicate that residential consumers of long distance services predominantly rely on brand-name suppliers despite the presence of services from other suppliers that offer significantly lower prices.

- The three major long distance carriers compete to attract and retain customers. Sprint and MCI, which face higher customer turnover than AT&T, have introduced various innovations in pricing and service including, most recently, calling plans designed to attract high volume residential customers.
- We presented data on customer turnover patterns which indicated that Sprint and MCI face higher customer "churn" than AT&T and are particularly close substitutes for one another. This suggests that the adverse competitive effects of the proposed merger would be greater than implied by these firms' shares alone.
- We also showed that the announcement of the merger of MCI WorldCom and Sprint resulted in higher stock prices for rival long distance suppliers. This result indicates that investors believed that the proposed transaction would result in higher prices for long distance consumers (and thus higher profits for rivals to MCI WorldCom and Sprint).

3. Drs. Besen and Brenner take issue with various aspects of our findings. They argue that fringe long distance suppliers will constrain any anticompetitive effect of the proposed merger of Sprint and MCI. Briefly summarized, they claim that:

- Brand recognition of the major long distance carriers is not an impediment to the growth of emerging suppliers, and that fringe suppliers and dial around carriers, taken as a whole, can readily attract large numbers of customers; and
- A large number of consumers are willing to switch to services provided by fringe and dial around suppliers. They further claim that available data are inconsistent with the view that Sprint and MCI WorldCom are relatively close substitutes for each other.[3]

3. Drs. Besen and Brenner misstate a key economic issue before regulators in asking whether

4. Drs. Warren-Boulton and Dalkir state that the analysis of the stock market's reaction to announcement of the MCI WorldCom merger is "fundamentally flawed." They present an alternative analysis that they claim indicates that "there is thus no support for any inference that the financial markets expect that this merger will result in higher prices for long distance."[4]

5. This ex parte reply declaration responds to the major arguments made by economists that submitted declarations on behalf of Sprint and MCI WorldCom in their reply comments. For the reasons discussed below, we conclude that these arguments provide no basis for altering our conclusion that the proposed transaction is likely to adversely affect residential consumers of long distance services.[5]

6. The remainder of this declaration is organized as follows:

- Section II responds to the claim by Drs. Besen and Brenner that we have ignored changes in the long distance industry and that these changes protect consumers from potentially adverse consequences of the proposed transaction. We show that the recent emergence of new long distance networks does not ensure that the proposed transaction will not harm retail competition for mass market customers since the new carriers have not yet established significant "brand-name" recognition.
- Section III responds to claims by Drs. Besen and Brenner that fringe firms will constrain prices from rising following the proposed merger. We show that the growth in fringe suppliers in recent years has not been accompanied by a decline in prices

(...continued)
the transaction would allow "a merged MCI WorldCom-Sprint to raise prices without losing market share." (¶43). Instead, the relevant question is whether the transaction will enable MCI WorldCom to profitably increase prices. Greater revenues from fewer customers could enhance profits even if its overall sales decline. (All subsequent references to Besen and Brenner are to their March 20,2000 declaration.)

4. Warren-Boulton and Dalkir, p. 4.
5. Our decision to focus on major points and not to respond to each claim is made in the interest of brevity. Our failure to address other claims should not be interpreted to suggest that we accept the merit of these claims.

charged by AT&T, as would be expected if Drs. Besen and Brenner were correct in their claim that fringe suppliers constrain pricing by the major branded suppliers.

- Section IV responds to the claims by Drs. Besen and Brenner that consumers frequently switch to fringe suppliers. We show that the results presented by Drs. Besen and Brenner reflect an inappropriate approach to identifying when consumers switch long distance carriers which overstates the competitive importance of dial-around providers and fringe suppliers.
- Section V addresses the stock price analysis presented by Drs. Warren-Boulton and Dalkir. We show that if one were to accept their view that announcement of the proposed transaction raised only slightly the market's perception of the likelihood that the merger ultimately would be concluded, then our results would implicitly underestimate (by a factor of ten) the adverse competitive effects that would result if the transaction were actually to be completed. We also show more generally that their approach to event analysis is likely to produce misleading results and is incorrect in cases such as this in which two (or more) companies are bidding to acquire a target firm.

II. DRS. BESEN AND BRENNER INCORRECTLY CLAIM THAT WE HAVE IGNORED CHANGES IN THE LONG DISTANCE INDUSTRY

7. Drs. Besen and Brenner stress the changes in competitive conditions in the long distance marketplace in arguing that the proposed transaction will not adversely affect consumers. Specifically, they focus on the changes in the long distance marketplace including the development of a number of emerging long distance networks. They claim that our analysis "ignores the fact that a carrier can contribute to providing competitive alternatives to residential customers without itself serving residential customers directly."[6]

6. Besen and Brenner, p. 12.