

premises equipment provide evidence that BOC entry into an adjacent market will not harm competition.³⁴

44. Neither corridor nor intraLATA toll services demonstrate that discrimination by an integrated firm will not occur. In the case of corridor traffic, the ability of the BOC to do significant damage was limited historically because customers typically had to dial around their presubscribed interLATA carrier in order to use the BOC for corridor calls. Cross-subsidy and discrimination are unlikely to overcome this large handicap. In the case of intraLATA toll, BOCs retained monopoly power precisely because they engaged in significant discrimination. In particular, the BOCs refused to provide intraLATA equal access until ordered and then delayed its implementation. For example, Ameritech repeatedly challenged state commission orders to provide intraLATA one-plus presubscription, resulting in a serious delay of intraLATA toll competition. For almost ten years US West successfully resisted orders from Minnesota regulators to provide one-plus intraLATA dialing. This problem was remedied only by the 1996 Act. BOCs have also engaged in price squeezes in intraLATA toll markets, offering retail intraLATA services at prices below the price that it charged would-be competitors for intraLATA toll calls.

45. The problems do not stop once intraLATA equal access is ordered. The Kentucky and Florida Public Service Commissions found that BellSouth engaged in anticompetitive business office practices to disadvantage its intraLATA rivals.³⁵ Ameritech initiated PIC freezes in three of its five states, just when those intraLATA

³⁴ Taylor Decl., p. 17.

³⁵ See Florida Public Service Commission, Investigation into IntraLATA 1+ Presubscription, Docket Nos. 960658-TP and 930330-TP, December 23, 1996; Kentucky Public Service Commission, In the Matter of Implementation of IntraLATA 1+ Presubscription, Dockets 95-285 and 95-396, August 13, 1996.

markets were opened to presubscription. PIC freezes make it more difficult for consumers to switch carriers. As a result, in Illinois and Michigan the PIC-freeze solicitations were found to be anticompetitive.³⁶

46. There are also examples of non-BOC local telephone companies behaving anticompetitively in interLATA markets. For example, SNET acquired a substantial share of the interLATA market in Connecticut despite having higher prices than competitors. Of course, SNET's market was not effectively opened to competition. As a result, it was the only carrier that could effectively offer the bundled product. SNET's early success might also be explained in part by SNET's decision to stop billing AT&T's calls, with the result that many customers who did not want to pay separate bills for local and long distance service switched from AT&T to SNET.³⁷ In general, however, the incentives for discriminatory conduct are higher for BOCs than for independent telephone companies. Due to their broader geographic scope, a higher portion of interLATA traffic both originates and terminates within their territory.

47. Dr. Taylor argues that experience in the cellular market provides evidence that the BOCs will not discriminate. The evidence Dr. Taylor cites for this proposition does not prove his point. For example, he points out that despite a late start, non-wireline suppliers have market shares that are, on average, virtually equal to those of the Bell cellular companies.³⁸ This is not at all surprising, given that cellular demand was strong

³⁶ See MCI Telecommunications Corporation, *et al*, v. Illinois Bell Telephone Company, Illinois Commerce Commission, Case Nos. 96-0075, 96-0084 (Order dated April 3, 1996); and In the Matter of the Complaint of Sprint Communications Company L.P. Against Ameritech Michigan, Michigan Public Service Commission, Case No. U-11038 (Opinion and Order dated August 1, 1996).

³⁷ See B. Douglas Bernheim and Robert D. Willig, The Scope of Competition in Telecommunications, ch. 4 (Oct. 1996).

³⁸ Taylor Decl., p. 18.

while each of the two competitors were constrained to half of the spectrum capacity.³⁹

Anticompetitive efforts to capture market share are unlikely to be profitable when capacity is constrained to begin with.

48. Moreover, there were cellular interconnection disputes when the service commenced. Non-wireline carriers wanted to access local exchange networks on a carrier-to-carrier basis. The BOCs refused and offered instead to interconnect cellular carriers like any other large customer.⁴⁰ These disputes ended only after the BOCs came to dominate the non-wireline side of the business through acquisitions. Finally, cellular carriers could charge supracompetitive prices without the need to discriminate further. The erosion of prices for wireless services with the entry of PCS shows that cellular pricing was not competitive. By the time PCS carriers entered the mobile market, however, the critical wireless interconnection issues had been resolved. Local wireline interconnection and pricing issues are still being resolved.

49. The information service business does not provide a comfort that entry into long distance by a BOC that retains monopoly control of local services would not harm competition. Until passage of the 1996 Act, the BOCs were not allowed to provide information services between LATAs, leading them not to provide many information services. As a result, their incentive to engage in anticompetitive behavior was limited. However, efforts to provide more sophisticated interconnection arrangements for ISPs

³⁹ With fixed spectrum, a cellular carrier would have to engage in expensive cell site splitting to capture a large fraction of its competitors traffic.

⁴⁰ Peter W. Huber, The Geodesic Network: 1987 Report on Competition in the Telephone industry (January 1987), pp. 4.12-4.15, describes early cellular interconnection disputes.

failed in part because the BOCs resisted meaningful unbundling for information services and in part because access charges are priced substantially above cost.⁴¹

50. Dr. Taylor specifically mentions voice messaging service as a case of procompetitive BOC participation in information services markets. Yet one of the most well known examples of discrimination by a BOC is BellSouth's efforts to favor its own MemoryCall service by strategically altering the timing of unbundled network features.⁴² Other problems with VMS competition are detailed in a contemporaneous HAI response to the paper by Jerry Hausman and Tim Tardiff that Dr. Taylor cites to support his position.⁴³

51. The CPE analogy is also not useful. At the time of divestiture, the BOCs were allowed to market, but not manufacture, CPE only because the competitive risks resulting from their limited role were not significant, and robust competition for CPE developed before the 1996 Act terminated the manufacturing restriction. During that time, the Commission developed a simple and quite stable CPE interface.⁴⁴ This interface essentially guarantees equal access to competitors. By contrast, the interfaces required by local competitors are not yet stable, and may never be.

52. Finally, Dr. Taylor argues that discrimination in quality of service is impossible.⁴⁵ My former colleague, Dale Hatfield, addressed these issues in a

⁴¹ For a discussion of the failure of Open Network Architecture to provide for meaningful interconnection arrangements for ISPs, see Hatfield Associates, "ONA: A Promise Not Realized," (April 6, 1988).

⁴² See, In the Matter of the Commission's Investigation Into Southern Bell Telephone and Telegraph Company's of MemoryCall Service, Order of the Georgia Public Service Commission, Docket No. 4000-U, June 4, 1991.

⁴³ See Hatfield Associates, Inc., "The Benefits of Structural Separation: Reply," May 19, 1995. This paper also describes problems with discrimination by BOCs against voice mail competitors.

⁴⁴ 47 C.F.R. §§68.1, *et seq.*

⁴⁵ Taylor Decl., p. 27.

Declaration opposing an Ameritech section 271 application.⁴⁶ With rapid technological change, there will be ample opportunity for ILEC discrimination against CLECs and long distance carriers.

VII. Long Distance Competition

53. Dr. Taylor argues that consumers have benefited as a result of Verizon entry into the long distance market in New York and that the current long distance market is not competitive. Previous efforts by Dr. Taylor to demonstrate that long distance pricing is not competitive have been thoroughly rebutted elsewhere.⁴⁷ Much of Dr. Taylor's analysis of consumer benefits is based on comparisons of pricing plans offered by Verizon and the existing long distance carriers. The Proferes Declaration shows that Dr. Taylor's comparisons are not accurate. When like plans are compared, the result is that other distance competitor plans are comparable to, or better than, Verizon's. Furthermore, Dr. Taylor ignores the fundamental fact that Verizon is a new entrant into the interLATA long distance market. It is common for new entrants to engage in short-term promotional pricing designed to build a customer base, and more competitive prices in the months after entry does not mean that the BOCs will continue this approach. Moreover, Verizon's desire to obtain section 271 authorization in numerous other states in the near future gives it an additional incentive to set prices lower in the short term. It is much too early to make any claims about the long run equilibrium in the interLATA market.

⁴⁶ Before the FCC, In the Matter of Ameritech Application under Section 271 of the Telecommunications Act of 1996, Declaration of Dale N. Hatfield, on behalf of MCI Telecommunications Corp., February 14, 1997.

⁴⁷ See R. Carter Hill and T. Randolph Beard, "A statistical Analysis of the Flow-Through of Reductions in Switched Access Charges to Residential Long Distance Rates," May 24, 1999.

VIII. Path Dependency and Verizon Long Distance Entry

54. In both Texas and New York, the BOC was forced to open markets in a meaningful way before it received section 271 authority. As discussed above, the proof was in the pudding. At the time of the applications, the BOC was provisioning UNE-P in significant numbers. If Verizon's section 271 application for Massachusetts is granted before Verizon makes a commercially viable UNE-P package available at cost-based rates to its competitors, it is unlikely that Verizon will make it available afterwards. Section 271 authority is the carrot that induces BOCs to open their markets. If they are rewarded before they have earned it, they have great incentives to act on their continuing ability to resist opening their local markets after they start providing long distance service.⁴⁸

55. The consequences for consumers will be higher prices for local, long distance, and bundled service, and reduced innovation in both basic and advanced services. As described above, there is a limit to facilities entry in the state determined by economics, technology, and Verizon cooperation. Once Verizon has the authority it seeks, it will have a tremendous advantage in competing for consumers that have a preference for bundled service offerings. Therefore, Verizon will have the incentive to preserve this advantage both by anticompetitive conduct in the market and delaying tactics in agencies

⁴⁸ In a comparison between GTE and the BOCs, Federico Mine found that BOCs were more likely to cooperate with entrants than GTE, which already had interLATA authority. See "The Role of Incentives for Opening Monopoly Markets: Comparing GTE And RBOC Cooperation with Local Entrants," Georgetown University Economic Working Paper 9907004, July 27, 1999.

and courts. Finally, granting premature entry will increase the need for later intrusive regulation.⁴⁹

IX. Conclusion

56. UNE-based competition is not a viable alternative in Massachusetts for carriers seeking to compete against Verizon to serve mass market customers. Because current conditions in Massachusetts are so different from those in New York and Texas when these earlier applications were granted, granting section 271 authority to Verizon in Massachusetts would harm consumers and stand in the way of a solution to the problems that prevent effective local competition from developing.

⁴⁹ See Marius Schwartz, "The Economic Logic for Conditioning Bell Entry Into Long Distance on the Prior Opening of Local Markets," Economic Analysis Group, Antitrust Division, U.S. Department of Justice, Working Paper, March 15, 2000, p. 44.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on October 13, 2000.

G. Daniel Kelly

DECLARATION OF A. DANIEL KELLEY

ATTACHMENT 1

Attachment 1

A. Daniel Kelley

PROFESSIONAL EXPERIENCE

Senior Vice President, HAI Consulting, Inc., Boulder Colorado, current position.

Conducting economic and applied policy analysis of domestic and international telecommunications issues. Recent assignments include investigation of broadband competition and interconnection, antitrust analysis of local telephone company mergers, and costing and interconnection studies in various countries. Other assignments have included analysis of competitive conditions in wireless markets, the economics of cable television regulation, analysis of the prospects for local telephone competition, and measuring the economic cost of local service.

Director of Regulatory Policy, MCI Communications Corporation, 1984-1990.

Responsible for developing and implementing MCI's public policy positions on issues such as dominant carrier regulation, Open Network Architecture, accounting separations and Bell Operating Company line of business restrictions. Also managed an interdisciplinary group of economists, engineers and lawyers engaged in analyzing AT&T and local telephone company tariffs.

Senior Economist and Project Manager, ICF Incorporated, 1982-1984.

Telecommunications and antitrust projects included: forecasting long distance telephone rates; analysis of the competitive effects of AT&T's long distance rate structures; a study of optimal firm size for cellular radio markets; analysis of the FCC's Financial Interest and Syndication Rules, and competitive analysis of mergers and acquisitions in a variety of industries.

Senior Economist, Federal Communications Commission, 1979-1982.

Served as Special Assistant to the Chairman during 1980-1981. Advised the Chairman on proposed regulatory changes in the broadcasting, cable television and telephone industries; analyzed legislation and drafted congressional testimony. Coordinated Bureau and Office efforts on major common carrier matters such as the Second Computer Inquiry and the Competitive Carrier Rulemaking. Also held Senior Economist positions in the Office of Plans and Policy and the Common Carrier Bureau.

Staff Economist, U.S. Department of Justice, 1972-1979.

Analyzed proposals for restructuring the Bell System as a member of the economic staff of U.S. v. AT&T; investigated the competitive effects of mergers and business practices in a wide variety of industries.

EDUCATION

1976	Ph.D. in Economics	University of Oregon
1971	M.A. in Economics	University of Oregon
1969	B.A. in Economics	University of Colorado

PAPERS AND COMPLETED RESEARCH

"New Zealand Telecommunications: The State of Competition" (1998), with Todd Telecommunications Consortium.

"Cable and Wireless Alternatives to Residential Local Exchange Service," Berkeley Conference on Convergence and Digital Technology (1997), with Alan J. Boyer and David M. Nugent.

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"Gigabit Networks: Is Access a Problem?" IEEE Gigabit Networking Workshop (1992).

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"Social Objectives and Competition in Common Carrier Communications: Incompatible or Inseparable?" in Harry M. Trebing ed., Communications and Energy in Transition (1981), with Nina W. Cornell and Peter R. Greenhalgh.

"An Empirical Survey of Price Fixing Conspiracies," Journal of Law and Economics (1974), with George A. Hay. Reprinted in Siegfried and Calvari, ed., Economic Analysis and Antitrust Law (1978) and the Journal of Reprints for Antitrust Law and Economics (1980).

TESTIMONY BEFORE REGULATORY AGENCIES

Federal Communications Commission, Application of Cellular Communications of Cincinnati, July 25, 1983 (with Robert J. Reynolds): Optimum firm size in the cellular radio market.

Maryland Public Service Commission, Case No. 0450-Phase II, May 31, 1983: Access charge implementation issues.

New York Public Service Commission, Case No. 28425, June 1983: Access charge implementation issues.

Florida Public Service Commission, Docket No. 820537-TP, June 30, 1983, November 4, 1983, April 9, 1984, June 4, 1984, September 7, 1984, October 25, 1984 and August 15, 1985: Access charge implementation issues.

Pennsylvania Public Utility Commission, Docket No. R-832, August 5, 1983: Rate Case.

New Jersey Board of Public Utilities, Docket No. 83-11, February 20, 1984: Access Charge.

New York Public Service Commission, Case 88-C-102, March 2, 1990: Alternative Operator Service Issues.

California Public Service Commission, A.90-07-015, July 10, 1990: AT&T Deregulation.

New York Public Service Commission, Case 28425, October 8, 1990: IntraLATA Dial 1 Competition.

Massachusetts Department of Public Utilities, DPU 90-133, October 17, 1990: AT&T Deregulation.

Georgia Public Service Commission, 3905-U, November 16, 1990: Incentive Regulation.

California Public Service Commission, I-87-11-033, September 23, 1991: IntraLATA Competition.

Georgia Public Service Commission, Docket No. 3987-U, January 31, 1992: Cross-Subsidy.

Colorado Public Utilities Commission, Docket No. 92R-050T, August 24, 1992: Collocation.

Connecticut Department of Public Utility Control, Docket No. 9106-10-06, September 25, 1992: Infrastructure.

Maryland Public Service Commission, Case No. 8584, Phase II, July 21, 1995: Local Competition.

Connecticut Department of Public Utility Control, Docket No. 95-06-17, September 8, 1995: Local Competition .

Federal-State Joint Board on Universal Service, CC Docket No. 96-45, June 5, 1996: Cost Modeling.

TESTIMONY (CONT'D)

Colorado Public Utilities Commission, Docket No. 96A-287T, September 6, 1996: Arbitration.

Hawaii Public Utilities Commission, October 17, 1996: Arbitration.

Oregon Public Service Commission, Dockets ARB 3 & 6, September 6, 1996: Arbitration.

Michigan Public Service Commission, October 24, 1996: Arbitration.

New York Public Service Commission, Case No. 28425, May 9, 1997: Access Charges.

Colorado Public Utilities Commission, Docket No. 97F-175T, July 18, 1997: Access Charges.

Utah Public Service Commission, Docket No. 97-049-08, October 2, 1997: Access Charges.

Connecticut Department of Public Utility Control, Docket No. 96-04-07, February 10, 1998:
Access Charges.

Massachusetts Department of Public Utility Control, Docket No. 98-15, August 14, 1998:
Wholesale Discount.

Connecticut Department of Public Utility Control, Docket No. 95-06-17RE02, August 3, 1999:
Wholesale Discount.

Washington Utilities and Transportation Commission, Docket No. UT-991991,
March 24, 2000: WCOM-Sprint Merger

California Public Utilities commission, Application No. 9-12-012, April 14,
2000: WCOM-Sprint Merger.

DECLARATION OF A. DANIEL KELLEY

ATTACHMENT 2

Attachment 2

Market Penetration Estimation Methodology

- 1) Using the Verizon Massachusetts records from the HAI Model 5.0a database, sum business, residential, special and public lines by wire center. Line data in the HAI Model 5.0a database are taken from ARMIS Report 43-08 for 1996.
- 2) Gross the total lines by wire center up to 1999 levels with Verizon Massachusetts line data taken from ARMIS report 43-08 for 1999.
- 3) Compute the average monthly change in line counts using ARMIS report 43-08 data for 1996 and 1999. This factor is used to bring the 1999 total lines by wire center forward to 6/30/00. The net result of steps 1-3 is a list containing Verizon wire centers in MA and their associated 6/30/00 line count estimates. This is the "lines by wire center" list.
- 4) Using the Local Exchange Routing Guide (LERG), build a data set showing Verizon MA wire centers and the NPA NXXs they serve. Throw out records containing non-MA NPAs.
- 5) Develop a list showing the count of NXXs by NPA by wire center. Determine the fraction of NXXs in each NPA by wire center. In the vast majority of cases, all the NXXs associated with a given wire center are served within the same NPA (i.e., 100% of the NXXs are served in the same NPA for a given wire center).
- 6) Multiply the lines in each wire center (taken from the "lines by wire center" list) by the fraction of NXXs in each NPA by wire center. The net result is a list containing lines by wire center by NPA.
- 7) Sum the lines in each NPA to arrive at the estimate of total lines by NPA. Line totals for business, residential, special and public lines are kept separate throughout the entire process.
- 8) Accept Verizon estimates of various categories of competitor lines.



DECLARATION OF A. DANIEL KELLEY

ATTACHMENT 3

Attachment 3

Verizon Has the Incentive and the Ability to Engage in a Price Squeeze

In Attachment B to his Declaration, Dr. Taylor argues that if Verizon obtained long distance authority in Massachusetts, it would not have an incentive to reduce competition to provide long distance services by engaging in a price squeeze based on above-cost access charges.¹ However, there are circumstances in which an access-long distance price squeeze would be rational for Verizon. In fact, current circumstances in Massachusetts (and other states where access is priced substantially above cost) would give Verizon the incentive to set a price for a bundle of local and long distance service that would prevent other firms from offering a competing service, thereby reducing competition and innovation in bundled services.

Although Dr. Taylor does not address this issue, the fact that rates for unbundled network elements (“UNEs”) are priced far above cost in Massachusetts gives Verizon the same incentive and ability to impose a price squeeze that result from the fact that access charges are priced above cost. Because both access and UNEs (which theoretically can be used as a substitute for access in a bundled product) are priced above cost, and because competing providers of bundled services can obtain both types of connections with residential customers only from Verizon, long distance authority would give Verizon the incentive to reduce the price of the bundled local and long-distance service to the point where equally or more efficient competitors could not effectively compete. The opportunity for this price squeeze exists so long as Verizon charges its competitors an inflated price for bottleneck inputs such as UNEs or access that substantially exceeds the

¹ Taylor Decl., Attachment B.

cost of the input to Verizon. If Verizon receives authority to offer long distance services in Massachusetts, the narrow and even negative margins between the retail price of the bundled service and the wholesale price of an essential input would have the practical effect of denying most Massachusetts consumers the opportunity to purchase bundled services on a competitive basis.

A price squeeze is rational under realistic circumstances

With respect to the potential for an access-long distance price squeeze, Dr. Taylor's basic argument is that such a price squeeze would be irrational because the ILEC would suffer an opportunity cost by foregoing the sale of access to the long distance carrier. Although Dr. Taylor illustrates his analysis with a numerical example, the basic point he makes is quite simple: if Verizon is a monopoly supplier of essential switched access services, and these services are sold at a large mark-up above incremental costs, then Verizon is indifferent between whether or not it serves the customer itself, or sells the access at a premium to a competitor.

In other words, Dr. Taylor argues that a price squeeze is not profitable to Verizon because it can, in effect, extract the maximum profit its access monopoly provides without offering the final service. This is a restatement of the old economic idea, associated with Spengler (1950), that any essential input monopoly need not integrate forward in order to extract all potential profits.²

Dr. Taylor's simple static analysis fails to recognize that for the independent long distance carrier, the private marginal cost of access is the price it must pay the ILEC, while the ILEC's private marginal cost of access is not the price it charges, but the lower

² Spengler, "Vertical Integration and Antitrust Policy", Journal of Political Economy, Vol. 58, 1950, pp.347-52.

cost it incurs. In these circumstances, the ILEC can benefit from taking retail business from the long distance carrier instead of selling overpriced access.

For example, the ILEC may be able to offer customers non-linear pricing packages that include deep volume discounts that the long distance carrier cannot match because it must pay high per minute access charges, even though the long distance carrier may be equally, or more efficient than the ILEC. There is no opportunity cost associated with the new minutes these non-linear pricing plans would stimulate. Only the ILEC can profitably provide them and the result is an artificial competitive advantage.

An example of an ILEC facing a zero opportunity cost is when the customer may migrate to a long distance carrier's dedicated access service. Taking business from the long distance carrier by reducing long distance rates in this situation does not cost the ILEC switched access revenues because the ILEC was likely to lose those revenues anyway. The independent long distance carrier cannot respond because it must incur the full cost of the access charges.

Dr. Taylor concedes that in theory, "as long as access rates are priced above incremental cost and Verizon's access prices are regulated under a price cap with no earnings sharing, Verizon will have an incentive to price its interLATA service lower than it would if it were simply seeking to maximize profits from interLATA services." [Attachment B, p. 4] He sees no problem with this result because consumers would benefit from the lower prices.

The problem here is that long-distance carriers are not "free to match any price reduction by the BOC affiliate" as he claims [p. 5]. The long distance market is competitive and IXCs are earning competitive returns. The short-run impact of the ILEC

stimulating access demand in this way may be to reduce retail prices, but the long-term effect will be to deter entry, growth and innovation by unaffiliated IXCs.

Price squeezes with bundled services

With respect to the UNE pricing problem at issue in this proceeding, Dr. Taylor's analysis is inapplicable because it focuses solely on a single product, long distance services, when the actual nature of integrated competition will involve multi-product bundled services offerings. Once this discrepancy is recognized, the nature of the resulting perverse incentives is easy to show even using a static model similar to that described by Dr. Taylor.

Let us start by restating Dr. Taylor's simple static model. For simplicity, and for no other reason, I make the following assumptions:

- A = cost of switched access
- C = Verizon's incremental cost of access
- $A > C$
- Px = price of long distance service
- Pl = price of local service
- Pb = price of a bundled offering of local plus long distance service
- LDC = the other (non access) costs of LD service

Assume that local service regulation causes Pl to equal the cost of local service to a customer. Also assume that bundling of services is profitable because consumers like dealing with a single provider, so that a seller could, in principle, charge a premium for a bundled service. Of course, the practicality of this course of action depends on the extent of competition for bundled offerings.

With competition in the LD marketplace, any IXC must offer service at price $P_x = A + LDC$. In this model, this also describes Verizon's pricing if it complies with a long distance price imputation rule imposed on its LD service. Verizon must charge at least A

+ LDC, although the social costs are just $C + LDC$, and $C < A$. Dr. Taylor's static analysis shows that, with a focus on LD service competition only, this rule will mean that Verizon would not generally profit from a price squeeze in LD prices. This result occurs precisely because, in this setting, the opportunity cost of selling access to a customer to an IXC equals A , not C . In other words, there is no incentive to price squeeze because the incumbent, Verizon, would use the access service in exactly the same way, and thus earn the same return, as the IXC.

Price squeezes, and similar anticompetitive incentives, arise only when the value of the asset (in this case, access service) is greater for the incumbent than for the IXC (as in the dynamic examples I discuss above). Yet, the local monopoly position enjoyed by Verizon itself creates precisely such an incentive. Suppose that Verizon sells access to an IXC. The profit to Verizon is just $A - C$. Because Verizon has a monopoly in local service, it has market power over bundled offerings as well as purely local offerings. With P_b the price of the bundled offering of Verizon, the value of carrier access to Verizon, which it needs to offer the bundle, is then $P_b - LDC - C - P_l$, which is the profit earned from selling a bundle to a customer. When there is a bundle benefit, P_b is greater than $P_l + P_x = P_l + A + LDC$, so that the value of retaining access to a customer exceeds $A - C$. Thus, if there is any bundle benefit, lack of local competition and, thus, lack of bundled service competition, implies that the incumbent Verizon IS NOT indifferent between selling the access for A or using it for itself.

This simple point raises the question: when would access be equally valuable to both the IXCs and the incumbent, so that no anticompetitive actions would arise (assuming always that all firms are equally efficient)? The profit $P_b - LDC - C - P_l$ is

exactly equal to $A-C$ when $P_b = A + LDC + PI$, which is the “competitive” price of a bundled offering when the effective access rate is A . Obviously, this price arises only when there is robust competition for bundled offerings. This argues that the state of local competition, and the realism of element prices and resale, is critical in assessing the competitive effects of the entry authority Verizon is requesting in this proceeding.

I turn finally to the “price squeeze” effect that Dr. Taylor dismisses. The purpose of a price squeeze, of course, is to drive out or weaken an equally efficient competitor in the downstream market (here, bundled local and long distance services). It is true that, under Dr. Taylor’s static assumptions, no price squeeze is profitable for long distance as a separate, stand alone product. However, it is easy to see that the monopoly position enjoyed by Verizon, and the difference in access rates, A , and costs, C , does result in this case in exclusion of other carriers from the LD market. If there is an inherent advantage to offering a “bundled” service, and other carriers are not realistic bundled competitors, the incumbent can increase profits by pricing a bundled offering. The ILEC’s profits are greater at any price that is both above $A + LDC + PI$ (i.e., its economic costs), and below $A + LDC + PI + \text{bundle benefit value}$, where the bundle benefit value simply refers to the value created for consumers by having a single provider of integrated services. The consumer would select an integrated provider, i.e. the incumbent, although the incumbent is not more efficient than its would-be competitors in anything – it merely enjoys monopoly power in local service, and can therefore offer bundled services. It is also clear that this effect persists when potential competitors can enter local only through element sales at inflated prices – this complication merely places a price cap on bundled prices determined by the degree of overcharging for elements.