

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

In the Matter of:)
)
Verizon Communications Inc. and) WT Docket No. 05-75
MCI Inc. Applications for Approval)
of Transfer of Control)

**PETITION TO DENY
of
CONSUMER FEDERATION OF AMERICA,
CONSUMERS UNION,
and
U.S. PUBLIC INTEREST RESEARCH GROUP**

Mark Cooper
Director of Research
Consumer Federal of
of America
1424 16th Street, N.W.
Washington, D.C. 20036
301-384-2204

Gene Kimmelman
Senior Director of Public Policy
Consumers Union
1666 Connecticut Ave., N.W.,
Suite 310
Washington, D.C. 20009
202-462-6262

Ed Mierzwinski
Consumer Program Director
U. S. Public Interest
Research Group
218 D Street, SE
Washington, DC 20003
202-546-9707

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OPPOISIOTN OF CONSUMER GROUPS

Pursuant to sections 214 (a) and 310 (d) of the Communications Act of 1934, as amended, the Consumer Federation of America (CFA),¹ Consumers Union (CU)² and the U.S. Public Interest Research Group (U.S. PIRG)³ respectfully submit this Petition to Deny the applications, submitted by SBC Communications Inc. (“SBC”) and AT&T Corp. (“AT&T”), that seek approval of the Federal Communications Commission (“FCC” or “Commission”) to transfer control to SBC of the licenses held directly and indirectly by AT&T.

The proposed mergers of dominant Bell operating companies and their largest wireline telephone competitors (SBC-AT&T, Verizon-MCI) pending before the FCC will have profoundly anticompetitive effects across the full range of product and geographic markets touched by the merging parties. To mask this obvious potential for harm to the public interest, the merging parties have provided the Commission with a mountain of rhetoric, but not even a molehill of specific product and geographic market data with which to analyze the impact of the mergers. CU, CFA and U.S. PIRG believe that if not rejected or dramatically altered, these mergers could set the marketplace back to a world more akin to deregulated monopoly than competition.

The Commission’s policy of setting a time clock to approve mergers has been abused by these companies by filing grossly inadequate applications and then pressuring the Commission to give an answer, without adequate time to analyze a proper record. The Commission should require that the Companies file adequately documented petitions and restart the clock on merger review when they do.

The Commission also has two mergers pending simultaneously that will dramatically

alter the overall competitive structure of the industry, removing the two largest non-Bell companies from the marketplace at virtually the same time. It simply cannot ignore the combined impact of the mergers, which involve the four largest firms in the industry. With the largest incumbent local exchange carriers (ILECs) who are also the largest wireless carriers acquiring the largest competing local exchange companies (CLECs) who are simultaneously the largest interexchange carriers (IXCs), we are witnessing the ultimate demise of the consumers' hope for more and more choices and lower prices for local, long distance, wireless, and the new Internet-based services entering the market.

Six years ago, in analyzing the last major merger wave in the local telephone industry, we urged the Commission to consider the overall harm to industry structure. In stating our opposition to the SBC-Ameritech merger, and chastising the Commission for approving the Bell Atlantic Nynex merger, we demonstrated the following.

These mergers would result in a market structure that is simply too concentrated to support effective competition. For the purposes of this discussion, we include an analysis of the independent and combined effects of the two mega-mergers. There are two reasons we discuss both mergers.

First, the nation will be deeply affected by each merger. Second, it is also critical for regulators at the federal and state levels to begin to take a comprehensive view of the emerging structure of the telecommunications industry. The continuation of a deal-by-deal, piecemeal view will allow the industry to slip into a thoroughly anticompetitive structure with no overarching consideration of the cumulative effect of individual deals on the prospect for competition.⁴

In the case of the SBC-Ameritech and Bell Atlantic-Nynex mergers the Commission could use the excuse that it had already approved the latter merger. No such excuse exists

here. Both mergers are pending with filing deadlines just two weeks apart. The Commission should review them simultaneously, demand the production of data, and, we believe based on our analysis of the industry structure, reject both mergers or impose substantial conditions to correct the many anticompetitive effects that they will have. Specification of conditions that might redress the competitive harm caused by these mergers can only be accomplished after the detailed data on product and geographic markets is made available.

FAILURE TO PROMOTE THE PUBLIC INTEREST

The Commission simply cannot look back on the carnage of the past six years and conclude that its decision to allow a handful of incumbents to dominate the local telecommunications market has served the public interest. Not only have we suffered through a wave of bankruptcies and scandals that destroyed billions, if not trillions of dollars of equity, but the piecemeal approval of mergers and the failure to enforce market opening and network access policies enacted by Congress has allowed the industry structure to devolve into what *Business Week* called a “cozy duopoly.”⁵ This “cozy duopoly” has failed to serve the most fundamental public interest objective of the Communications Act.⁶

Creating a Digital Divide

The “cozy duopoly” fostered by the Commission’s policies has failed to provide ubiquitous advanced telecommunications services at affordable prices. *Business Week* gave a stunning example. It pointed out that

Now, most markets are cozy duopolies, at best, where consumers can get broadband only from a phone or cable company. The result is that U.S. consumers can pay \$35 or more for a 1.5-megabit-per-second connection, compared with Yahoo! BB’s price of \$25 for 26 megabits.⁷

In other words, the DSL prices are over twenty times more expensive on a megabit basis. Cable is ‘only’ 15 times more expensive. *Business Week* drew a direct connection between the failure to promote intramodal competition and the slowness of high-speed Internet to spread.

What helped the rollout of broadband in Korea and Japan were not massive government subsidies, as some believe, but policies that allowed vigorous competition. In particular, those countries forced the incumbent phone companies to let startups use their networks at reasonable, government-set prices. Those startups, especially Hanaro in Korea and Yahoo! BB in Japan, waged fierce battles against giant rivals, driving prices down and speeds up...

On this score, the U.S. has blown it. This summer the Bells won an eight-year battle to stop competitors from using their networks at deep discounts. That prompted AT&T and MCI Inc., which had been using the Bell’s lines, to retreat from consumer markets.

The decision to rely on a “cozy duopoly” has resulted in a high cost, bundled approach to service roll out. “Cozy duopolies” do not serve consumers well. They do not compete vigorously on price or innovate, bringing benefits (lower prices and new goods and services) to consumers. Rather, each protects its own base (phone or cable service), generally staying out of the other’s service territory. They bundle services (e.g., phone or cable with broadband) in order to keep potential competitors (such as satellite, which lacks a viable broadband service) at bay. As a result, to get a variety of good marketplace choices and prices, consumers must buy extra services – DSL tied to local phone service, or cable modem service tied to a cable video package. In order to get the benefits of this “bundle-only” competition, the average household must double or triple its spending.⁸ This dramatically suppresses adoption of the new technology.

Two recent reports from Nielsen//NetRatings, which charts the penetration of media, make the point crisply. In an April release entitled “Affluent Americans Power Internet Growth,” Nielsen remarked on the importance of costs.

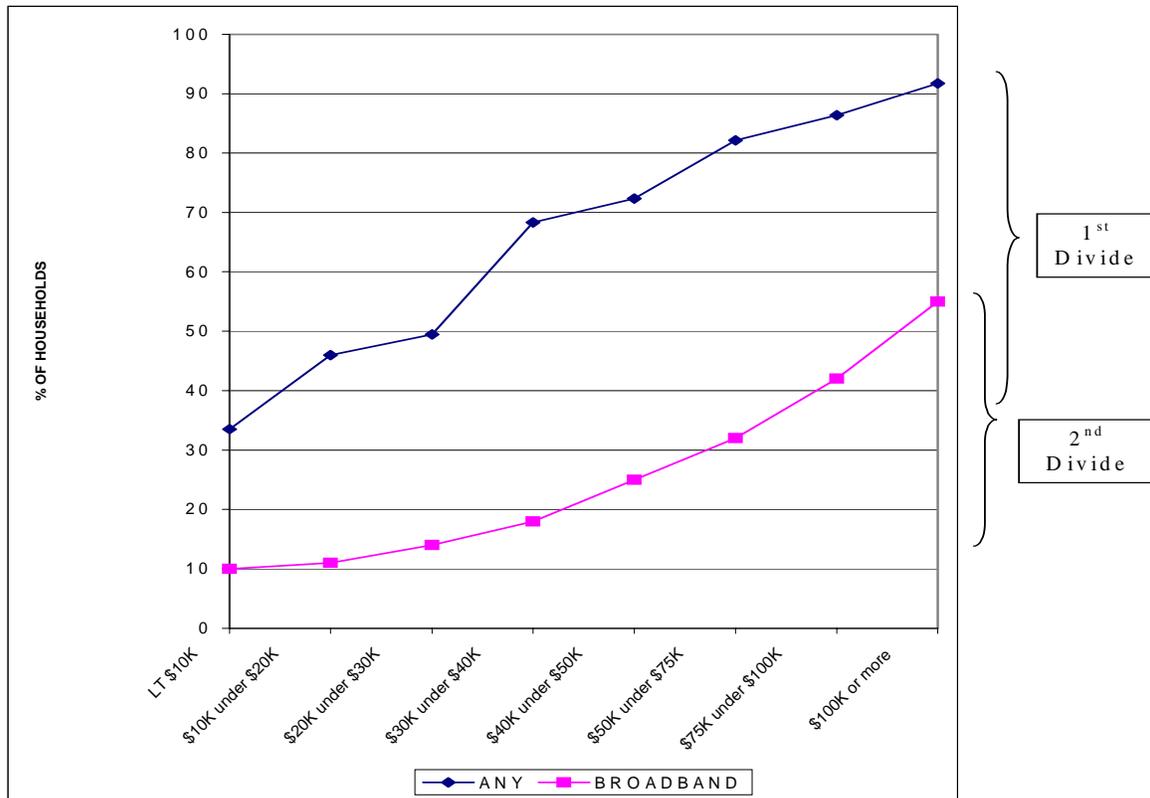
Costs plays a tremendous part in Internet access patterns, said Kenneth Cassar, director of strategic analysis, Nielsen ratings. While broadband has become much less expensive over the past few years, it’s still a significant cost compared to narrowband. Couple high-speed access with other utility expenses, and household with tighter budgets simply would not be able to afford the luxury of having broadband.⁹

In an August 2004 release, entitled “U.S. Broadband Connections Reach Critical Mass, Crossing 50 Percent Mark For Web Surfers,” Nielsen noted that the penetration of Internet access had stagnated. “Despite a plateau in the growth of U.S. Internet access, we’ve seen continued high double-digit growth in users’ broadband access.”¹⁰

Three quarters of those with incomes below \$10,000 (about one-in-ten households) do not have Internet at home. Moreover, less than half of all households with incomes below \$30,000 have the Internet at home, while over eighty percent of those with incomes above \$50,000 do (see Exhibit 1). This sharp contrast between lower and upper income households represents a very substantial divide in the population.

While lower income households have been gaining access to the narrowband Internet, the Internet has not been standing still. Broadband now accounts for about half of all Internet access from the home, but its distribution follows an uneven pattern. Upper income households have moved on to high speed Internet service. More than half of all households with incomes above \$75,000 have high speed Internet at home, while half of all households with incomes below \$30,000 do not have the Internet at all. Thus, the “cozy duopoly” has

**Exhibit 1:
Penetration of Internet at Home by Household Income Reveals a
Growing Divide**



Sources: Nielsen/Netratings, “A affluent Americans Power Internet Growth,” April 19, 2004; Pew Internet and American Life Project, Database, February 2004.

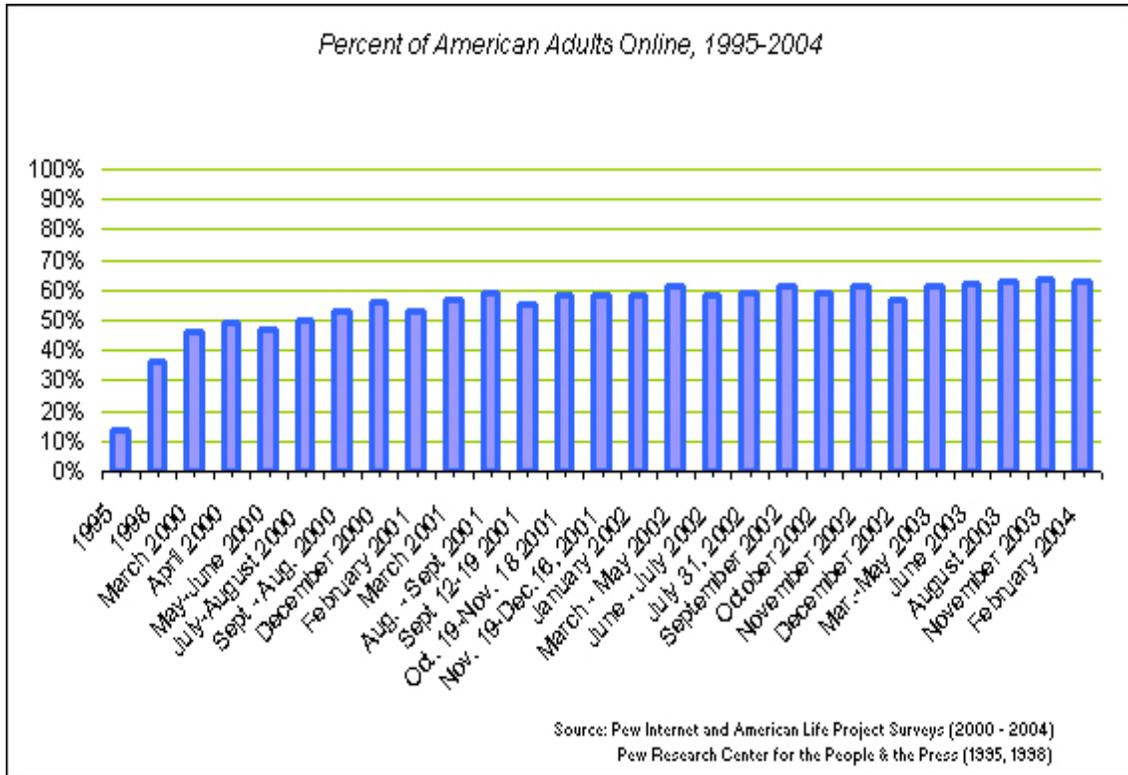
spawned a second generation in the digital divide.

Falling Behind on Broadband

Internet access at home appears to have reached a plateau at less than 60 percent. The growth of the percentage of Americans who have access anywhere appears to have slowed and is inching toward the two-thirds mark (see Exhibit 2). Usage of the Internet has leveled off and it is lower income households who have been left behind.

The failure of the “cozy” duopoly to provide affordable broadband service is at the core of the decline of America from third in broadband penetration in 2000¹¹ to 16th in the

**Exhibit 2:
Penetration Of The Internet Has Stagnated**

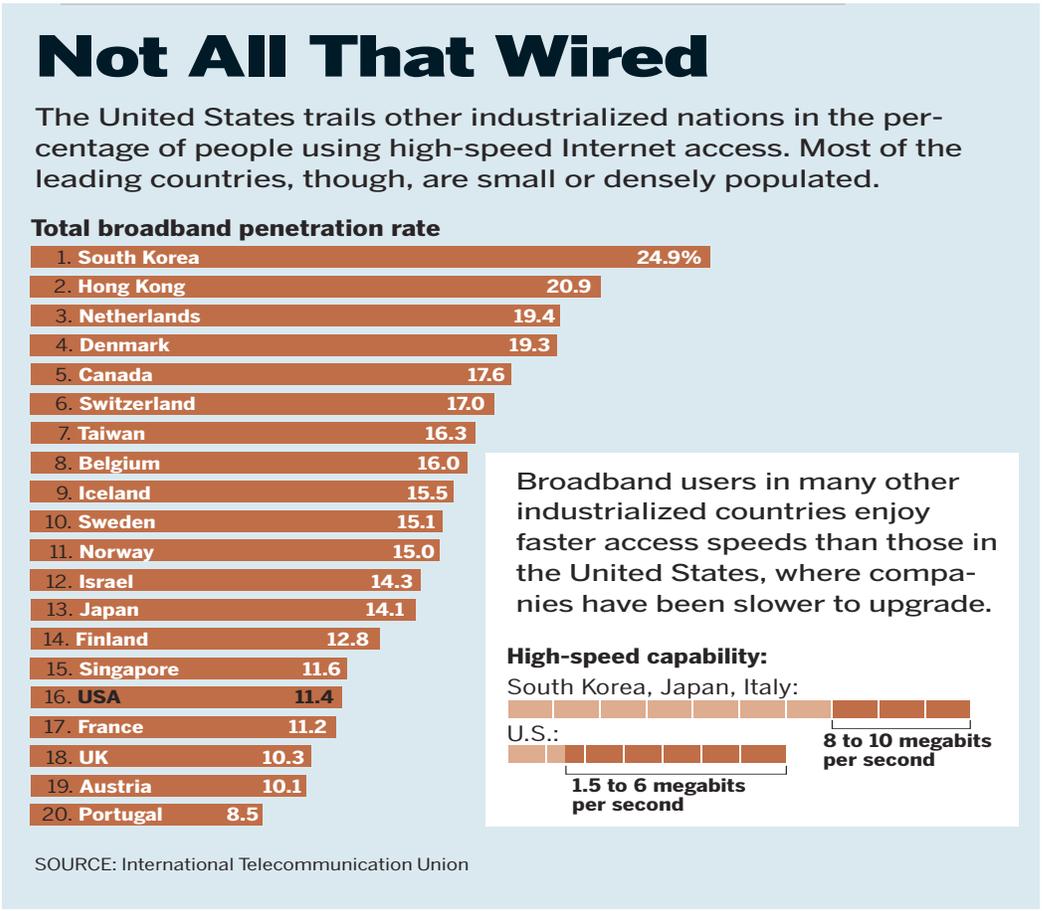


Source: Pew Internet and American Life Project Surveys (2000-2004), Pew Research Center for People and the Press (1995, 1998)

world (see Exhibit 3).¹² The culprit for the digital divide is not population density or spendthrift government subsidies; rather, it is the lack of competition and the abuse of vertical market power. With lagging broadband penetration, innovation in the applications layer—the services that use the physical connection—has gone abroad. Jobs follow the exit of innovation.¹³ The precipitous decline in leadership has been widely noted in well-respected rankings, as recently reported in the Harvard Business Review.

Harvard Business School's Michael Porter, for instance, ranked the United States as the world's most competitive nation in his initial 1995 Global Innovation Index. According to Porter's projections, by 2005, the U.S. will have tumbled to sixth among the 17 member countries of the Organization for Economic Co-operation and Development (OECD) – trailing (in order) Japan, Finland, Switzerland, Denmark, and Sweden. The 2004 Globalization Index developed by A.T. Kearney and published in *Foreign Policy* ranks the United States seventh behind Ireland, Singapore, Switzerland, the Netherlands, Finland, and Canada.¹⁴

Exhibit 3: Broadband Penetration



CQ GRAPHIC / MARILYN GATES-DAVIS AND JAMIE BAYLIS

There are obviously many causes of this decline, but it is interesting to note that eight of the nine countries ranking ahead of the U.S. in this list have higher levels of penetration of broadband than the U.S.

This analysis leads us to conclude that it is time to abandon the “cozy duopoly” approach and give competition a real chance to promote the public interest by saying NO to these mergers.

PROMOTING COMPETITION

The Commission should have little difficulty reaching this conclusion because these mergers also fail to pass muster, even if the more narrow view of promoting and preserving competition is the focus of the analysis.

The Verizon-MCI Merger

Verizon is the dominant local exchange carrier in its home territory by far. It is also the number one long distance carrier and wireless service provider in most of its markets. MCI is the number one or two competitive local exchange carrier in most of Verizon’s service territory. It is the second largest unaffiliated long distance company.

While MCI had reduced its emphasis in its local residential business based on unbundled network element platform (UNE-P) after the FCC decision to eliminate it, it still retains millions of customers throughout Verizon’s service areas.

MCI pressed its role in the enterprise VoIP market,²³ claiming an advanced VoIP service.

MCI is uniquely positioned to enable the cable industry to rapidly enter the advanced telephony market.

MCI has the most connected farthest-reaching IP network in the world based on number of company owned POPs.

MCI has one of the largest local footprints outside of the ILECs.
MCI is one of the nation's largest long distance providers.
MCI is widely recognized in VoIP services.²⁴

While it was emphasizing business market services, it had

entered into a multi-year, multi-million dollar agreement with Time Warner Cable to provide consumers with next-generation voice-over-IP (VoIP) communications services utilizing MCI's global voice and data network.

As a result of the services provided by MCI under the terms of the agreement, Time Warner Cable will be able to deploy its residential Internet protocol ("IP") voice service, Digital Phone, nationwide. In addition to providing local points of interconnection to terminate IP voice traffic to the public switched telephone network, MCI will also deliver enhanced 9-1-1 service, local number portability as well as manage network integration and electronic bonding of both companies' order entry systems.²⁵

MCI played a key "maverick" role in the industry for decades. Not only did it break open the long distance monopoly for residential customers, but it also pioneered local competition in New York and elsewhere. Because of MCI's competitive leadership, incumbents and competitors are able to offer a uniform package across a large number of markets. MCI initiated the process with its "Neighborhood" program and other companies have followed suit. The ILECs have been forced to match the offers and the resulting consumer savings are totaling huge sums.

The SBC-AT&T Merger

SBC is the dominant local exchange carrier in its home territory by far. It is also the number one long distance carrier and wireless service provider in most of its markets. AT&T is the number one or two competitive local exchange carrier in most of SBC's service territory. It is the largest unaffiliated long distance company.

Applicants claim the proposed merger will not and cannot hurt mass market

competition. To support this far reaching assertion, applicants cite AT&T's decision, prior to the merger, to unilaterally cease any efforts to market services actively to the mass market, and thus, absent the merger, AT&T would not be in head to head competition with SBC in the mass market.

There is no dispute that the FCC's recent Triennial Review Order, fully supported by SBC, drove AT&T, MCI and other CLECs from serving the residential mass market through the UNE-P platform, but they were migrating to other technologies.

While AT&T had declared its intention to phase out its local business based on unbundled network element platform (UNE-P) after the FCC decision to eliminate this avenue to competition, it still retains millions of customers throughout SBC's service areas. It had also declared its intention to continue to compete in the market relying on voice over Internet protocol (VoIP). Because of the FCC's decision to raise UNE-P prices, AT&T had raised its prices, but it switched to VoIP, which is a lower cost technology that would have alleviated those price pressures. In other words, AT&T had set out on a strategy to remain a viable competitor, a strategy that is cut short by this merger. Verizon lists AT&T as a competitor for local residential service in its application.¹⁵

In fact, AT&T has hardly withdrawn itself from competing for residential mass market customers. In the face of steep increases in UNE prices, AT&T turned to the VoIP market as a more profitable method of reaching mass market customers.¹⁶ AT&T became an aggressive player in the VoIP market, aiming to become the nation's "premier provider" of competitive VoIP calling plans.¹⁷ AT&T set a goal of winning 1 million business and residential VoIP customers by the end of 2005, according to company officials.¹⁸ Within a few months of the

initial roll out of its VoIP offering, and shortly after the FCC's TRO decision, the company engaged in aggressive price cutting of its "CallVantage" plan.¹⁹ AT&T continues to sell local phone service, including VoIP over its website, <https://www.callvantage.att.com>. Proprietary evidence introduced by consumer interveners in the California merger approval proceeding supports AT&T's strong presence in the VoIP market.²⁰

Eliminating AT&T CallVantage as a competitive threat may have been a factor in SBC's acquisition of AT&T. While AT&T, AOL and others compete in the VoIP market, SBC is struggling to introduce a consumer market VoIP offering.²¹ Buying up an established VoIP competitor makes sense for SBC. Speaking at the American Enterprise Institute last month, AT&T Chairman and CEO David Dorman noted that "AT&T's residential Voice over Internet Protocol (VoIP) service, AT&T Call Vantage, would remain an important component of the combined AT&T-SBC consumer bundle."²²

Over the years since the passage of the Telecommunications Act of 1996, AT&T and MCI have pursued various approaches to delivering telecommunications products to consumers, including fixed and mobile wireless, cable, resale, UNE-P and facilities based entry. They are the largest current and potential competitors to the Bell operating companies. The foreclosure of the UNE-P approach is recent and the entire CLEC industry is developing alternative models. The elimination of the largest competitors will be a severe blow to the competitive fabric of the telecommunications industry.

The End of Competition in Local Markets

The wave of proposed mergers in the telecommunications industry — SBC attempting to gobble up AT&T, and Verizon trying to swallow MCI — mark the ultimate demise of the

era during which consumers were led to expect more and more choices and lower prices for local, long distance, wireless, and the new Internet-based services exploding on the market. The Commission cannot bury its head in the sand and ignore the fundamental impact of these simultaneous mergers on the industry.

The simultaneity of the proposed mergers is reinforced by the similarity of the arguments and flaws in the applications. In their statements and filings, the merging parties fantasize about intermodal competition and present nationwide data that purports to show that telecommunications markets are not highly competitive. This approach to market analysis is simply wrong. Telecommunications markets are still essentially local markets. In order to provide telecommunications services, one must have a last mile technology to distribute the service to the consumer and a middle mile medium to aggregate traffic and deliver it to large national and international communications and Internet networks. These last- and middle-mile facilities are the bottlenecks through which all telecommunications must flow.

These are the bottlenecks that the incumbent local exchange carriers (ILECs) like Verizon and SBC leveraged to maintain their market power over customers. These are the bottlenecks that competitive local exchange carriers (CLECs), AT&T and MCI foremost among them, were trying to break down. When the analysis moves from this macro-level to take a more granular view of real product and geographic markets, the impact of the merger becomes even uglier from the consumer point of view.

The finding that local markets were open to competition in Section 271 proceedings, which allowed the Bell operating companies to re-enter the in-region long distance business, was based upon the availability of unbundled network element platforms (UNE-P). UNE-P

accounted for the vast majority of residential consumers who had switched to competitors.

With the removal of UNE-P and the refusal of Bell operating companies to provide access to the local network in a manner that makes electronic aggregation of loops in central offices available, the Commission should conclude that local markets are no longer open to competition.

These two proposed mergers represent a double dose of anticompetitive chutzpah that spells disaster for consumers.

- Within their regional market, first the Bells made life so miserable for competitors that they go into bankruptcy or throw up the hands in despair. Then the Bells say they should be allowed to buy up their largest local competitors, because they really aren't very good current or potential competitors.
- When competing head-to-head with other companies outside their region, the Bells flip the argument around, with the same unfortunate result for consumers. In order to secure approval of their previous mergers, which eliminated potential out of region competitors, the Bells promised to compete out of their home regions markets, but they did not try very hard and have not done very well. So the Bells say, since we cannot be considered really good competitors now or in the future, we should be allowed to buy up the companies we were supposed to compete with.

The failure of competition becomes an excuse for the further re-consolidation and re-integration of the market, which eliminates the vestiges of competition and makes new entry into the market more difficult.

THE CURRENT STATE OF COMPETITION

The basic dynamics of a competitive marketplace is clear in theory. When companies vigorously compete against one another, they have incentives to beat the competition through lower prices and are driven to make the investments necessary to improve quality or develop

new services. The market forces firms to invest and price aggressively, for fear of falling behind. Vigorous competition ensures that we all pay fair prices for the goods and services we enjoy. Unfortunately, the telecommunications marketplace is anything but competitive.

Rather than competing with one another for each customer, the telecom giants got bigger by merging with one another, resulting in less and less competition. As these large companies acquired a larger and larger footprint, it became harder and harder for new entrants to gain a toehold in the market. Today, the result is a concentrated market that is far from the economic vision of vigorous competition. And the proposed SBC-AT&T and Verizon-MCI mergers, if approved, will be the final nails in the coffin of the local competition experiment the Congress launched with the passage of the 1996 Telecom Act.

Wireline Services

Local Competing local exchange carriers or CLECs were supposed to bring competition to the marketplace after passage of the 1996 Act. But SBC and Verizon litigated, stymied, and strangled local voice competition until it has almost completely withered. As a result, the CLECs that were supposed to offer so much competition to the dominating Bells are dying in droves.²⁶ Born as local monopolies, the Bell companies have remained anti-competitive to the core. Once the 1996 Act was signed into law, the Bell companies immediately set out to bulk up their local monopolies into regional monopolies through mergers and acquisitions. In the end, they never competed in one another's regions as envisioned by Congress, and they never fulfilled the promises they made during their previous mergers. This will only get worse if these mergers are approved.

Long distance. SBC and Verizon have run a brutal bait-and-switch game with long

distance service. After having been allowed to re-enter the long-distance market because policymakers determined local markets were open – a finding that was overwhelmingly based on the availability of UNE-Ps – they launched a vigorous campaign to eliminate the availability of UNE-Ps. SBC and Verizon’s gambit was a success and, as expected, the competition is drying up.

Voice over Internet Protocol/Broadband.

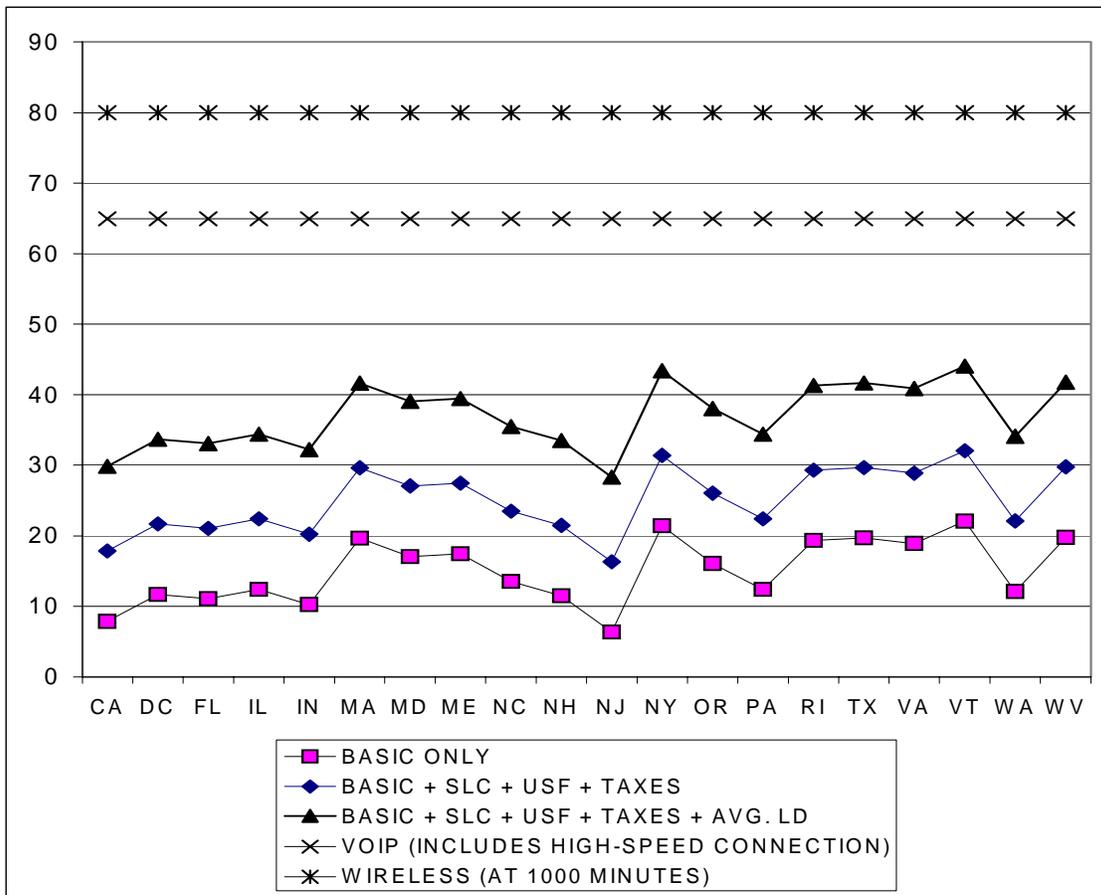
SBC and Verizon often point to new technologies, such as Voice over Internet Protocol (VoIP) as the source of the supposedly great level of competition, but these are actually quite limited. Given that 70 percent of households don’t have broadband service and, therefore, cannot take advantage of VoIP calling,²⁷ VoIP is not yet an effective competitor to the traditional wired phone service. And VoIP has other problems. VoIP does not have reliable 911 service. It does not work when the power goes out. Even worse, SBC, is blocking access from VoIP providers to enhanced 911 networks.

Making matters worse, SBC and Verizon (as well as BellSouth) also use an anti-competitive bundling tactic to ensure that VoIP can never effectively compete with their basic local voice services. Neither Verizon nor SBC will sell a consumer DSL on a stand-alone basis, what is known as “naked” DSL. Both force consumers to buy their voice service in order to get a DSL line. So a consumer who wants to buy VoIP from a competitor has to pay for local service twice.

In March 2005, the *New York Times* reported on the problems of bundling DSL with local wireline phone service, citing numerous examples of DSL customers..., who rely on wireless phones for normal calling, never using the wireline phone that he pays \$360 a year to

keep connected. He is not alone—there are thousands more who, like him, “have to pay for a service I’m never using.”²⁸ Tacking on local phone service to a DSL bill raises the monthly price from \$20-\$40 (which are often only for a limited trial period and for those willing to sign a one-year contract) to \$50-80 (See Exhibit 4). This practice mirrors cable, which sells broadband for \$40-60, so long as you purchase its television service bringing your total to \$80-100 every month. Both telephone companies and cable operators force consumers to buy bundles of services – to pay twice – if they want to purchase VoIP service from a competitor.

EXHIBIT 4: LOWEST PRICED ALTERNATIVES FOR TELEPHONE SERVICE



Sources: Billy Jack Gregg, *A Survey of Unbundled Network Element Prices in the U.S.*, February 2005; Verizon Application, *Declaration of Husser, et al.*, Exhibit 2. State prices are statewide averages. Wireless assumes 400 minutes at the average cost of \$.10 per minute

Wireless

Two critical factors limit the ability of wireless services to effectively compete with traditional services. First, even with a big bucket of minutes, wireless costs about ten cents a minute for the typical pattern of use of local calls – five times as much, on a per-minute basis, as local flat-rate dialtone, which is the staple of local service. Wireless is also less reliable than wireline and has limited access to the 911 system. Second, Cingular and Verizon Wireless, the nation’s two largest cell phone companies, are owned by two large Bells – SBC (with BellSouth) and Verizon, respectively – and, therefore, have little incentive to compete with their own wireline affiliates. Through mergers and acquisitions, as well as their brand name prominence, SBC and Verizon are each the leading wireless supplier within their respective local market.²⁹

Community Broadband Internet Providers

Communities not well-served by telephone companies and cable operators should be able to deploy their own digital infrastructure. Many communities have only a single broadband provider or a cable or telephone company duopoly. In these communities, rates remain high and service remains poor. As the market becomes more concentrated, the threat of municipal entry becomes necessary to promote competitive services such as voice or video over the Internet. A new study released by CFA, CU, and other public-interest groups shows that community Internet providers, or even the threat of municipal entry, could provide the competition necessary to keep rates low and quality of service high.³⁰

For example, community Internet providers are charging lower prices than Bell DSL service providers are charging: \$16 in Chaska, Minnesota, \$20 in Rio Rancho, New Mexico,

Moorhead, Minnesota and Lompoc, California, and an estimated \$15 in Philadelphia. And if a consumer wants it, they can pay an additional \$25 for unlimited local and long distance VoIP service—a significant monthly savings. In other words, today’s market conditions could have evolved to a world where broadband and unlimited local and long-distance calling are available nationwide for as little as \$40 a month. The SBC and Verizon, offerings cost about twice that, and mergers plus wrong-minded regulatory policies are almost certain to make this lower-cost, more competitive market disappear before it ever gets a chance to take hold and spread.

But SBC and Verizon do not merely oppose these networks. They actively fight community efforts by misleading consumers and policymakers about the network’s economic operation and effects. When they fail, they move their efforts to state legislatures to block towns, cities and counties from deploying broadband networks—work the companies should be doing more of themselves.

The more competitors they gobble up and the bigger these companies get, the less incentive they have to devote resources to competing in the marketplace for consumers, and the greater the incentive they have to prevent other entities from competing with them. And even when a community provides Internet service, it doesn’t mean that private investment from companies like SBC and Verizon dries up. A recent economic study shows that these municipal broadband networks don’t crowd out private investment and competition,³¹ while another new study analyzes a community with municipally-operated broadband, which has had significantly faster economic growth compared to matched communities.³²

THESE MERGERS MAKE THE TELECOMMUNICATIONS MARKET WORSE

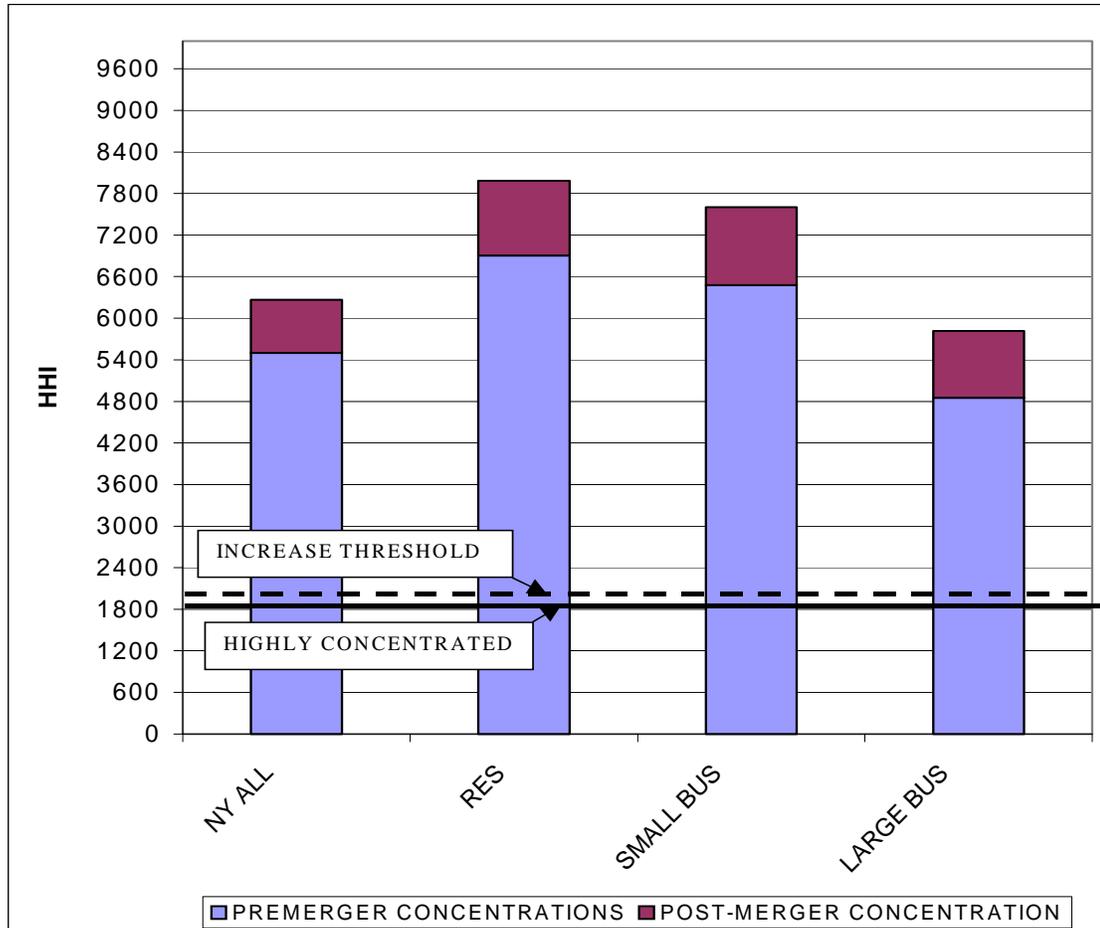
Horizontal Consolidation

The SBC/AT&T and Verizon/MCI mergers will have a deep impact in important telecommunications sectors like the local and long-distance residential and business markets. Today, pre-merger, SBC and Verizon have about an 80 percent residential market share of local telephone service in their regions,³³ and that number will increase as a result of the latest acquisitions and the decision of the Federal Communications Commission to eliminate unbundled network element platforms (UNE-P), which allowed AT&T and MCI to compete in local markets. By buying up their largest competitors and eliminating the last vestige of competition, the market shares of these two behemoths in their regions will likely exceed 90 percent in the residential sector.

Although the merging companies have failed to voluntarily provide meaningful information on product and geographic markets, state commissions have begun the process investigating the impact of the SBC/AT&T merger and the severe problems it will cause are becoming clear.³⁴ As the Commission well knows, merger analysis starts by evaluating industry structure with a measure of concentration known as the HHI (Hirschman, Herfindahl Index). A market with an HHI of more than 1,000 is considered concentrated and any merger that raises the HHI by more than 100 points in such a market is suspect. A market with an HHI above 1800 is considered highly concentrated and any merger that raises concentration more than 50 points is suspect. By these standards, the merger's anti-competitive impact will be extremely large.

A dominant firm with a local telephone service market share of 80 percent would

**EXHIBIT 5:
IMPACT OF THE SBC-AT&T MERGER ON CALIFORNIA LOCAL MARKETS
COMPARED TO DOJ/FTC MERGER GUIDELINES**



Source: New York Public Service Commission, *Analysis of Local Exchange Service Competition in New York State*, 2002 Competitive Analysis, p. 9; “Protest of the Utility Reform Network, Utility Consumer’s Action Network, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum,” *In the Matter of the Joint Application of SBC Communications Inc. (“SBC”) and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego (U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T’s Merger With a Wholly-Owned Subsidiary of SBC, Tau Merger Sub Corporation*, before the Public Utilities Commission of the State of California, Application 05-02-027, February 28, 2005, Exhibit 2

ensure an HHI of 6400. But in California, the concentration ratio for residential customers today, before the merger, is just over 6900 (see Exhibit 5). The SBC/AT&T merger will increase the concentration in the California residential market to 90 percent, creating an HHI of 8100. Attachment A presents the protest filed in California by Consumers Union and other

consumer representatives, including members of CFA.

The two corporations each already has about a 40 percent market share in the residential long-distance market within their regions, but if this merger is approved, this will increase substantially to an estimated 70 percent.³⁵ In fact, if these mergers go through, the telecommunications market will look a lot like the old days of “Ma Bell” before AT&T was broken up. SBC and Verizon will have about a 90 percent market share in residential local wireline,³⁶ 70 percent in long distance,³⁷ and 40-50 percent in wireless.³⁸ They will have the incentive and opportunity to squeeze out competitors that need access to the local or interstate “long-haul” networks.³⁹

And if VoIP is a competitive threat, these mergers will add to the problems outlined above, and remove the two largest potential VoIP competitors from the market where they are needed most – in the home service territories of the two largest Bells. AT&T will no longer exist to compete against SBC’s wireline business in SBC’s service territory. The same holds for MCI, which will no longer compete against Verizon’s wireline business in Verizon’s service territory.

The big business service market appears to be only barely more competitive than residential, when measured by lines, and again these mergers would exacerbate the already-significant problems in this market segment. On average, these two companies have about a 75 percent market share for medium and large business customers.⁴⁰ These two proposed mergers, if allowed to go through, will increase the in-region market share substantially to the 80 percent range, since AT&T and MCI are such large players in the market and because of the geographic pattern of competition.⁴¹ These regional fortresses would also anchor their

dominance over national corporate accounts.

The HHI in the large business segment is just under 4900. A dominant firm with a market share of 70 percent would cause the HHI to be at least 4900. The merger would raise the HHI in the California large business market to over 5800.

Exhibit 5 also contains data from New York, which is more aggregated and somewhat older, but it reinforces the conclusion that geographic market analysis will show that local markets to be much more highly concentrated than national data would and indicates that the merger will have a large negative impact. Across residential and business markets, the HHI for December 2002 was about 5500. A Verizon-MCI merger would increase the HHI by over 700 points.⁴²

Given this increasingly consolidated market for wired services, and especially considering the demise of competitors to the Bells – CLECs – it is critical for policymakers to consider the geographic distribution of the SBC and Verizon markets when analyzing these two mergers. MCI had its most intense competitive presence in Verizon's service territory; the Verizon-MCI merger will eliminate Verizon's most vigorous in-region competitor.⁴³ The situation with SBC-AT&T is similar. AT&T has a large presence in SBC's service territory. If these mergers go through, policymakers will effectively be allowing SBC and Verizon to buy market power that eliminates their strongest in-region competitors.

Vertical Integration

These mergers also pose severe problems because they would allow the companies to control many of the critical inputs into the market, making it that much more difficult for competitors to obtain access to such inputs. Specifically, AT&T and MCI are large providers

of Internet and interstate transport (backbone). As independent companies, their interest is in maximizing traffic. SBC and Verizon are large purchasers of Internet and interstate backbone services. As unaffiliated buyers, they make up a large portion of the market. From a competition standpoint, it is important to keep SBC and Verizon, which need the Internet and interstate backbone services as inputs, separate from AT&T and MCI, which provide this critical input. Otherwise, SBC's and Verizon's competitors will have difficulty gaining this input and are more likely to go out of business.⁴⁴

The result of these proposed mergers – called “upstream vertical integration” in the parlance of economics – would therefore likely have a dramatic impact on the market for Internet and interstate backbone traffic. SBC and Verizon would have an incentive to abuse their control over those assets to diminish competition for their retail businesses, rather than maximize the revenue flowing over those assets.

As a vertically integrated entity, both of the resulting behemoth companies would have an incentive to maximize profits by using their leverage in the form of a price squeeze. Unfortunately, the opportunity to run a classic price squeeze will be readily available in the form of excessive access charges. The regional Bell companies have been overcharging for access, particularly special access that was prematurely deregulated by the FCC. AT&T and MCI were the leading critics of the access charge system. Should these mergers go through, those who profit from those overcharges will have swallowed those who sought lower access charges that drive down prices for consumers. These mergers should not be allowed to proceed until access charges are reformed.

This prediction is no paranoid delusion, but the logical extension of SBC and Verizon's

current activities. In Court cases like *Brand X*⁴⁵, regulatory proceedings such as the wireline proceeding, and petitions to the FCC, SBC and Verizon both support the elimination of the obligation to interconnect and carry traffic on just, reasonable, and nondiscriminatory rates terms and conditions. They are buying the assets that provide critical inputs for their competitors, but at the same time they are seeking the right to discriminate against those competitors. These mergers would undoubtedly exacerbate the price-inflating, anti-competitive dangers that already exist in today's market.

If these mergers are not blocked or substantially altered by the Antitrust Division of the Department of Justice and the FCC, these regional Bells will become regional Behemoth Bells that swallowed up their original parent company (AT&T) and its main competitor (MCI), leaving consumers almost no better off than they were before the old Bell monopoly was originally demolished.

The magnitude of the two pending mergers is indisputable even at the national level (see Exhibits 6a and 6b). The number 1 (Verizon) and number 4 (MCI) companies in terms of total industry revenue are proposing to merge into a segment leader with one-third of the total industry revenue. The number 2 (SBC) and number 3 (AT&T) firms in the industry are proposing to merge to form a company that would have one-quarter of the total revenue. These two industry leaders would account for over half of all revenue. The third largest company (Bell South) would be less than a quarter the size of the industry leader. It also has a substantial joint venture with the number two firm.

Even measured at the level of national revenue in telecommunications, each of the mergers individually violates the merger guidelines. They take an already concentrated market

EXHIBIT 3: TOTAL TELECOMMUNICATIONS REVENUE MARKET STRUCTURE

EXHIBIT 3 (a): PRE-MERGER TOTAL REVENUES REVEAL A MODERATELY CONCENTRATED MARKET WITH TWO LARGE LOCAL COMPANIES, SBC AND VERIZON AND TWO LARGE LONG DISTANCE COMPANIES, AT&T AND MCI, WHICH ARE ALSO THE LARGEST LOCAL

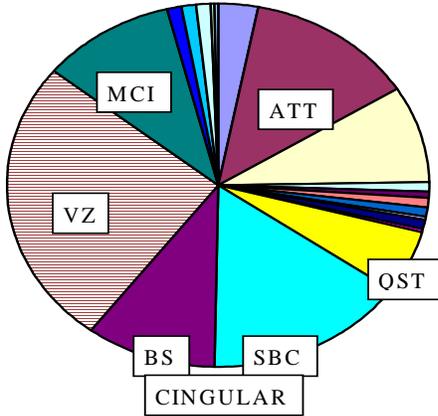


EXHIBIT 3 (b): POST MERGER (SBC-AT&T, VERIZON-MCI) TOTAL REVENUES ARE HIGHLY CONCENTRATED AND THE INDUSTRY IS DOMINATED BY TWO LARGE PLAYERS

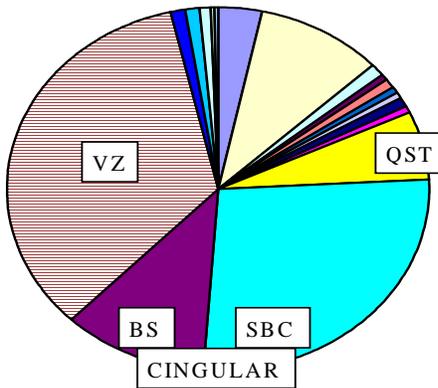
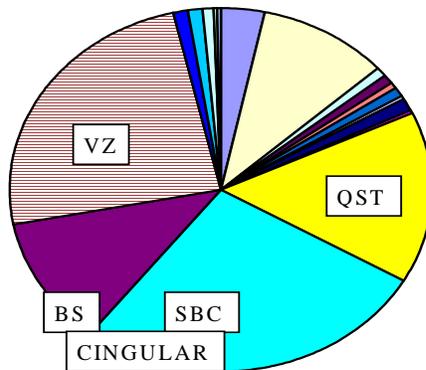


EXHIBIT 3 (c): A QWEST-MCI MERGER CAUSES A MUCH SMALLER INCREASE IN CONCENTRATION AND LEAVES A THIRD LARGE PLAYER IN THE MARKET



FEDERAL COMMUNICATIONS COMMISSION, STATISTICS OF COMMUNICATIONS COMMON CARRIERS, 2003-2004, TABLES 1.1 AND 1.2.

and dramatically increase the market concentration. The Verizon-MCI merger increases the concentration by 500 points. The SBC-AT&T merger increases concentration by 30 percent. Taken together the mergers drive the industry well past the highly concentrated threshold.

Although Section 310 precludes a comparative analysis in merger review, implicitly and explicitly the question frequently arises as to what would happen if the mergers are not approved. Indeed, this question came up explicitly during a hearing before the House Commerce committee. In the case of MCI, there is a ready answer. It would likely be acquired by a second suitor, who has offered a higher acquisition price per share. It is appropriate to ask, therefore, what the impact of that merger would be. Exhibit 6c shows the results graphically. It is quite apparent that the competitive impact of a Qwest-MCI merger would be much less severe. The Qwest-MCI merger increases the concentration by only one-sixth as much as the Verizon-MCI merger, less than 100 points. It also produces a much more balanced industry structure, with three large firms. Measured by the routine Merger Guidelines, even if it was approved after an SBC-AT&T merger, it would not violate the threshold for closer scrutiny at the national level. There is also less competitive overlap of assets at the local level.⁴⁶

The evidence is overwhelmingly clear. The Commission should just say no to these mergers or impose substantial conditions to reverse the severe anticompetitive harms they will impose. Specifying such conditions must await the provision of data on a product and geographic basis so that the nature of the harm to competition and the steps necessary to repair it can be analyzed in detail.

DECLARATION OF MARK COOPER

I, Mark Cooper, on behalf of myself and the Consumer Federation of America and Consumers Union, hereby declare upon my own personal knowledge that the Consumer Federation of America and Consumers Union are, as stated in their Petition To Deny in this proceeding, interested in the outcome of Petitioners' Application both as consumers of telecommunications services and as representatives of telecommunications customers in all fifty states.

I further verify and affirm upon my own personal knowledge that the grant of Petitioners' Application, absent condition, would harm the public interest for the specific reasons set forth in the Petition To Deny of Consumer Federation of America and Consumers Union and in this Reply.



By: _____

Date: 4/9/05

ENDNOTES

¹ The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power and cooperative organizations, with more than 50 million individual members.

² Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to Provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Reports*, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with more than 4 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

³ U.S. PIRG is an advocate for the public interest. When consumers are cheated, or our natural environment is threatened, or the voices of ordinary citizens are drowned out by special interest lobbyists, U.S. PIRG speaks up and takes action. We uncover threats to public health and well-being and fight to end them, using the time-tested tools of investigative research, media exposés, grassroots organizing, advocacy and litigation. U.S. PIRG's mission is to deliver persistent, result-oriented public interest activism that protects our environment, encourages a fair, sustainable economy, and fosters responsive, democratic government.

⁴ "Comments of the Consumer Federation of America and Consumers Union: The Impact of Megamergers on the Prospects for Competition in Local Markets," *Proposed Transfer of Control SBC and Ameritech*, Federal Communications Commission, CC Docket No. 98-141, October 15, 1998, pp. 2-3.

⁵ Yang, Catherine, "Behind in Broadband," *Business Week*, September 6, 2004; see also, Sarah Lacy, "America: still The High Speed-Laggard," *Business Week online*, April 6, 2005.

⁶ The opening sentence of the Communications Act states "For the purpose of regulating interstate and foreign communications by wire and radio so as to make available, so far as possible, to all people of the United States, without discrimination on the basis of race, color, religion, national origin or sex, a rapid, efficient nationwide and world-wide wire and radio communication services with adequate facilities are reasonable charges." Section 310 (d) requires that the commission shall not transfer licenses "except upon application to the Commission and upon finding by the Commission that the public interest, convenience and necessity will be served thereby." In approving the SBC-SNET merger, the FCC noted that "we must apply to the transfers before us, require us to weigh the potential public interest harms against the potential public interest benefits and to ensure that, on balance, the merger serves the public interest which, at a minimum, requires that it does not interfere with the objectives of the Communications Act." *In The Matter Of Applications For Consent To The*

Transfer Of Control Of Licenses And Section 214 Authorizations From Southern New England Telecommunications Corporation, Transferor To SBC Communications, Inc., Transferee, Memorandum Opinion and Order, 13 FCC Rcd. 21,292 (1998).

⁷ Yang, p. 89.

⁸ *A Nation Online*, (Washington, D.C.: National Telecommunications Information Administration, September 2004), Current Population Survey Data Base, for subscription to specific services. Zimmerman, Paul R., *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (Washington, D.C.: Industry Analysis and Technology Division, Wireline Competition Bureau, Federal Communications Commission) for local and long distance bills. Bundle prices are from visits to web sites of major carriers. Comparisons based on average basic local plus average long distance. Cable modem service costs about \$45 per month. DSL service costs about \$30. However, the local phone companies serving 85 percent of the nation require DSL customers to also take voice, making the basic connectivity costs for a high speed line that will support VOIP even more expensive. *UNE Fact Report 2004, Prepared for and Submitted by BellSouth, SBC, Qwest, and Verizon, In the Matter of Unbundled Access to Network Elements, Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, WC Docket No. 04-313, CC Docket No. 01-338, October 2004. Federal Communications Commission, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service*, 2004.

⁹ “Affluent Americans Power Internet Growth, According to Nielsen/Netratings,” April 19, 2004.

¹⁰ August 18, 2004.

¹¹ Yang.

¹² International Telecommunications Union, *The Portable Internet*, September 2004, p. A-32, gives the complete list of nations.

¹³ Richard Florida, “America’s Looming Creativity Crisis,” *Harvard Business Review*, October 2004.

¹⁴ Florida, p. 3.

¹⁵ Verizon Application, *Declaration of Husser, et al.*

¹⁶ Ellen Muraskin, “AT&T’s VOIP Rollout Heats Up Price War,” *Eweek*, July 8, 2004, available at: <http://www.eweek.com/article2/0,1759,1620387,00.asp>

¹⁷ Ben Charny, “AT&T to Launch VoIP nationwide, CNET News.com, February 25, 2004, available at: http://news.com.com/AT38T+to+launch+VoIP+nationwide/2100-1037_3-5164973.html?tag=nl

¹⁸ *Id.*

¹⁹ Muraskin.

²⁰ Application 05-02-027, Before the California Public Utilities Commission, Protest of the Utility Reform Network, Utility Consumers’ Action Network, Disability Rights Advocates, Consumers Union of U.S., Inc., The Greenlining Institute, and Latino Issues Forum, April, 14, 2005, p. 35.

²¹ “AOL Rolls Out Net Phone Service,” *Contact.com*, April 18, 2005, available at: http://www.conntact.com/article_page.lasso?id=38898

²² “AT&T Chairman Says Communications Industry Restructuring Will Heighten Competition, Drive Renewed Interest and Stability, PR Newswire, March 24, 2005, available

at: www.prnewswire.com

²³ Carolyn Duffy Marsan, "MCI Beefs up VoIP offerings", Network World ISP News Report Newsletter, March 31, 2004, available at: <http://www.nwfusion.com/newsletters/isp/2004/0329isp2.html>

²⁴ <http://consumer.mci.com/cablevoice/faqs.jsp>.

²⁵ <http://consumer.mci.com/cablevoice/timeWarnerPR.jsp>.

²⁶ Cooper, Mark, *Stonewalling Local Competition: The Baby Bell Strategy to Subvert the Telecommunications Act of 1996* (Consumer Federation of America, January 1998); *Competition At The Crossroads: Can Public Utility Commissions Save Local Phone Competition?* (Consumer Federation of America, October 7, 2003)

²⁷ Cooper, Mark, *Expanding the Digital Divide and Falling Behind in Broadband Falling Behind in Broadband*, (Consumer Federation of America and Consumers Union, October 2004), shows that penetration of the Internet into homes has stalled below 60 percent, while just over half of all Internet households have broadband.

²⁸ Richtel, Matt "Dangling Broadband from the Phone Stick," *New York Times*, February 2, 2005.

²⁹ Letter to Michael Powell, September 16, 2004.

³⁰ Consumer Federation of America, Consumers Union, Media Access Project, Free Press, "Connecting the Public: The Truth About Municipal Broadband," April 11, 2005.

³¹ Ford, George, "Does Municipal Supply of Communications Crowd-Out Private Communications Investment? An Empirical Study," *Applied Economic Studies*, February 2005.

³² Ford, George and Thomas Koutkey, "Broadband and Economic Development: A Municipal Case Study from Florida," *Applied Economic Studies*, April 11, 2005.

³³ Federal Communications Commission, *Local Telephone Competition: Status as of June 31, 2004*, December 2004, Tables 6, 11, show this figure at just over 80 percent of SBC and just under 80 percent for Verizon. This is prior to the impact of the UNE-P decision. Facilities-based competition accounted for only about one-fifth of total competition (Local Competition, Table 10). Most of this competition was in the medium or large business market.

³⁴ "Protest of the Utility Reform Network, Utility Consumer's Action Network, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum," *In the Matter of the Joint Application of SBC Communications Inc. ("SBC") and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego (U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T's Merger With a Wholly-Owned Subsidiary of SBC, Tau Merger Sub Corporation*, before the Public Utilities Commission of the State of California, Application 05-02-027, February 28, 2005.

³⁵ See note 4 above.

³⁶ *Local Telephone Competition*, Tables 6, 11.

³⁷ Precursor, *Telecom Vital Statistics: Pillars of the Bell 2005 Competitive Respite Thesis*, January 24, 2005, put Verizon and SBC long distance market shares at close to 40 percent at year-end 2004, and predicted a gain of another 10 percent, without the mergers. AT&T and MCI national market shares were approximately 30 percent and 20 percent, respectively, as reported in Industry Analysis and Technology Division, *Trends in Telephone Service*

(Washington, D.C.: Federal Communications Commission, May 2004), p. 9-5. Because of their respective geographic foci, the in-region market share of the long distance companies being acquired respectively is likely to be higher than the national average. Thus, a 70 percent residential market share is a cautious estimate.

³⁸ Consumer Federation of America and Consumers Union, Letter to Chairman Michael Powell, September 16, 2004.

³⁹ See Cooper, Mark, *The Public Interest in Open Communications Network* (Washington, D.C.: Consumer Federation Of America, July 2004), Chapter IV, for a discussion of past anticompetitive practices of telephone companies against CLEC and ISPs. For a discussion of the problem of vertical leverage against intermodal competitors see “Petition to Deny of Consumer Federation of America and Consumers Union,” *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation*, WT Docket No. 04-70, May 3, 2004 and “Reply of Consumer Federation of America and Consumers Union,” *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation*, WT Docket No. 04-70, May 20, 2004.

⁴⁰ *Local Telephone Competition*, Tables 6 and 11.

⁴¹ Richtel, Matt “Valuing MCI in an Industry Awash in Questions,” *New York Times*, February 2, 2005, C-4, puts AT&T’s national market share for the “corporate telecommunications market” at 15 percent and MCI’s at 12 percent.

⁴² New York was the first state to open its market to competition, so that competitors had penetrated substantially by December 2002. The increase thereafter was modest. Thus, the year-end 2002 data gives a reasonable indication of the state of competition and the impact of the merger.

⁴³ That the geographic overlap of assets is more concentrated in specific regions and products than the national average has been noted in the press accounts of the proposed mergers. Almar Latour and Dennis K. Berman, “Qwest Presses Its Bid for MCI,” *Wall Street Journal*, February 4, 2005, C-4, the *Wall Street Journal* described Verizon and MCI as follows: “A tie-up between Verizon and MCI also could face cultural challenges: The companies have been fierce competitors and have been at loggerheads in court.” The map accompanying Matt Richtel, “Valuing MCI in an Industry Awash in Questions,” *New York Times*, February 2, 2005, C-4, shows a concentration of MCI data centers in the Northeast.

⁴⁴ The vertical problem in the cable video and high speed Internet markets are discussed in Cooper, Mark, *Cable Mergers and Monopolies: Market Power in Digital Communications Networks* (Washington, D.C.: Economic Policy Institute, 2002), Chapters 4 and 5; see also *The Public Interest in Open Communications Networks*, Chapter IV; Petition to Deny and Reply, not 9 above.

⁴⁵ *National Cable & Telecommunications Association, et. al. v. Brand X*, Nos. 04-277 & 04-281.

⁴⁶ Almar Latour and Dennis K. Berman, “Qwest Presses Its Bid for MCI,” *Wall Street Journal*, February 4, 2005, C-4. Yuki Noguchi and Ben White, “MCI, Qwest in Advanced Discussion,” *Washington Post*, February 4, 2005, E-5. Ken Belson and Matt Richtel, “For MCI, Qwest May Not be Most Desirable,” *New York Times*, February 4, 2005, C-12.

**ATTACHMENT A:
PROTEST OF THE UTILITY REFORM NETWORK, UTILITY CONSUMERS'
ACTION NETWORK, DISABILITY RIGHTS ADVOCATES, CONSUMERS UNION
OF U.S., INC., THE GREENLINING INSTITUTE, AND LATINO ISSUES FORUM,
BEFORE THE CALIFORNIA PUBLIC UTILITIES COMMISSION, APPLICATION
05-02-027, APRIL, 14, 2005**