

ATTACHMENT 1

**REPLY DECLARATION OF GUSTAVO E. BAMBERGER,
DENNIS W. CARLTON, AND
ALLAN L. SHAMPINE**

REDACTED – FOR PUBLIC INSPECTION

**REPLY DECLARATION OF
GUSTAVO E. BAMBERGER,
DENNIS W. CARLTON
and
ALLAN L. SHAMPINE**

May 24, 2005

I, Gustavo E. Bamberger, hereby declare the following:

I, Dennis W. Carlton, hereby declare the following:

I, Allan L. Shampine, hereby declare the following:

I. INTRODUCTION AND OVERVIEW.

1. We previously submitted a declaration in this matter dated March 9, 2005.

Our qualifications and curricula vitae are included in that report.

2. In that declaration we concluded based on our initial analysis that the proposed transaction between Verizon and MCI would benefit consumers by enhancing the ability of the combined firm to develop innovative services and enabling the merged firm to operate at substantially lower costs than those that MCI and Verizon would face separately. We also concluded that the transaction was unlikely to create significant competitive problems.

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3. We have now been asked to evaluate claims made by various parties submitted in opposition to the proposed transaction.¹ Given the limited time available to prepare a reply, we have not attempted to address each claim made by opponents. Instead, we have attempted to identify and respond to the major arguments that are common to a variety of opponents. This reply focuses on comments made by Prof. Joseph Farrell on behalf of Global Crossing;² Prof. Simon Wilkie, on behalf of a coalition of CLECs;³ Prof. B. Douglas Bernheim on behalf of Qwest; Susan Baldwin and Sarah Bosley on behalf of the New Jersey Division of the Ratepayer Advocate; Lee Selwyn and others (hereafter, Selwyn), on behalf of the National Association of State Utility Consumer Advocates; and a variety of commenters focused primarily on Internet backbone concerns.⁴ We may supplement our response based on our continuing analysis, including that of additional information.

4. Our comments focus on opponents' claims that:

- The proposed transaction significantly reduces competition in the provision of special access services in Verizon's region by: (i) eliminating MCI as an alternative provider of facilities-based special access services;

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1. One of us (Carlton) recently co-sponsored a reply declaration in the SBC/AT&T matter. Because many of the opponents' comments are identical or substantially the same, parts of this reply declaration coincide with the prior reply declaration.
 2. Prof. Farrell filed his testimony in the SBC/AT&T proceeding, but his testimony is referenced by Global Crossing in this proceeding as well.
 3. Prof. Wilkie's testimony was sponsored by Cbeyond, Conservent, Eschelon, Nuvox, TDSMetrocom, XO, and Xspedius (hereafter, CLEC Coalition, or Cbeyond, et al).
 4. These include Broadwing/SAVVIS, Comptel/ALTS, Earthlink and Cox.

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and (ii) eliminating MCI as an “aggregator” or reseller of Verizon special access services.

- The proposed transaction, by increasing vertical integration, creates incentives for the merged firm to disadvantage or discriminate against rival suppliers of business enterprise services by raising special access rates.
- The proposed transaction, together with the proposed merger of SBC with AT&T, will reduce competition due to “mutual forbearance” by Verizon and SBC.
- The proposed transaction will reduce competition in the provision of mass market services by eliminating MCI as an actual or potential competitor.
- The proposed transaction will harm competition in the provision of Internet backbone service. More specifically, opponents claim the transaction will lead to Verizon and MCI (and SBC and AT&T) becoming “mega-peers” with one another, and denying or degrading access or transit to other Internet backbone providers.

5. We conclude that there is no empirical support for these concerns. The opposition comments do not lead us to alter our prior conclusion that the proposed transaction is unlikely to result in harm to consumers. The remainder of this declaration is organized as follows:

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- Section II addresses opponents’ claims that the transaction will reduce horizontal competition in the provision of special access.
- Section III addresses opponents’ claims that increased vertical integration resulting from the transaction will result in harm to consumers.
- Section IV addresses opponents’ claims that approval of the merger of Verizon and MCI, along with approval of the pending merger of SBC and AT&T, will harm consumers as the result of “mutual forbearance” between the merged companies.
- Section V addresses opponents’ claims that the proposed transaction will reduce competition in the provision of services provided to mass market consumers.
- Section VI addresses opponents’ claims relating to the denial or degradation of Internet backbone access or transit.
- Section VII replies to miscellaneous comments by opponents and their experts made in response to our prior declaration.

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II. OPPONENTS EXAGGERATE THE PROPOSED TRANSACTION'S EFFECT ON COMPETITION IN THE PROVISION OF SPECIAL ACCESS SERVICES.

A. BACKGROUND AND OVERVIEW OF OPPONENTS' COMMENTS.

1. Background.

6. Special access services “employ dedicated facilities that run directly between the end user and another carrier’s point of presence (POP) or between two discrete end user locations.”⁵ Special access services do not use local exchange switches.⁶

7. There are several components of special access services provided by LECs. These include: (i) “channel termination” facilities, which reflect services provided over facilities between a customer’s premises and the LEC end office; (ii) interoffice facilities between the LEC end office and the LEC serving wire center;⁷ and (iii) a second “channel termination” between the LEC serving wire center and the competitive carrier’s point of interconnection with the LEC.⁸

5. FCC, In the Matter of Special Access Rates for Price Cap Local Exchange Carriers, WC Docket No. 05-25, Order and Notice of Proposed Rulemaking, January 31, 2005, (hereafter, Special Access NPRM), ¶7.

6. Ibid.

7. The serving wire center is the LEC facility at or near the other carrier’s point of interconnection with the LEC network. The serving wire center is typically a facility that is separate from the LEC end office.

8. Such facilities are sometimes referred to as “entrance facilities.”

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8. In certain geographic areas, CLECs also provide dedicated capacity between a customer's premises and non-LEC interconnection points using their own fiber and other facilities that bypass the LEC's network.⁹

2. Concerns regarding reduced competition for facilities-based dedicated access services.

9. Several opponents claim that the proposed transaction will reduce horizontal competition in the provision of special (or dedicated) access services provided by Verizon and MCI through:

- The removal of MCI as a horizontal competitor to Verizon in the provision of wholesale local access services.¹⁰
- The removal of MCI as a reseller of Verizon special access services.¹¹

10. Prof. Farrell suggests that individual buildings may be an appropriate geographic market.¹² In addition, other opponents contend that MCI special access services constrain Verizon's "region-wide" prices for special access services.¹³

9. MCI and other CLECs provide "private line," "dedicated access" or "special access" services that compete with ILECs' special access services. Following opponents' terminology, we do not distinguish between private line, special and dedicated access in responding to the opponents' competition arguments.

10. Declaration of Simon Wilkie, WC Docket No. 05-75, May 9, 2005 ("Wilkie"), ¶25.

11. Opposition of Broadwing Communications, LLC, and SAVVIS Communications Corporation, WC Docket No. 05-75, May 9, 2005 ("Broadwing/SAVVIS"), p. 23; Wilkie, ¶18.

12. Statement of Joseph Farrell, WC Docket No. 05-65, April 25, 2005 ("Farrell"), ¶3.

13. Broadwing/SAVVIS, p. 22.

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B. THE PROPOSED TRANSACTION DOES NOT SIGNIFICANTLY REDUCE FACILITIES-BASED SPECIAL ACCESS COMPETITION.

11. Opponents claim that the proposed transaction will harm competition in the provision of special access services but present no data to support this claim. We have obtained data that permit us to analyze this issue. Our analysis of these data indicates that opponents overstate the importance of MCI as a supplier of facilities-based special access services in Verizon's region and the reduction in competition resulting from the proposed merger. The analysis described below indicates:

- MCI serves a relatively small number of buildings in Verizon's territory;
- MCI is one of many CLECs that provide local fiber optic facilities in Verizon's region;
- Many buildings served by MCI are in areas in which other CLECs are not "impaired," as reflected in the FCC's criteria for determining when ILECs are obligated to provide special access services as unbundled network elements;
- For most of the relatively small number of MCI buildings that are in areas where current FCC rules would deem CLECs "impaired," other CLECs operate local fiber networks in the same areas. This indicates that rivals are often well positioned to compete to provide services to many of these buildings.

12. Our analysis is organized as follows:

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- Following Prof. Farrell’s suggestion, we first evaluate the competitive overlap between MCI and Verizon in the provision of local access services on a “granular” level, using buildings as the geographic unit of analysis.
- Next, we analyze the competitive overlap between Verizon, MCI and other CLECs using Verizon wire center serving areas as the geographic unit of analysis. The FCC’s “impairment” criteria and our identification of other CLECs located near buildings served by MCI use this geographic framework.
- Finally, we analyze the extent of competitive overlap using the MSA as the geographic unit of analysis.

13. Our analysis is limited to MSAs in Verizon’s territory in which MCI operates local fiber facilities because there is a potential reduction in horizontal competition in the provision of special access resulting from the proposed merger only in such areas.

1. Regulatory and Antitrust Standards.

14. In undertaking this analysis, we make use in part of the FCC’s approaches to evaluating competition in the provision of dedicated access services used in current and past proceedings. For example, we utilize, in part, the “impairment standard” for high capacity loops defined in the FCC’s recent Triennial Review Remand Order (TRRO), which is used to identify areas in which ILECs are obligated to make high

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capacity loops available to CLECs on an unbundled basis.¹⁴ We also reference the FCC’s framework for establishing special access pricing flexibility in its Access Charge Reform Order.¹⁵

15. In interpreting our analysis and results, it is important to note that the “impairment” standard defined by the FCC in the TRRO, which is defined in more detail below, is not an antitrust standard but a regulatory one.

16. A customer in a building served by MCI (and thus potentially subject to the loss of an independent fiber supplier as a result of the proposed transaction if that building is also served by Verizon) is not necessarily harmed by the merger, even if it is in an “impairment” area in which the ILEC is required to offer high capacity loops on an unbundled basis. For example, there may be other CLECs within economical reach of such buildings that will constrain price after the merger. The data discussed below show that most MCI-lit buildings are in areas served by other CLECs.

17. The data also show that, despite the frequent presence of other CLECs in nearby areas, many CLEC-lit buildings are served by only one CLEC. This can indicate

14. FCC, In the Matter of Unbundled Access to Network Elements, Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, WC Docket No. 04-313; CC Docket No. 01-338, February 4, 2005 (hereafter, Triennial Review Remand Order, or TRRO).

15. FCC, In the Matter of Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Interexchange Carrier Purchases of Switched Access Services Offered by Competitive Local Exchange Carriers; Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket No. 96-262; CC Docket No. 94-1; CCB/CPD File No. 98-63; CC Docket No. 98-157, Fifth Report And Order And Further Notice Of Proposed Rulemaking, August 5, 1999 (hereafter, Access Charge Reform Order).

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that if one CLEC already serves a building, then others often find it more profitable to serve other buildings (instead of becoming the second CLEC at a location). Under these circumstances, it cannot be inferred that a merger harms consumers in buildings served by Verizon where MCI is now the only CLEC. The fact that one CLEC serves a building does not suggest that other firms would be incapable of doing so economically if prices were to rise.

18. Similarly, if there are already multiple CLECs in a building, then the loss of an independent competitor also may not adversely affect price. CLECs already serving (or capable of serving) a building will have strong incentives to expand service to that building given that they have already sunk the costs associated with establishing an interconnection.

19. In addition, pricing at locations subject to the loss of an independent supplier may be determined by factors other than the number of suppliers at that location. For example, if the customer purchases services as part of a multilocation contract, pricing may be unrelated to any reduction in the number of competitors at the (limited) number of buildings affected by the proposed transaction. Moreover, the FCC has stated that the availability of high capacity UNE loops may also serve to lessen concerns that the merger will lessen competition: “the availability of UNEs is itself a check on special access pricing ...”¹⁶ A merger also may affect prices in areas where ILECs are not obligated to offer high capacity loops on an unbundled basis, although a merger would be

16. TRRO, ¶65.

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unlikely to result in higher prices in such areas if the regulators have properly identified areas where rivals are capable of readily deploying high capacity circuits.

20. If pricing depends on the number of CLECs with local fiber at a given location, this would imply that a building defines a geographic market. We note that the FCC's Access Charge Reform proceedings rejected the use of geographic areas smaller (and larger) than MSAs for evaluating competition in the provision of special access and has granted "pricing flexibility" on an MSA by MSA basis. In that proceeding, the FCC concluded that "... MSAs best reflect the scope of competitive entry, and therefore are a logical basis for measuring the extent of competition."¹⁷ Thus, we present below certain measures of competitive conditions in the provision of special access services on both building-specific and MSA-specific bases.¹⁸

21. In making MSA-specific determinations regarding pricing flexibility, the FCC in the Access Charge Reform Order evaluated the extent of CLEC collocation based on the geographic area served by ILEC central offices.¹⁹ Similarly, the TRRO set "triggers" based on conditions in geographic areas served by ILEC central offices. Thus, much of our analysis below maintains these approaches.

17. Access Charge Reform Order, ¶72.

18. The geographic scope of these analyses is based on commenters' suggestions and FCC usage in non-merger reviews, and does not foreclose analyzing the effect of the proposed transaction using broader geographic definitions.

19. The terms "central office" and "wire center" are used in the text based on the term used by the cited source, but can be considered interchangeable for purposes of this declaration.

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22. The FCC’s analysis in the Access Charge Reform proceeding also was based in part on the number of CLECs that had collocated facilities in a given ILEC central office. The FCC’s framework is based on the view that the presence of collocated firms indicates that firms are well positioned to enter and thus can protect competition in the provision of dedicated access. Thus, even if there is a reduction in the number of CLECs operating in a building served by an ILEC central office, competition may not be harmed due to the presence of other collocators. We analyze below the impact of the transaction on the number of collocators serving Verizon’s central offices.

2. Data Description.

23. Prof. Wilkie appears to use data from GeoResults on buildings served by CLECs using any type of connecting facilities (i.e., fiber, copper or wireless).²⁰ We do not have access to Prof. Wilkie’s data, but we have obtained GeoResults data covering buildings served by companies providing fiber facilities in Verizon MSAs.

24. We also use data from GeoResults because Prof. Wilkie has used this source. We have not verified the reliability of the GeoResults data. Data presented elsewhere by Verizon and MCI indicate that the GeoResults data are not always accurate. Nevertheless, even based on this source, relied upon by Prof. Wilkie, we show: (i) that MCI accounts for a modest share of CLEC activity in the overlap areas; and (ii) that other CLECs typically operate in areas served by MCI.²¹ Verizon and MCI have performed

20. More specifically, he appears to use GeoResults “Hub” data.

21. We use GeoResults “Lit” data. These data are a subset of the “Hub” data that identify firms that own equipment connected to fiber facilities (as opposed to copper

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similar analyses using other data sources that are documented in the declarations of Quintin Lew & Ronald Lataille; and Jonathan Powell, Peter Reynolds and Edwin Fleming. We summarize their results below as well. In addition, Verizon has provided us with data on whether wire centers serving these buildings are considered “impaired” with respect to DS-3 high capacity loops.²²

3. Characteristics of Buildings Served by MCI and the Extent of Competitive Overlap.

25. Prof. Wilkie claims that it is “instructive to view a few sample markets to appreciate how substantial AT&T and MCI are in these wholesale markets.”²³ As support, he presents a table with data for six metropolitan areas that reports the number of buildings served by all CLECs, and the number served by CLECs other than AT&T and MCI. These data show the fraction of CLEC-served buildings where either AT&T or MCI are the only serving CLECs, but Prof. Wilkie’s table does not report the fraction of

connections which are included in the “Hub” data). We attempt to limit the analysis to major CLECs and end-user locations. Accordingly, we exclude locations where the building CLLI code is the same as the serving wire center CLLI code (indicating that the building is in fact a serving wire center and not an end-user location). We also limit the analysis to carriers which appear in both the NPRG CLEC Report (as discussed in our previous declaration) and the GeoResults data – **[Begin Proprietary]**

[End Proprietary]

22. These classifications are made based on current collocation and line data.

23. Wilkie, ¶19.

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CLEC served buildings where MCI is the only serving CLEC. Prof. Wilkie's calculation overstates the reduction in competition resulting from the proposed merger unless it is also assumed that Verizon/MCI and SBC/AT&T cease competing after the merger. As we discuss elsewhere in this declaration, there is no basis to assume that SBC/AT&T would cease to be a competitor of Verizon/MCI because of these mergers.

26. Prof. Wilkie provides disaggregated data on buildings served by MCI (apart from those served by AT&T) only once in his declaration. For the New York metropolitan area, Prof. Wilkie reports that CLECs serve 16,869 buildings (either through their own facilities or using resold ILEC facilities), while MCI serves 1,085 buildings.²⁴ That is, Prof. Wilkie's data indicate that MCI serves only six percent of CLEC-served buildings in New York.

27. The declaration of Powell, *et al.*, provides data from MCI on buildings lit by CLECs from whom MCI purchases access services.²⁵ (We refer to these as "MCI-reported CLECs.") In Verizon East (the former Bell Atlantic/NYNEX territories), MCI serves roughly [Begin Proprietary] [End Proprietary] "on-net" buildings.²⁶ MCI-reported CLECs serve [Begin Proprietary] [End Proprietary] of the same

24. Wilkie, ¶19. Similar figures can be calculated for non-Verizon MSAs Cleveland and Milwaukee from Prof. Wilkie's May 9, 2005 *ex parte* presentation to the FCC. For Cleveland, the fraction of CLEC served buildings served by MCI is less than eight percent. For Milwaukee, it is less than six percent.

25. Declaration of Jonathan Powell, Peter Reynolds and Edwin Fleming, WC Docket No. 05-75, May 24, 2005 ("Powell, Reynolds & Fleming Declaration").

26. These data include a limited number of buildings served by copper facilities from a fiber network.

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buildings. This indicates that more than 45 percent of MCI-served buildings are also served by other MCI-reported CLECs. This likely understates the extent to which MCI-served buildings are served by other CLECs because there are other CLECs that do not sell access to MCI and thus do not report locations they serve to MCI.²⁷

28. As noted above, we have also performed an analysis of “lit” buildings using a subset of the GeoResults data (relied upon by Prof. Wilkie) that includes only fiber lit buildings. These data identify many fewer fiber-served buildings served by MCI than those reported by MCI. We are aware of no evidence that any such underreporting is more (or less) severe for MCI than for other CLECs. For the MSAs in our analysis, MCI serves only 22 percent of CLEC-served buildings identified by GeoResults, and MCI is the only CLEC serving a building using fiber for only 17 percent of CLEC-served buildings.

29. We understand that there are many buildings in Verizon’s MSAs that Verizon does not serve with fiber facilities. However, even making the extreme assumption that Verizon provides fiber to all of the buildings served by CLECs, then the GeoResults data indicate that there would be a decline from two to one in the number of fiber-based local carriers as a result of the proposed transaction for only 621 buildings in Verizon’s territory.

27. The data do not include, for example, **[Begin Proprietary]**
[End Proprietary]

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4. Number of MCI-served buildings for which ILECs are required to offer high capacity loops on an unbundled basis.

30. This section classifies MCI-lit buildings based on the determinants of impairment established in the TRRO in order to assess those that are more and less likely to be at risk of competitive harm as a result of the proposed transaction. As mentioned above, the TRRO establishes criteria for identifying areas where CLECs may be at a cost disadvantage in deploying access facilities. We understand that the FCC’s determination was not based on an analysis of the determinants of dedicated access pricing in different geographic areas but on the potential availability of supply. Thus, these analyses provide general guidance for evaluating the likely effect of the proposed merger on price.

31. According to Powell, *et al.*, 51 percent of MCI’s “on-net” buildings are in wire centers which are not considered “impaired” for DS-3 loops using the FCC’s standards.²⁸ In addition to the wire center criteria, the FCC standards provide that carriers serving a building with two DS-3s of capacity or more are not considered “impaired” with respect to DS-3 loops.²⁹ Powell, *et al.*, report that **[Begin Proprietary]** **[End Proprietary]** percent of MCI’s “on-net” buildings have current demand from MCI of greater than two DS-3 equivalents, and so would be exempt from DS-3 unbundling.³⁰ They further report that at least **[Begin Proprietary]** **[End Proprietary]** percent of MCI’s lit buildings are either in wire centers that meet the

28. Powell, Reynolds and Fleming Declaration.

29. TRRO, ¶177.

30. Powell, Reynolds and Fleming Declaration.

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“triggers” the Commission established for de-listing high-capacity DS-3 loops, or have sufficient demand to justify the use of OC-n circuits, which are not available as UNEs.³¹

5. MCI-lit buildings in areas served by other CLECs.

32. This section analyzes the extent to which MCI-lit buildings are in Verizon wire center service areas that also are served by other CLECs, according to the GeoResults data. As mentioned above, there are concerns about the accuracy of the GeoResults data, and the results may therefore understate the true presence of other CLECs.

33. The FCC’s TRRO criteria are based in part on the geographic areas served by ILEC central offices in defining impairment. Given the FCC’s view that the presence of fiber-based collocation equipment in an ILEC central office service area is significant in evaluating competitive conditions, this additional information on the presence of local fiber in the central office service area also is likely to be of value in assessing the likelihood that the merger results in the risk of harm to competition. If MCI and other CLECs operate local fiber facilities in an area served by a given ILEC central office, then it is likely that firms also could do so economically if prices rose from current levels.³²

31. Powell, Reynolds and Fleming Declaration.

32. The ability of another CLEC to serve a particular building depends on the distance and other geographic factors that affect the cost of a building interconnection. The costs faced by a new CLEC deploying service to a building can depend in part on the physical proximity of its fiber to a building. The new CLEC’s costs of entry may also be lower than those that had been faced by an existing CLEC serving the building if the new CLEC can utilize building-specific conduit or other facilities established by other CLECs.

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34. Table 1 reports the number of MCI-lit buildings in Verizon’s region identified by GeoResults classified by the number of CLECs that provide service to buildings in the same ILEC wire center serving area. Results are reported separately: (i) for all 781 MCI-lit buildings; (ii) for all 621 MCI-lit buildings for which MCI is the only identified CLEC; and (iii) for the 431 buildings for which (a) MCI is the only identified CLEC, and (b) that also meet the FCC’s “impairment” standard (i.e., the ILEC is required to unbundle DS-3 loops).³³

35. The analysis indicates:

- 621 of the 781 MCI-lit buildings identified by GeoResults are in Verizon wire center service areas served by at least one other CLEC.
- 431 of the 621 MCI-lit buildings identified by GeoResults in which MCI is the only reported CLEC are in Verizon wire center service areas served by at least one other CLEC.
- 281 of the 431 MCI-lit buildings identified by GeoResults in areas that meet the FCC’s impairment triggers (i.e., the ILEC is required to unbundle DS-3 loops) and related criteria are in Verizon wire center service areas served by at least one other CLEC.

33. These buildings are classified based on whether they are in the serving areas of wire centers that meet the “impairment” test without addressing building specific capacity issues relating to “impairment.”

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Table 1

Number of CLECs in Verizon Wire Center Service Areas with MCI-Lit Buildings Reported in GeoResults

Number of CLECs (Including MCI)	All MCI-Lit Buildings		Buildings Served by MCI Alone		"Impairment Area" Buildings	
	Number	Percentage	Number	Percentage	Number	Percentage
1	150	19.2%	150	24.2%	150	34.8%
2	150	19.2%	129	20.8%	112	26.0%
3	86	11.0%	68	11.0%	61	14.2%
4+	395	50.6%	274	44.1%	108	25.1%
Total	781	100%	621	100%	431	100%

Source: GeoResults Lit Buildings Data

Notes: Limited to CLECs Identified in NPRG 2005 Report;
Based on Verizon MSAs with the largest special access demand in which MCI operates.

36. Thus, the majority of MCI-lit buildings reported by GeoResults, including those that may be considered at greater risk of harm resulting from the proposed merger, are in areas served by Verizon central offices which will continue to be served by at least one other CLEC post-merger. In sum, these results indicate that other CLECs are typically well-situated to supply the large majority of buildings now served by MCI if prices were to rise from current levels.

6. MSA area analysis.

37. As noted above, the FCC concluded in its Access Charge Reform Order that MSAs are the appropriate geographic unit for analysis of competition in the

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provision of special access circuits, reflecting the FCC's conclusion that MSAs "best reflect the scope of competitive entry."³⁴ We have used data from GeoResults to identify the number of CLECs that have local fiber facilities in each of the metropolitan areas in which MCI has local facilities.

38. As shown in Table 2, there are an average of 8.3 CLECs (including MCI) that operate local fiber networks in the 37 Verizon MSAs in which MCI operates local fiber facilities, as reported by GeoResults.³⁵ Verizon has presented similar results for contiguous clusters of wire centers.³⁶

34. Access Charge Reform Order, ¶72.

35. There is only one metropolitan area (State College, PA) in which the GeoResults data identify MCI as the sole CLEC provider of local fiber facilities. We understand from MCI that it does not operate fiber facilities in State College, PA.

36. See Lew & Lataille Declaration, WC Docket No. 05-75, March 9, 2005 ("Lew & Lataille Declaration").

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Table 2

**Number of CLECs with Local Fiber at the MSA Level
Reported by GeoResults**

Number of CLECs (Including MCI)	Number of MSAs with CLECs Identified by GeoResults
1	1
2	2
3	5
4+	29
Average Number of CLECs	8.3

Source: GeoResults Lit Building Data.

Notes: Limited to CLECs identified in NPRG 2005 Report. Based on Verizon MSAs with largest special access demand in which MCI operates

6. Implications.

39. The data and analyses lead to a number of important conclusions regarding the competitive effect of the proposed transaction on special access.

- The data indicate that only a modest number of buildings in Verizon’s territory are served by MCI and thus are subject to any potential reduction in competition.
- The vast majority of MCI-lit buildings identified by GeoResults (more than 80 percent) are in Verizon wire center service areas where other CLECs operate. This facilitates the ability of other firms to replace MCI as a competitor in serving these buildings and implies that a reduction in

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the number of CLECs providing local fiber to a building does not necessarily imply a material reduction in competition.

- Despite the frequent presence of other CLECs in the wire center serving area, a majority of MCI-lit buildings are served by only MCI. This indicates that if one CLEC already serves a building, then others often find it most profitable to provide facilities to other buildings. The fact that only one CLEC typically serves a building does not imply that other firms are incapable of economically serving the building if prices were to rise.

40. In sum, even using the data source identified by Prof. Wilkie, there is no basis to conclude that the relatively small number of buildings at issue means that this merger will materially reduce competition or harm consumers of special access. This conclusion holds using both granular and regional analyses, as suggested by Prof. Farrell.

C. THE PROPOSED TRANSACTION DOES NOT SIGNIFICANTLY REDUCE THE NUMBER OF CLECS COLLOCATING FACILITIES IN VERIZON CENTRAL OFFICES.

41. As discussed above, the FCC relies on information on the extent to which CLECs have collocated fiber-based equipment in ILEC wire centers and related information in evaluating whether to grant ILECs pricing flexibility for special access services. While collocation in central offices does not necessarily imply the presence of local fiber to customer premises, the FCC considers these criteria to be a “proxy for irreversible, sunk investment in channel terminations between the end office and the

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customer premises.”³⁷ The presence of collocators provides information on CLECs’ ability to provide special access and other services in narrowly defined geographic areas.

42. Verizon reported in its original filing that MCI had fiber-based collocation in [Begin Proprietary] [End Proprietary] Verizon wire centers; that there was at least one competitive provider with fiber facilities in 96 percent of those wire centers; and that 81 percent of MCI’s lit buildings were in wire center serving areas with four or more competitive providers with fiber.³⁸ These data indicate that following the proposed transaction a variety of fiber-based CLECs will remain in virtually all central offices in which MCI has fiber based collocation. Following the FCC’s logic, this implies that the transaction will not substantially reduce prospects for competition in the provision of special access services in these areas.

37. FCC, Access Charge Reform Order, ¶104. The FCC concluded that collocation “is probative of the degree of sunk investment by competitors in channel terminations between the end office and the customer premises throughout the MSA. In addition, as we discuss above, collocation is a conservative measure of competition in that it does not measure competition from competitors that bypass LEC facilities altogether. Given the lack of other data in the record, therefore, we conclude that it is reasonable to rely on collocation as a proxy for irreversible, sunk investment in channel terminations between the end office and the customer premises and to set the applicable thresholds high enough to account for the limitations inherent in this trigger.”

38. Lew & Lataille Declaration, ¶¶23-24.

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D. AVAILABLE DATA INDICATE THAT THE PROPOSED TRANSACTION DOES NOT ELIMINATE A SIGNIFICANT RESELLER/AGGREGATOR OF VERIZON SPECIAL ACCESS SERVICES.

43. Opponents' claims that the transaction will harm competition by eliminating MCI's role as a significant reseller/aggregator of Verizon special access services are not supported by available evidence.

44. First, we understand that MCI does not act as a simple "reseller" of Verizon special access services. Instead, we understand that MCI sells wholesale special access ("Metro Private Line") services to other carriers only when some part of the service is provided by MCI using its own facilities.³⁹

45. Even then, MCI's sales of wholesale local private line services that include Verizon special access service are competitively insignificant. MCI's wholesale local private line service revenues in Verizon East are approximately [**Begin Proprietary**] [**End Proprietary**] million per year, and over [**Begin Proprietary**] [**End Proprietary**] percent of MCI's private line revenues are from circuits that use only MCI facilities.⁴⁰ In contrast, Verizon had special access revenue of roughly [**Begin Proprietary**] [**End Proprietary**] in 2004.⁴¹

46. According to Powell, Reynolds & Fleming, the discounts that MCI receives on special access elements that it uses for its own special access offerings are

39. Powell, Reynolds & Fleming Declaration. As discussed elsewhere in this declaration, MCI has a handful of "grandfathered" pure resale special access circuits (Type IV).

40. Powell, Reynolds & Fleming Declaration.

41. Data from Verizon.

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”largely independent of volume.”⁴² This suggests that MCI is not in a unique position to engage in such resale, if it were profitable to do so.

47. In sum, available data indicate that MCI is a relatively insignificant provider of dedicated access as an aggregator or reseller of Verizon special access services.

III. COMMENTERS’ CLAIMS THAT VERTICAL INTEGRATION BY VERIZON HARMS COMPETITION ARE MISPLACED AND BASED ON INCOMPLETE ANALYSIS.

A. OVERVIEW OF OPPONENTS’ COMMENTS.

48. In addition to concerns about the reduction in horizontal competition for the provision of dedicated access services, opponents also express concern that vertical integration between Verizon’s special access facilities and MCI’s provision of business enterprise services (which may rely in part on Verizon special access facilities) will have an independent adverse effect on competition.

49. For example, Prof. Wilkie argues:

[Post-merger] Verizon could charge an access price that would foreclose the CLECs [from offering retail services] and so charge the monopoly price to the customer and earn the monopoly rent for Verizon’s [retail] service. (Wilkie, ¶23)

Other opponents make similar claims.⁴³ Another argument advanced by opponents is that Verizon may have an incentive to degrade the quality of service it provides to rivals.⁴⁴

42. Powell, Reynolds & Fleming Declaration.

43. Broadwing/SAVVIS, pp. 28-29.

44. Broadwing/SAVVIS, p. 31.

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B. OPPONENTS IDENTIFY CONCERNS THAT ARE INDEPENDENT OF THE PROPOSED MERGER.

50. The vertical concerns raised by merger opponents are the consequence of Verizon's alleged market power in the provision of special access services. If special access services are competitively supplied (or if the downstream services that utilize special access are competitive) then there can be no concern that the proposed merger creates any incentive for Verizon to raise special access prices.

51. On the other hand, the opponents' allegation that Verizon exercises market power in the pricing of special access is an issue that exists independently of the proposed merger. If this problem does exist and creates social harm then a regulatory solution may be required. Opponents' complaints about Verizon's market power in the provision of special access presumably would apply to all ILECs, not just Verizon (and have in fact been made with respect to SBC in the SBC/AT&T transaction proceeding). A regulatory review enables all interested parties to comment on the issue and enables a general remedy to be fashioned if a competitive problem is identified. Such a review by the FCC is already underway.⁴⁵

52. It is also important to note that if, as opponents claim, Verizon has market power in the provision of special access, then vertical integration may also have efficiency benefits.⁴⁶

45. See, generally, Special Access NPRM.

46. Carlton and Perloff, *Modern Industrial Organization*, 4th ed. (2005), pp. 415-418; Farrell, ¶42.

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53. Another issue independent of the merger is whether Verizon has incentives to degrade the quality of its special access services. Opponents fail to explain how the merger increases Verizon's ability to discriminate in this way, or how Verizon could do so without detection by regulators. Any such quality degradation would have to be detectable by consumers in order to affect their choice of carrier. However, if it was detectable to consumers, then regulators should also be able to observe it and take action.

C. ANALYSIS OF THE COMPETITIVE EFFECT OF THE PROPOSED TRANSACTION REQUIRES ANALYSIS OF ALL MERGER-RELATED EFFICIENCIES.

54. Evaluation of the competitive effects of the proposed transaction also requires consideration of merger-related efficiencies. Various efficiencies were discussed in the declaration of Stephen Smith submitted as part of the parties' Application. This declaration established that the proposed transaction would be expected to: (i) generate substantial cost savings; and (ii) accelerate delivery of new services to customers.

55. Although consumers may benefit from merger-related efficiencies, the parties opposing the proposed transaction would not. To the contrary, many parties opposing the proposed merger are CLECs that both purchase inputs from Verizon and compete with MCI and Verizon in the provision of business services. The creation of a more efficient competitor through the merger would be expected to harm certain opponents' prospects in competing to provide business services.

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IV. THERE IS NO BASIS FOR CONCERN THAT THE PROPOSED TRANSACTION WOULD HARM COMPETITION DUE TO “MUTUAL FORBEARANCE” BETWEEN VERIZON AND OTHER ILECS.

A. OVERVIEW OF OPPONENTS’ COMMENTS.

56. Several opponents suggest that the proposed merger, together with the proposed merger of SBC and AT&T, will harm competition in the provision of a variety of services due to the history of “mutual forbearance” and “tacit collusion” between Verizon and SBC.⁴⁷

B. ANY POLICY OF “MUTUAL FORBEARANCE” WOULD BE EXTRAORDINARILY COSTLY TO THE MERGED FIRM.

57. Opponents’ mutual forbearance claims are based on what they claim to be an absence of historical competition and an aversion to out-of-region competition by Verizon and SBC.⁴⁸ As discussed further below, opponents ignore important historical examples of competition between Verizon and other ILECs and ignore explanations for ILECs’ limited out-of-region activity unrelated to mutual forbearance.

58. However, even if we accept opponents’ characterization, they ignore the fact that the proposed transaction fundamentally alters the mix of assets owned by

47. Petition to Deny of Cbeyond Communications, Conversent Communications, Eschelon Telecom, TDS Metrocom, NuVox Communications and XO Communications, WC Docket No. 05-75, May 9, 2005, (“Cbeyond, et al.”), pp. 51-64; Declaration of B. Douglas Bernheim, WC Docket No. 05-75, May 9, 2005 (“Bernheim”), pp. 23, 25. Opponents use the terms “mutual forbearance” and “tacit collusion” in discussing these concerns. For simplicity, we adopt the “mutual forbearance” terminology in responding to these comments.

48. Wilkie, ¶26.

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Verizon as well as SBC. Changes in the structure of Verizon (and SBC) lead to changes in their incentives.

59. The merged Verizon/MCI will have extensive physical and human assets throughout the United States and abroad. MCI today operates local and long distance network facilities throughout the SBC, BellSouth and Qwest service areas and is a leading provider of business services throughout these areas. Any strategy by the merged firm not to continue to compete aggressively for customers outside of Verizon's region would be extraordinarily costly because Verizon is the ILEC to only 32 percent of the United States.⁴⁹ Due to the fixed nature of many network costs, revenue lost by the merged firm's failure to bid aggressively in SBC's territory would have a large effect on profitability.

60. Put simply, there is no reason to expect that the merged firm would find it in its interest not to compete aggressively outside of Verizon's region. This holds with respect to the merged company's incentive to utilize and extend its local fiber facilities (and compete with ILECs for access traffic) as well as its sales of business services. Opponents stress that local fiber facilities operated by MCI and other CLECs provide them a significant cost advantage. There is no reason to expect that the merged firm would choose not to continue to fully utilize such out-of-region cost advantages following the merger.

49. FCC, Trends in Telephone Service, May 2004, Table 7.3.

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61. Prof. Wilkie also recognizes that an ILEC's ownership of out-of-region facilities reduces the likelihood of mutual forbearance. Prof. Wilkie claims in his May 9, 2005 *ex parte* submission to the FCC that the “[o]nly way to avoid this tacitly collusive outcome would be if SBC and Verizon build local facilities throughout each other’s territories.” Thus, even Prof. Wilkie recognizes that out-of-region facilities reduce the likelihood of mutual forbearance. Purchasing these facilities through merger has precisely the same effect on the merged firm’s incentives as building these facilities.

62. If, as opponents claim, the proposed transaction were to lead to mutual forbearance with respect to the provision of business services then, all else equal, the beneficiaries of this behavior would be the merger opponents that provide such services. In contrast, if the merger enables Verizon and MCI to offer improved service quality and reliability, merger opponents that provide business services would face increased competitive pressure by the more efficient firm even though consumers would be better off.

C. OPPONENTS IGNORE EXISTING COMPETITION BETWEEN VERIZON AND OTHER ILECS AND NON-COLLUSIVE EXPLANATIONS FOR HISTORIC PATTERNS OF COMPETITION.

63. As noted above, opponents’ “mutual forbearance” claim is based in part on their view that Verizon and ILECs do not, and will not, actively compete. However, there are significant examples of such competition.

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64. For example, Verizon and SBC compete directly for wireless customers through Verizon Wireless (which is 55 percent owned by Verizon) and Cingular (owned jointly by Cingular and BellSouth). Cingular and Verizon Wireless are the first and second largest wireless suppliers in the United States. These firms compete aggressively and provide service nationally.

65. These examples reinforce what should be an obvious point – it is costly for a firm to acquire out-of-region facilities and then not use them. In fact, the empirical evidence indicates that firms that acquire significant out-of-region facilities – e.g., cellular towers, Qwest’s long distance network, Verizon’s GTE territories – use those assets to compete. There is no basis to conclude that Verizon (or SBC) would go to the trouble and expense of acquiring national networks and then not aggressively use them.

D. A VARIETY OF INDUSTRY FACTORS MAKES MUTUAL FORBEARANCE IN THE PROVISION OF BUSINESS SERVICES UNLIKELY.

66. While opponents argue that the proposed merger will result in mutual forbearance (or tacit collusion) among providers of telecommunications among business customers, they ignore a variety of industry characteristics that complicate such behavior.

For example:

- Customers of business services are highly heterogeneous with respect to size, geography, and services demanded as well as service quality required. Customers also differ with respect to their desired supplier mix, with some choosing a single provider for all services, others using different providers for different services,

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and others using multiple suppliers for the same service for redundancy purposes.

These circumstances make it more difficult for firms to monitor each others'

behavior and thus provide incentives to cheat on a collusive agreement.

- Customers differ with respect to purchasing practices, with some customers using formal RFPs and biddings while others negotiate informally. Problems in observing prices resulting from negotiated deals and/or non-public bids make it more difficult to monitor rivals' prices and more difficult to sustain a collusive agreement.
- Sales to business customers often involve lumpy, multi-year contracts which can provide strong incentives to "cheat" on a collusive agreement.
- Customers are often highly sophisticated and often purchase with the assistance of professional third parties, including consultants, value-added resellers and systems integrators. Such circumstances enhance customers' ability to detect collusion.
- Services often are provided over both owned and leased facilities. Thus, the actual firms involved in providing services may not be transparent to rivals. This in turn indicates that attempts to deviate from a collusive agreement can be difficult to detect.

67. These circumstances, along with differences in supplier characteristics, complicate the ability of firms to engage in mutual forbearance. Suppliers may differ with respect to the technological solutions that they offer, cost structure (e.g., the extent

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to which they utilize their own facilities) and relative size. For example, AT&T reports first quarter 2005 revenues of \$7.0 billion while MCI's revenues for the same period were \$4.8 billion (per company press releases). This difference suggests that the opportunity costs of a mutual forbearance strategy would differ substantially between a merged SBC/AT&T and a merged Verizon/MCI. Opponents fail to explain how suppliers could successfully engage in mutual forbearance in the face of these obstacles and present no evidence that the transaction would facilitate any such outcome.

E. THERE IS NO BASIS FOR OPPONENTS' CLAIM THAT THE PROPOSED TRANSACTION WOULD HARM INCENTIVES TO INNOVATE.

68. There can be no dispute that the telecommunications industry has been marked by rapid technological changes in recent years. Dramatic growth in the Internet, wireless services, private voice and data networks, the convergence of voice and data transmission technologies, the deployment of long distance and local fiber optic networks, and improvements in network electronics are a few examples.

69. In our prior declaration, we discussed how the merger would allow the combined firm to provide innovative IP-based services more efficiently and to accelerate the deployment of such services to a broader range of customers. We also discussed how Verizon and MCI intend to make services, such as security services, developed for enterprise customers available to other customers. Moreover, it may be difficult for firms

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to achieve these gains in the absence of merger given the recognized difficulties in establishing contracts for new technologies.⁵⁰

70. In dismissing these arguments, opponents present no evidence to support their view that the merger would harm innovation competition. For example, they do not claim that large telecommunications mergers in the recent past slowed the development or deployment of the new technologies noted above.

71. Many parties compete to develop new telecommunications innovations. New telecommunications services and technologies result from efforts of not only ILECs and IXCs but also equipment manufacturers, CLECs, new long distance network providers, wireless service providers, and systems integrators as well as others outside the industry. Given these circumstances, it is unlikely that the proposed transaction will reduce innovation competition.

V. THE PROPOSED TRANSACTION IS UNLIKELY TO ADVERSELY AFFECT COMPETITION IN THE PROVISION OF SERVICES FOR MASS MARKET CONSUMERS.

A. OVERVIEW OF OPPONENTS' COMMENTS.

72. Opponents also claim that the proposed transaction will harm mass market consumers. For example:

- The Selwyn report characterizes “the current industry condition” as a “debacle.”⁵¹ The report concludes that “[t]he vertical and horizontal

50. Carlton and Perloff, *Modern Industrial Organization*, 4th ed. (2005), pp. 548-558.

51. “Confronting Telecom Industry Consolidation,” Lee Selwyn, Helen Golding & Hillary Thompson, April 2005, (“Selwyn”), p. iii.

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integration and market concentration that will result from these two combinations will afford the two post-merger RBOCs near-monopoly control of the local market within each RBOC's core local service footprint."⁵²

- Prof. Wilkie concludes, based in part on a merger simulation analysis, that “the merger will induce significant consumer harms in the market for mass wireline service.”⁵³

B. OPPONENTS FAIL ADEQUATELY TO ACCOUNT FOR MCI'S PRE-MERGER DECISION TO RE-FOCUS AWAY FROM MASS MARKET SERVICES AND MANAGE ITS IRREVERSIBLE DECLINE.

73. Many of the concerns expressed by merger opponents relating to mass market services are not merger related. Mr. Selwyn believes that implementation of the regulatory framework of the 1996 Telecom Act has been a “debacle” due to court decisions “to withdraw regulatory protections that had been put in place to preserve the intended procompetitive opportunities...” Similarly, Baldwin & Bosley argue that the “imminent disappearance of UNE-P will likely eliminate the minimal mass market competition that has evolved.”⁵⁴ However, these events are unrelated to the proposed transaction. They occurred prior to the decision of Verizon and MCI to combine their companies.

52. Selwyn, p. 42.

53. Wilkie, ¶44.

54. Declaration of Susan Baldwin and Sarah Bosley, WC Docket No. 05-75, May 9, 2005 (“Baldwin & Bosley”), p. 21.

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74. MCI's mass market business is in "continuing and irreversible decline."⁵⁵ This implies that in the absence of the transaction, MCI would be a less important competitive factor in serving mass market customers. As such, prices charged by Verizon and other firms would likely be constrained, not by MCI, but by other factors. Indeed, a number of opponents point to MCI's shift away from the consumer business as evidence that no CLEC can survive as a mass market supplier.⁵⁶ MCI's decision, and the factors leading to it – such as a history of declining prices for mass market services and changes in regulatory requirements facing ILECs – are discussed in our initial declaration. In light of MCI's rapidly declining importance as a supplier of mass market services, the merger is likely to benefit remaining MCI long distance consumers because Verizon has stronger incentives than MCI to retain these customers.

75. Opponents present no evidence suggesting that MCI's decision was economically baseless and likely to be reversed. Given recent changes in the legal and regulatory environment and prior trends in MCI business that predate recent legal and regulatory events, opponents' claim that the merger eliminates a firm that has any substantial probability of re-emerging as a prominent provider of mass market services is highly speculative. Indeed, Baldwin & Bosley state that:

55. Declaration of Wayne Huyard, WC Docket No. 05-75, March 9, 2005, ¶2.

56. Selwyn, p. 51 ["With AT&T and MCI now 'impaired' out of existence..."]; Baldwin & Bosley, p. 20 ["AT&T and MCI have stopped or decreased the marketing of their residential telephone service..."].

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If, despite the TRRO setback, MCI *could* continue profitably, the merger then would eliminate an important competitor to Verizon. (Baldwin & Bosley, p.62; emphasis in original).

However, they present no evidence to support their carefully qualified suggestion that MCI might reverse its course in the absence of the proposed merger.

76. Prof. Wilkie also attempts to support his claim that the proposed transaction will harm competition in the mass market by presenting the result of a “Bertrand” merger simulation analysis.⁵⁷ Merger simulation calculations attempt to identify the effect of price on merger-related incentives to raise the price of differentiated products. These incentives arise because the merged firm can “recapture” customers that otherwise would be lost to rivals as the result of a price increase.

77. While the details of the analysis must be inferred from his brief description, it appears that Prof. Wilkie’s calculations do not account for a variety of factors that differentiate the proposed transaction from the “typical” situation evaluated with Bertrand merger-simulation models. For example:

- If MCI has determined that its profit-maximizing strategy in the absence of the merger is to dramatically reduce marketing these services and focus on managing the decline of this business (which must be the starting point of the merger analysis), then it is unlikely that a significant number of Verizon customers would be recaptured by MCI in response to an increase in Verizon prices. Under such circumstances, there would be little if any merger-related incentive to raise prices

57. Wilkie, ¶¶43-44.

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to current Verizon customers. Prof. Wilkie appears not to have accounted for this in his calculation.

- Verizon has stronger incentives than MCI to retain MCI's current customers. This is due in part to Verizon's interest in selling to current MCI customers ancillary services such as wireless or video services that MCI either does not offer or vigorously promote. Prof. Wilkie appears not to have considered this in his analysis.
- In addition, Verizon, to the extent that it has a lower cost structure than MCI for serving mass market consumers, would have a greater incentive to retain these customers. Prof. Wilkie appears not to account for merger-related cost savings in his analysis.
- Furthermore, the incentive and ability of the merged firm to raise price may be affected by its regulatory obligations to integrate MCI and Verizon pricing plans as well as regulatory obligations relating to geographic price uniformity. Prof. Wilkie appears to not account for these factors.

78. In addition, Prof. Wilkie assumes his final result without any evidence.

Prof. Wilkie claims that a five percent price increase to MCI's customers would be profitable because half of the lost customers would go to Verizon, and then claims that a five percent price increase to MCI's and Verizon's customers would cause "over a billion dollars of consumer harms per year."⁵⁸ This figure is primarily due to the assumed price

58. Wilkie, ¶44.

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increase to Verizon's customers to which Prof. Wilkie's analysis does not apply. That is, Prof. Wilkie never analyzes whether the merger would enable Verizon to raise prices to its own customers. As we have discussed, MCI's pre-merger decision to dramatically reduce marketing mass market services implies that it would cease to be a significant competitive factor in serving customers in the absence of the transaction, and so presumably the merger would not allow Verizon to "recapture" many customers if it attempted to raise price.

VI. OPPONENTS EXAGGERATE THE PROPOSED TRANSACTION'S EFFECT ON COMPETITION IN THE PROVISION OF INTERNET BACKBONE SERVICES.

A. OVERVIEW OF OPPONENTS' COMMENTS.

79. Several opponents claim that the proposed transaction will reduce competition for Internet backbone services. For example, ACN argues that:

[T]he undue concentration in the IP backbone market that the merger would produce creates a significant potential for harm.⁵⁹

Other commenters have made similar statements.⁶⁰ Opponents also cite the Department of Justice's complaint in the WorldCom/Sprint merger that a sufficiently large backbone might "tip" an Internet backbone services market.⁶¹ Opponents further claim that the merger will result in two "mega-peers," Verizon/MCI and SBC/AT&T, which will cause

59. Comments of ACN Communications Services, Inc., *et al.*, WC Docket No. 05-75, May 9, 2005 ("ACN"), p. 32.

60. Broadwing/SAVVIS, p. 37; Petition to Deny of Earthlink, Inc., WC Docket No. 05-75, May 9, 2005 ("Earthlink"), p. 10; CompTel/ALTS Petition to Deny, WC Docket No. 05-75, May 9, 2005 ("Comptel/ALTS"), p. 8.

61. Broadwing/SAVVIS, p. 44; Comptel/ALTS, p. 27.

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their rivals to “suffer degradation of the network and be forced to purchase transit or paid for peering at inflated, anti-competitive prices.”⁶²

B. THE PROPOSED TRANSACTION DOES NOT SIGNIFICANTLY REDUCE COMPETITION FOR INTERNET BACKBONE SERVICES.

80. The combined Internet traffic shares of Verizon and MCI today are smaller than MCI’s share alone was in previous years, including at the time of the Sprint/WorldCom merger.⁶³ The U.S. Department of Justice reported that MCI (UUNET) had a roughly 37 percent share of Internet traffic as of February 2000.⁶⁴ According to the Reply Declaration of Michael Kende, Verizon and MCI combined have a traffic share of less than 10 percent as of the 4th quarter of 2004. Furthermore, Verizon, MCI, SBC and AT&T combined have a traffic share of roughly 28 percent.⁶⁵ The fact that there was no “tipping” when MCI had a larger share than all four firms combined do today suggests that there would also be no “tipping” today due to two smaller firms created by the proposed transactions.

81. Furthermore, available evidence suggests that entry into the provision of Internet backbone services is relatively easy. Dr. Kende discusses, for example, how the decrease in the cost of inputs used by Internet connectivity providers, including the cost of long-haul fiber capacity, has allowed smaller backbones to expand. The various

62. Broadwing/SAVVIS, p. 37.

63. We understand that the available revenue data are not reliable. See Kende Reply Declaration.

64. U.S. Department of Justice, WorldCom/Sprint Complaint, June 26, 2000, ¶7.

65. Reply Declaration of Michael Kende.

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revenue and traffic share measures presented in the Kende declarations show substantial changes in shares (as well as entry) over time, again suggesting that “tipping” has not occurred and that entry is possible.

82. Opponents such as Broadwing/SAVVIS attempt to apply the “tipping” theory originally advanced by Cremer, Rey & Tirole (“CRT”) to multiple “mega-peers.”⁶⁶ However, the “tipping” theory referenced by these opponents did not contemplate multiple “dominant” firms. Indeed, the basic CRT model assumes only two firms, one of which is or will become “dominant.”⁶⁷ If multiple backbones are present, then, as CRT note, degrading connection quality with another backbone reduces both backbones’ quality relative to other backbones.⁶⁸ Thus, the “mega-peer” that degrades its connection with a smaller backbone will disadvantage itself relative to the other “mega-peer.” If “tipping” is a concern, then both “mega-peers” will have incentives not to disadvantage themselves relative to their rival.

66. Comptel/ALTS, p. 25; Broadwing/SAVVIS, p. 44.

67. Jacques Cremer, Patrick Rey & Jean Tirole, “Connectivity in the Commercial Internet,” *The Journal of Industrial Economics*, December 2000, (“Cremer, Rey & Tirole”), p. 448.

68. Cremer, Rey & Tirole, p. 435.

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B. OPPONENTS EXAGGERATE THE LIKELIHOOD AND COMPETITIVE IMPACT OF CHANGES TO PEERING ARRANGEMENTS.

83. As discussed earlier, opponents claim that the merged firms, as “mega-peers,” will either discriminate against one or all other Internet backbone providers, or will change their peering arrangements.⁶⁹

84. These claims were addressed by Prof. Marius Schwartz in his recent declaration on behalf of SBC and AT&T. As Prof. Schwartz explains, economic theory predicts that global degradation would not be profitable for the “mega-peers” given the shares observed since Verizon, MCI, SBC and AT&T collectively would have a traffic share of less than 50 percent.⁷⁰ As Dr. Kende notes, all four firms combined have a traffic share of less than 30 percent.⁷¹ With a share of less than 30 percent, global degradation or refusal to connect would harm the “mega-peers” relative to their rivals, which collectively have a larger share than the “mega-peers.”⁷² That is, global refusal to interconnect would deny the “mega-peers” access to more than seventy percent of Internet traffic, while other backbones would lose access to less than thirty percent of traffic. The “mega-peers” would thus be disadvantaged relative to other backbones.

85. Such a theory also assumes that the “mega-peers’ ” own customer base either cannot or will not act to counter this strategy. As Prof. Schwartz notes, companies

69. Broadwing/SAVVIS, p. 37.

70. Declaration of Marius Schwartz, WC Docket No. 05-65, May 7, 2005 (“Schwartz Declaration”), p. 9.

71. Kende Reply Declaration.

72. Schwartz Declaration, p. 9.

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such as cable providers have sufficiently large customer bases that they could foil such a strategy by diverting their traffic to backbones other than the “mega-peers.”

Furthermore, these companies would have strong incentives to foil a degradation strategy since it would result in higher prices for them, and would also disadvantage their own high-speed Internet access retail offerings relative to those of the “mega-peers.”⁷³

86. As a general matter, claims of “targeted” discrimination or denial of peering ignore the practical difficulties of such a strategy in a network such as the Internet.⁷⁴ The Internet, by its very nature, is designed to circumvent outages and obstacles. A “mega-peer” seeking to engage in targeted degradation would have to prevent the targeted backbone from reaching the mega-peer’s customers using transit purchased from another backbone provider that is peered with the “mega-peer.”⁷⁵

87. Furthermore, as noted in the Cremer, Rey & Tirole article and by Prof. Schwartz, a backbone which degrades or refuses to interconnect with another, smaller backbone causes both backbones’ quality to suffer relative to all of their other rivals. Thus, with a significant number of non-degraded rivals, “even a large relative size advantage over a rival is not sufficient to make targeted degradation profitable.”⁷⁶ As we have discussed, the Kende Reply Declaration reports that Verizon and MCI have a combined share of Internet traffic of less than 10 percent.⁷⁷

73. Schwartz Declaration, pp. 10-13.

74. Broadwing/SAVVIS, p. 46; Spitzer, p. 22.

75. Schwartz Declaration, pp. 16-17.

76. Schwartz Declaration, p. 17.

77. Kende Reply Declaration.

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88. Opponents also express concern that they might no longer be able to obtain payment free peering if some carriers see relative changes in their balance of traffic with the merged firm. As discussed above and by Prof. Schwartz, we see little competitive concern due to changes in the balance of traffic resulting from the proposed merger because of the existence of other backbones and easy entry. The fact that peering arrangements depend on traffic ratios does not, by itself, raise competitive concerns. Opponents themselves use precisely the same sorts of ratios when determining their own peering arrangements.⁷⁸ For example, Broadwing and SAVVIS require their peers to have certain minimum traffic levels, geographic reach, capacity and ratios of inbound to outbound traffic of no more than 2 or 2:5 to 1.⁷⁹ MCI currently allows up inbound to outbound ratios of up to 1.8 to 1 for its peers.⁸⁰

89. Settlement free peering, or exchange of traffic, is economically sensible when the relative costs to the two parties are similar.⁸¹ If the backbone providers' cost structures are sufficiently dissimilar, then companies would be expected to set up a payment mechanism, with the party imposing higher costs on the other paying the other party. In fact, we observe that companies such as Broadwing and SAVVIS will charge for transit or termination when costs are sufficiently asymmetric.⁸² We understand that

78. See also Schwartz Declaration, p. 16.

79. Broadwing/SAVVIS, p. 41.

80. Earthlink, p. 7; "MCI Policy for Settlement-Free Interconnection with Internet Networks, <http://global.mci.com/uunet/peering/>.

81. See Schwartz Declaration, pp. 18-19.

82. Broadwing/SAVVIS, pp. 41-42, setting forth the companies' requirements for peering.

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SAVVIS, for example, stopped peering with Verizon shortly after SAVVIS acquired Cable & Wireless USA.⁸³ Indeed, as Prof. Schwartz notes, failure to respond to changes in the relative costs of the parties would be inefficient.⁸⁴

VII. RESPONSE TO ADDITIONAL COMMENTS MADE BY OPPONENTS.

90. This section briefly responds to additional comments made by opponents and their experts in reference to our declaration that are not addressed above. Our failure to address any additional comments made by opponents or their experts should not be interpreted to imply that we agree with their particular claim.

Bernheim, ¶52

91. Prof. Bernheim states that “[a]nother problem with the Bamberger, Carlton, and Shampine (as well as Crandall and Sider’s [sic]) analysis of horizontal effects is that they fail to recognize the importance to many CLECs of originating and terminating MCI’s traffic. With MCI’s announced plans to migrate this traffic to Verizon’s network in-region, the transaction will further decrease the market share and financial strength of other carriers.”

92. There are several problems with Prof. Bernheim’s statement. First, he presents no support for the proposition that the loss of MCI traffic will harm carriers that serve MCI. Second, if the merger enables Verizon and MCI to realize efficiencies by moving traffic to each others’ networks, then it is not surprising, or troubling, that other

83. Reply Declaration of Robert Pilgrim, WC Docket No. 05-75, May 24, 2005.

84. Schwartz Declaration, pp. 18-19.

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firms may be disadvantaged in the competitive process. The appropriate focus of antitrust policy is consumer welfare, not the welfare of rival firms. Creation of a more efficient firm benefits society by improving resource allocation and also may benefit consumers.

Bernheim, ¶57

93. Prof. Bernheim claims that:

Whenever a transaction makes a very large competitor even larger, it raises significant competitive concerns, even if the change in its share would be relatively small. This view is in keeping with the Merger Guidelines, which acknowledge heightened concerns in such situations.

94. Prof. Bernheim mischaracterizes the Merger Guidelines' usage of concentration measures. The Guidelines do not conclude that transactions involving very large competitors always raise competitive concerns. Rather, the Guidelines state only that:

Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets [HHI greater than 1,800] post-merger potentially raise significant competitive concerns, depending on the factors set forth in Sections 2--5 of the Guidelines.⁸⁵

That is, the Department of Justice and Federal Trade Commission use the HHI concentration measure as a guide to determine which mergers require further analysis. As the Merger Guidelines recognize, there are many circumstances under which companies in a "highly concentrated" industry may not be able to raise prices following a merger.

85. U.S. DOJ and FTC, Horizontal Merger Guidelines, §1.51.

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Bernheim, ¶59

95. Prof. Bernheim states that “[o]n some secondary and tertiary routes to smaller cities, Verizon and MCI may be the only firms with transport facilities. The aggregated nationwide analysis of Bamberger, Carlton, and Shampine fails to address these overlaps.”⁸⁶

96. Prof. Bernheim presents no evidence to support his claims and identifies no specific routes that raise competitive concerns. Given the explosion of long distance fiber capacity in recent years by firms such as Qwest, Broadwing, Global Crossing, Level 3 and many others, it would seem to be difficult for Prof. Bernheim to argue that there are significant barriers to the deployment of new long distance fiber capacity.

CONCLUSION

97. Opponents make a wide variety of arguments regarding the effect of the proposed transaction on competition but present no data to support these claims. In the limited time available to prepare a response, we have used available data to analyze many of these claims. Based on this analysis, we find no empirical support for opponents’ concerns. The opposition comments do not lead us to alter our prior conclusion that the proposed transaction is unlikely to result in harm to consumers.

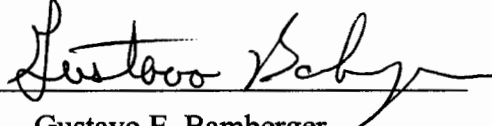
86. Bernheim, ¶59.

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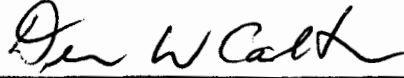
I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on May 23, 2005


Gustavo E. Bamberger

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on May 13, 2005

A handwritten signature in cursive script, appearing to read "Dennis W. Carlton", written in black ink.

Dennis W. Carlton

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on May 25, 2005



Allan L. Champagne