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Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the Matter of	)	
	)	
Application by Verizon New England Inc.,	)	
Bell Atlantic Communications, Inc.,	)	
(d/b/a Verizon Long Distance), NYNEX	)	CC Docket No. 01-9
Long Distance Company (d/b/a Verizon	)	
Enterprise Solutions), and Verizon Global	)	
Networks Inc., for Authorization To Provide	)	
In-Region, InterLATA Services in Massachusetts	)	
	)	

SUPPLEMENTAL DECLARATION OF A. DANIEL KELLEY
ON BEHALF OF WORLDCOM, INC.

Based on my personal knowledge and on information learned in the course of my duties, I, A. Daniel Kelley, declare as follows:

1. My name is A. Daniel Kelley. On October 16, 2000, I filed a Declaration on behalf of WorldCom, Inc. ("WorldCom") commenting on the Verizon's initial section 271 application for Massachusetts. On November 3, 2000, I, along with my colleague Richard A. Chandler, filed a Joint Reply Declaration on behalf of WorldCom. In this Supplemental Declaration, I analyze Verizon's renewed Massachusetts application and respond to arguments made in the Reply Declaration of William Taylor filed on November 3, 2000 in support of Verizon's first Massachusetts application. Verizon's "Supplemental Filing" does not change my conclusion that Verizon's entry into the long distance market in Massachusetts would not be in the public interest at this time.

2. The Bell Operating Companies ("BOCs") have been prohibited from

providing long distance service because their local monopoly gives them the incentive and ability to harm competition and consumers.[1] The 1996 Act eliminated legal barriers to local competition and encouraged entry into local markets by requiring the Bell Companies to open their networks to competitors by providing unbundled network elements ("UNEs") at cost-based rates.[2] Recognizing the potential problems with BOC entry in long distance, Congress specifically required a demonstration by a BOC that its local markets are truly open prior to long distance entry.[3]

3. My original Declaration demonstrated that while some facilities-based entry has occurred, local markets in Massachusetts are far from competitive. Barriers to facilities entry into local markets remain high. The low level of facilities competition and high barriers to additional entry and expansion make grant of section 271 authority highly risky.

4. In prior section 271 cases, the Commission has allowed BOCs to enter the long distance market even though local facilities competition was quite limited, both in terms of services and geographic penetration. However, in both New York and Texas, the degree to which the BOC networks were open was demonstrated by the fact that competitors were actually using UNE-Platforms ("UNE-P") in large and significantly increasing numbers. As I noted in my original Declaration, in both of those states there was substantial growth in UNE-P competition before the applications were granted. In Kansas and Oklahoma, actual UNE-P

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[1] U.S. v. American Tel. and Tel. Co., 552 F. Supp. 131, 188 (D.D.C. 1982).

[2] 47 U.S.C. §251(c).

[3] 47 U.S.C. §271(c) and (d)(1).

competition in significant quantities was not present. However, the UNE rates in those states are close to those in Texas, which are, in turn, significantly lower than in New York and now Massachusetts. Moreover, the Commission concluded that experience with SBC's OSS in Texas provided sufficient assurance that new entrants could actually obtain the UNE-P in commercial volumes in Kansas and Oklahoma.

5. UNE and UNE-P competition in Massachusetts remains limited, in large part because the UNE rates are well above true TELRIC. Dr. Taylor's Reply Declaration claims that there have been large percentage increases in UNE-P lines in Massachusetts.[4] See Taylor Reply Decl. ¶ 3. The total number of UNE-P lines remains small. The percentage increase is high only because the base from which the increase is measured was so small. Moreover, my previous Declaration focused on residential penetration. Dr. Taylor's data do not distinguish between residential and business customers.

6. The low level of platform competition should give the Commission

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[4]Dr. Taylor claims that I have underestimated the level of competition in Massachusetts. I agree with him that ". . . no particular level of market penetration is necessary to conclude that the local exchange market is open to competition in Massachusetts." However, as discussed infra, the lack of meaningful platform entry is a substantial indication that the market is not open. As for his other points, we evidently agree that ". . . a penetration loss for Verizon of 11.2 percent of its access lines," see Taylor Reply Decl. ¶ 21, does not prove that the local exchange market is "open to competition in Massachusetts." Id. Platform entry is particularly important for residential and small business subscribers and the absence of this option is critical. Dr. Taylor disputes the numerator of my market share estimates. I agree that E911 counts may underestimate the number of large business lines served by CLECs, but these customers are not likely candidates for platform competition anyway. The E911 count may also underestimate second lines provided by CLECs, but this effect is likely small. Finally, Dr. Taylor takes issue with my estimate of Verizon lines by wire center because of CLEC line growth. Given the relatively small presence of CLECs and significant growth in second lines in recent years, I stand by my estimate. However, I will recompute my estimates if his client provides me with the appropriate data.

considerable pause. Like New York and Texas, the urbanized Massachusetts market should be attractive to this type of entry by competitive local exchange carriers ("CLECs"), including those affiliated with interexchange carriers. Boston is one of only 13 cities nationwide ranked by Rand McNally as a major national business center.[5] Boston and its suburbs are densely populated and the demographics of the workforce make it an attractive market for residential entry. Given the attractiveness of the Massachusetts market, the likely explanation for the absence of UNE-P competition is that Verizon Massachusetts has not fully satisfied its section 271 checklist obligations. In particular, its UNE rates are too high.

7. As I noted in my original Declaration, excessive UNE prices present an insurmountable barrier problem for potential entrants. With prices of inputs set significantly higher than cost, the margin required for successful entry simply does not exist. Competitors are in a classic price squeeze.

8. Dr. Taylor disputes my analysis that shows that a BOC would engage in a price squeeze. See Taylor Reply Decl. ¶¶ 27-35. As I noted in my original Declaration, CLECs in Massachusetts are in a price squeeze as a result of Verizon's pricing of UNEs. The squeeze is obviously not as tight as it was before Verizon voluntarily reduced rates that were supposedly based on the TELRIC of providing those elements. See id. ¶ 33. Nevertheless, as shown in the Joint Declaration of Paul Bobeczko and Vijetha Huffman, entrants are still unable to successfully compete in Massachusetts under the revised UNE rates, even though they can compete in areas of other states, where Verizon's retail prices are higher or UNE rates are

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[5]Rand McNally 2001 Commercial Atlas & Marketing Guide, 132nd edition, Rand McNally Company, 2001.

lower.[6]

9. Dr. Taylor goes on at length in his attempt to show that a price squeeze such as the one that currently exists between residential retail rates and UNE-P prices in Massachusetts is not possible.[7] However, he ignored entirely my discussion of the relationship between anticompetitive pricing of UNEs and deterrence of additional entry, including potential facilities-based entry. As I noted in my original Declaration, using UNEs to acquire a customer base is a way to facilitate future facilities-based entry. For example, by collocating in BOC central offices where UNE-P sales have demonstrated that the investment is attractive, the CLEC is able to purchase unbundled loops rather than the full UNE-P and substitute its own switching for that of the BOC. The standard argument used by BOC economists to "prove" that such squeezes will not be attempted simply does not apply in this situation. A monopolist might be indifferent to sale of an input to a downstream competitor in certain cases. However, when sale of the input facilitates entry into the monopoly market, the calculus obviously changes. By setting UNE prices too high, the monopolist deters entry and collects full retail revenue and monopoly profits from customers that must continue to purchase its retail services.[8]

10. Only one further point concerning Dr. Taylor's discussion of price squeezes is necessary. Dr. Taylor wrote that:

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[6]Bobeczko & Huffman Decl. ¶¶ 3-10.

[7]This price squeeze is described in the Joint Declaration of Bobeczko and Huffman.

[8]Dr. Taylor would argue that this strategy would encourage facilities entry. I discussed barriers to facilities entry in my original Declaration. The main factor that has changed between then and now is that AT&T's present commitment to cable telephony is not known.

> Dr. Kelley acknowledges that customers would be better off by being able to receive one-stop shopping from Verizon, but he claims that this situation is undesirable because other interexchange carriers lose market share. Kelley Decl. Att. 3 at 7.

See Taylor Reply Decl. ¶ 32. What I actually wrote was the following:

> Consumers may be better off to the extent they can purchase a bundle from the ILEC, but not as well off as they would be if there were competition for bundled services. [emphasis supplied]

Dr. Taylor evidently does not understand the difference between promoting competition and protecting incumbents.

11. Verizon, of course, argues that its current UNE rates do comply with the Commission's TELRIC rules. However, Verizon claimed that the rates it filed with its first, now withdrawn, application also satisfied the TELRIC rules. The 49 percent reduction in switching and transport rates is well beyond a range of reasonableness that might exist around TELRIC estimates. If the original rates were reasonable, the current rates would have to be below cost. The continued absence of UNE-P entry as well as the analysis of Verizon's costs in the Declaration of Chris Frentrup demonstrate that both sets of rates are too high.[9]

12. The fact that the current rates are equal to those in New York does not mean they are equal to Verizon's costs in Massachusetts today. The New York switching and transport rates are about double those in other states, including Kansas, Oklahoma and Texas. CLECs are able to compete with Verizon in New York, to the extent they can, not because the UNE rates are low, but because retail rates in New York are relatively high – and higher than

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[9]The Frentrup Declaration shows that Verizon's rates were set above cost in it first application, and demonstrates the extent to which they remain above cost in Verizon's current application. See, generally, Frentup Decl.

Verizon's retail rates in Massachusetts. A large number of calls in that state are subject to message rates.

13. If the benefits of BOC entry were significant, the cost-benefit analysis of allowing BOC entry without substantial evidence that its networks are satisfactorily open would be different. This is not the case. As I noted in my original Declaration, long distance markets are intensely competitive, so the benefits of further entry are not likely to be large. Dr. Taylor disputes this conclusion. However, as I show below, his arguments are not credible.

14. Before addressing Dr. Taylor's specific empirical arguments concerning the state of long distance competition, it is necessary to correct an error in logic that he made. Dr. Taylor claims that the very act of BOC long distance entry will stimulate entry into local markets by long distance carriers. In doing so he disputes the conclusion reached by WorldCom witnesses Proferes, Nolan, Bobeczko, and Graham to the effect that BOC entry does not necessarily influence WorldCom's entry and expansion plans for local markets. See Taylor Reply Decl. ¶ 4. Taylor argues that my assertion that some customers place value on purchasing local and long distance services in a bundle is inconsistent with the Proferes, Nolan, Bobeczko, and Graham Joint Declaration. There is no logical inconsistency. Long distance carriers will make entry decisions based on a variety of factors. If it is the case that local entry will allow competitive long distance carriers to better serve some of their customers and make a profit doing so they will enter – as long as entry conditions allow such entry – whether or not the BOC enters long distance. If long distance carriers are able to profitably enter local markets, then competition among them will provide the bundles that customers demand. Open local markets, not BOC entry, are necessary for this result.

15. Entry through the use of the platform in Texas and New York began as the respective BOCs came into compliance with the checklist. It was the actions of the BOCs in opening their markets to competition that stimulated the entry. Where markets are large and lucrative and local monopoly networks are sufficiently open, entry will occur. For example, contrary to Dr. Taylor's argument, WorldCom has entered local markets through use of the platform in Pennsylvania, Illinois and Michigan, even though the BOCS do not have in-region, interLATA authority in those states. Equally important, WorldCom has not competed in local markets in the territories of incumbent LECs like the former GTE, SNET, and Sprint even though these carriers provide packages of local and long distance service, because the barriers to local entry in these areas are insurmountable.[10]

16. If the BOCs were to enter the long distance markets prior to opening their markets, entry by long distance carriers could not occur and sustained consumer benefits would not be likely to follow. That is, if the long distance carriers do not enter local markets, Verizon's incentive to provide bundled service at attractive rates is diminished. As I pointed out in paragraph 10 supra, consumers would benefit more if they enjoyed competition to provide bundles of services. Thus, the benefits Dr. Taylor attributes to Verizon entry into long distance are actually more accurately attributed to the fact that Verizon opened its markets and enabled long distance carrier entry. An open market – not Verizon entry – is the key.

17. The BOC contention that local markets are competitive when the long distance market is not is simply silly. In terms of structure, conduct and performance, the long

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[10]Likewise, WorldCom does not compete in those portions of Texas and New York where margins do not allow profitable entry. See Bobeczko & Huffman Decl. ¶ 9.

distance market is clearly far more competitive than the local market. Dr. Taylor's analysis purporting to demonstrate that the prices paid by residential consumers for long distance services are unreasonably high should be given no weight.

18. Prices in competitive markets are determined by a variety of independent variables. Dr. Taylor looks at one explanatory cost variable – access – and compares price movements with access cost movements over time for a single service of a single long distance carrier, AT&T. Even assuming for the sake of argument that his calculations are correct, his analysis does not prove anything other than that basic rates paid by some AT&T customers have risen. In competitive markets, prices rise and rate structures change in response to cost and demand changes. As markets become more competitive and regulatory distortions are eliminated, some consumers may pay more, but other consumers will pay less, average prices will decline, and consumers as a group will be better off. In fact, consumers have benefitted enormously from a dramatic decline in long distance prices in the last several years.

19. Dr. Taylor's analysis of long distance prices begins with 1991, prior to the time AT&T was declared non-dominant by the Commission.[11] There were distortions in the rate structure at that time, perhaps caused by residual AT&T market power or the lingering effects of regulatory control over the rate structure. In particular, there are fixed costs associated with serving customers. In competitive markets one would expect firms to collect those costs in an efficient manner. Given the fact that the rate structure inherited from AT&T's regulated monopoly did not account for fixed per customer costs, it is likely that increased competition and

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[11] In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, Order, 11 FCC Rcd. 3271 (1995).

the end to regulation would cause that rate structure to change.[12]

20. In another context, Dr. Taylor has recognized that "to ensure that society's scarce resources are put to their best use, and that only goods and services of highest value to society are produced and consumed, consumers (cost-causers) must be made to pay prices that fully reflect the costs they cause."[13] This same principal applies when competitive long distance carriers seek to recover the fixed per customer costs that their customers and regulators impose. Recovery of fixed costs from the cost causer demonstrates that long distance markets are competitive, not non-competitive.

21. Thus Dr. Taylor's Figure 1, apparently comparing access charges and fees stated on a per minute basis to AT&T rates is a gross distortion of economic reality. During the time period analyzed, access costs were imposed on long distance carriers in both fixed and per minute form. The basic per minute rates paid by customers who preferred not to pay the fixed costs they impose through a monthly fee are appropriately high. Indeed, absent residual regulation of the long distance market, these high per minute charges would probably not exist at all. All customers would be assessed a flat monthly fee to recover the fixed costs incurred to

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[12]Note that the AT&T price cap plan placed strict limits on changes to the residential basket. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873 (1989), ¶¶ 359-365. These regulatory restraints prevented rebalancing in the face of increased competition. Therefore, with the end of residential price caps for AT&T in 1995, one would expect to see the rate structure being rationalized to account for fixed costs.

[13]Direct Testimony of William E. Taylor on behalf of Qwest Corporation, In the Matter of Investigation into Qwest Corporation's Compliance with Certain Wholesale Pricing Requirements for Unbundled Network Elements and Resale Discounts, Arizona Corporation Commission, Docket No. T-00000A-00-0194, p. 5.

serve them. In competitive markets firms must price rationally. The ability of the so-called dial-around carriers to arbitrage the presubscribed interexchange carrier charge ("PICC") illustrates this point. These carriers did not have to pay per line PICC charges and were able to advertise low incremental rates as a result.[14]

22. Another reason why it might be reasonable to allow BOCs to enter the long distance market in-region even if there is some uncertainty about whether they have opened their local markets is if regulation can be depended upon to discipline BOC behavior. In his original Declaration, Dr. Taylor provided examples of BOC participation in competitive markets that allegedly did not lead to competitive problems. My original Declaration refuted these arguments, and Dr. Taylor's Reply Declaration attempted to refute my analysis. The assertions about BOC performance in competitive markets were made repeatedly before the MFJ Court and before Congress, often by Dr, Taylor himself. Past policy makers have appropriately discounted his arguments and there is no need to discuss them further here.

23. The framework in the 1996 Act recognizes that full checklist compliance, as well as a broader public interest finding that BOC local markets are effectively and irreversibly open, are required prior to BOC entry. The fact that competitors are not yet utilizing the UNE-P to compete in this market provides strong evidence that Verizon has not met these requirements and that its UNE rates are substantially above its costs.

24. This concludes my Supplemental Declaration on behalf of WorldCom.

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[14]I addressed Dr. Taylor's views on competition in Connecticut, see Taylor Reply Decl. ¶ 11, in my original Declaration. See Kelley Decl. ¶ 46.

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

Executed on February 5, 2001

G David Kelley