Dee May
Vice President
Federal Regulatory

EX PARTE OR LATE FILED

verizon

ORIGINAL

1300 I Street, NW, Suite 400 West
Washington, DC 20005

Phone 202 515-2529
Fax 202 336-7922
dolores.a.may@verizon.com

August 12, 2005

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Federal Communications Commission
Office of Secretary

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Ex Parte

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, S.W.
Washington, DC 20554

Re: **<u>Applications for Consent to Transfer of Control Filed by Verizon Communications Inc. and MCI, Inc., WC Docket No. 05-75</u>**

Dear Ms. Dortch:

On August 5, 2005, Verizon and MCI collectively filed comments in response to the New York State Department of Public Service Staff White Paper regarding the impact of the Verizon/MCI and SBC/ATT mergers on the New York consumers. (New York Department of Public Service Case 05-C-0237). Yesterday I provided copies to Tom Navin, Don Stockdale, Julie Veach, Bill Dever and Gail Cohen of the Wireline Competition Bureau.

A confidential version of this filing is also being made in the above proceeding. Please feel free to contact me with any questions.

Sincerely,

Dee May

Attachment

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List A B C D E

Robert P. Slevin
Associate General Counsel
Legal Department

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AUG 1 2 2005

Federal Communications Commission
Office of Secretary

verizon

Verizon New York Inc.
Room 3824
1095 Avenue of the Americas
New York, NY 10036

Phone 212 395-6390
Fax 212 764-2739
robert.p.slevin@verizon.com

August 5, 2005

BY HAND

Honorable Jaclyn A. Brilling
Secretary
New York Public Service Commission
Three Empire State Plaza
Albany, New York 12223

Re: Case 05-C-0237

Dear Secretary Brilling:

In accordance with the Notice Soliciting Comments on the Staff White Paper (issued July 6, 2005), enclosed please find an original and five (5) copies of the REDACTED VERSION of Petitioners' Comments on Department of Public Service Staff White Paper.

REDACTED versions of this filing are being served on the Active Parties List to this proceeding. PROPRIETARY versions are being served on Judge Liebschutz and any party that signs and returns Exhibit 1 to the Protective Order, as subsequently amended.

Respectfully submitted,

Robert P. Slevin

cc: Honorable Elizabeth A. Liebshutz (By E-Mail and By Hand)
Active Parties List (By E-Mail)

*** REDACTED VERSION ***

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AUG 1 2 2005

Federal Communications Commission
Office of Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of the Joint Petition of Verizon Communications Inc., and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction Over or, in the Alternative, for Approval of Agreement and Plan of Merger.	)	Case 05-C-0237

PETITIONERS' COMMENTS ON DEPARTMENT OF PUBLIC SERVICE STAFF WHITE PAPER

Of Counsel:

SCOTT H. ANGSTREICH
Kellogg, Huber Hansen, Todd Evans & Figel, P.L.L.C.
Sumner Square
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
202-326-7900

SANDRA DiIORIO THORN
ROBERT P. SLEVIN
1095 Avenue of the Americas
New York, New York 10036
212-395-6390

Counsel for Verizon Communications Inc.

LAURA GALLO
200 Park Avenue
New York, New York 10166
212-519-4436

Counsel for MCI, Inc.

Dated: August 5, 2005

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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Joint Petition of	)	
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Verizon Communications Inc., and	)	
MCI, Inc.	)	**Case 05-C-0237**
	)	
for a Declaratory Ruling Disclaiming	)	
Jurisdiction Over or, in the Alternative,	)	
for Approval of Agreement and Plan	)	
of Merger.	)	
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PETITIONERS' COMMENTS ON
DEPARTMENT OF PUBLIC SERVICE STAFF
WHITE PAPER

Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI") (collectively, the "Petitioners") hereby submit these comments in response to the Department of Public Service Staff ("Staff") White Paper (the "White Paper").

I. PRELIMINARY STATEMENT

The White Paper "presents *preliminary analyses* and *tentative conclusions* about the impact of [the Verizon/MCI and SBC/AT&T] mergers on New York consumers."[1] Although Staff forthrightly acknowledges that its preliminary analyses are based on incomplete information, Staff nevertheless tentatively concludes that the Verizon/MCI transaction will impact what it describes as the "markets" for residential and small business customers (the "mass market"), for medium and large business customers (the "enterprise market"), and for wholesale services (such as transport and special access services). Believing that the transaction will result

[1] White Paper at 4.

in a competitively significant increase in market concentration, as measured in most cases by the Herfindahl-Hirschmann Index (or "HHI"), Staff offers for the parties' consideration and comment a number of remedies ostensibly designed to address the harms that Staff believes might flow from this increased concentration. As described more completely below, Staff's preliminary analyses in fact are fundamentally flawed in numerous material respects and all of its suggested remedies are unnecessary, prohibited by law and contrary to sound public policy in a rapidly changing communications industry, and therefore, should not be adopted.

As a general matter, Staff's analyses of the various "markets" are internally inconsistent and contradictory. For instance, Staff on the one hand acknowledges (accurately and often) that "there is significant mass market intermodal competition providing voice and data alternatives in most parts of New York,"[2] yet on the other fails to account for much or all of this competition when analyzing the transaction's effect on mass market competition. Staff also acknowledges that an HHI analysis "is not the sole criterion that should be examined in a merger review."[3] And yet Staff's tentative conclusions that the transaction will harm mass market, enterprise and wholesale customers because it will increase concentration in the markets for those customers are premised almost *entirely* on Staff's HHI analyses of those "markets." Moreover, despite its admission that the data used in the analyses are incomplete and in some respects inaccurate, Staff relies on those data as if they were complete and accurate. These errors render Staff's analyses of the transaction's effect on competition nearly meaningless. They also render unnecessary the various remedies Staff suggests might be needed to address the harms that the flawed analyses indicate would result from the transaction.

[2] *Id.* at 5.

[3] *Id.* at 16.

Staff's suggested remedies should be rejected for other reasons as well. Most of the suggestions are beyond the Commission's authority to adopt, and not merely because the Commission has no jurisdiction to review the transaction or to impose conditions on its approval.[4] The remedies either relate to interstate services provided under federal tariff or contract or they would, if adopted, require Verizon to take action that is inconsistent with the Telecommunications Act of 1996 (the "1996 Act"), as authoritatively construed by the Federal Communications Commission (the "FCC") and the federal courts. Moreover, many of Staff's suggested remedies are unnecessary in that they purport to address problems that do not currently exist and that will not arise as a result of the transaction. Adopting such remedies would impose unreasonable burdens on Verizon New York at a time when its financial condition is already suffering from the effects of the very competition that makes the transaction necessary and that protects against the kinds of harms that Staff tentatively – and erroneously – concludes will result from the transaction.

In the discussion that follows, Petitioners demonstrate the various flaws in each of Staff's preliminary analyses of the transaction's effect on competition. Petitioners show that there is no factual basis for Staff's tentative conclusions that the transaction will affect competition in a way that requires adoption of competitive remedies. And Petitioners show why the remedies themselves are either inappropriate, unnecessary, or both, such that the Commission should reject them entirely.[5]

[4] *See* Section V, *infra.*

[5] Along with these Comments, Petitioners are also providing Comments prepared by Gustavo E. Bamberger, Dennis W. Carlton and Allan L. Shampine, economists from Lexecon. The Lexecon Comments support these Comments and are annexed as Exhibit 1.

II. STAFF'S PRELIMINARY ANALYSES OF THE TRANSACTION'S EFFECT ON COMPETITION ARE FLAWED AND PROVIDE NO BASIS FOR ADOPTING REMEDIES FOR PURPORTED COMPETITIVE HARMS

The White Paper discusses Staff's preliminary views of the transaction's potential impacts on competition in New York for several customer segments – specifically, the mass market, the enterprise market and the wholesale markets for transport and special access and high-capacity loops. The White Paper's preliminary analysis of each segment is fundamentally flawed in numerous material respects. First, with respect to virtually all of the segments, Staff improperly uses HHI calculations as its sole criterion for gauging the transaction's possible effects on competition. The HHI calculation was never intended to be – and, when used by the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), is not – the sole criterion, and in fact is of little (if any) use in evaluating a rapidly changing market.

Second, aside from the flaws inherent in Staff's reliance on HHI calculations, Staff's calculations are fundamentally flawed in numerous material respects. They are based on incomplete and stale data, rendering the calculations worthless as predictions of the effect of this transaction on competition. As discussed in the sections below, none of Staff's analyses provides any basis for adopting any of the remedies that Staff offers for consideration. Moreover, the specific remedies about which Staff has sought comment are flawed for numerous reasons, including that they would exceed the Commission's jurisdiction, cause unwarranted customer disruption, or address matters that are unrelated to this transaction.

A. HHI Analysis Cannot Be Applied Mechanically To The "Markets" Defined By Staff Here

1. HHIs Do Not Provide, And Are Not Used By The Federal Agencies That Review Mergers As, Conclusive Evidence Of Competitive Harms From A Transaction

Staff's preliminary analysis places far more weight on its HHI calculations than is warranted under either economic theory or actual DOJ and FTC practice. Although Staff appears to recognize the inherent limitations of the HHI review,[6] it nevertheless tentatively concludes, time and again, that the transaction "warrant[s] further review" and "requires countervailing remedies" because – and *only* because – Staff calculated "an increase in [HHI] . . . [that] exceeds the threshold levels in the DOJ/FTC Guidelines."[7] HHI calculations, however, cannot soundly be relied upon in such a mechanical manner, even in such a preliminary analysis.

The HHI – or Herfindahl-Hirschmann Index – is seductive because it is an apparently simple arithmetic calculation, summing the squares of the market shares of the various firms in the market.[8] But as the leading antitrust treatise explains, "the HHI should always be used tentatively," because "although the HHI appears to give definitive answers to how markets respond to increasing variations in the number and size disparities among firms, such responses are in fact far more complex and depend on" a variety of other factors.[9]

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[6] Staff expressly recognized that an "HHI review is not the sole criterion that should be examined in a merger review." *Id.* at 16. Staff, moreover, correctly stated that any "presumption" of competitive harm that might arise from HHI review "could be overcome" based on "factors affecting the competitiveness of the market," including the extent of "[e]ntry barriers and current trends in the market." *Id.* And Staff also acknowledged that "[a]ny anticompetitive impact of the merger[] must be balanced" against the "benefits" from the transaction. *Id.* at 12.

[7] *Id.* at 29, 32; *see id.* at 25-26, 30, 37. Although Staff did not perform HHI calculations when it considered the effect of the transaction on special access and high-capacity loops, its consideration of that segment is flawed for other reasons, as discussed below.

[8] Thus, for example, if there is only one firm in the market, with a 100 percent market share by definition, the HHI is 10,000 (100 x 100); if there are five equal-sized firms, the HHI is 2000 (20 x 20 x 5); if there are five firms, one with 40 percent and four each with fifteen percent, the HHI is 2500 ((40 x 40) + (15 x 15 x 4)).

[9] P. Areeda *et al.*, IV *Antitrust Law* ¶ 930b at 136-37 (1998).

Not surprisingly, the DOJ's and FTC's Horizontal Merger Guidelines ("Guidelines"), on which the White Paper relies heavily in drawing conclusions from its HHI calculations, suggests only a limited role for HHI calculations, as merely "an aid to the interpretation of market data."[10] More important, since the Guidelines were issued, HHIs "have, if anything, become *progressively less significant*," as FTC Commissioner Thomas Leary explained in 2002.[11] In a similar vein, Lawrence Fullerton, then-Deputy Assistant Attorney General for Antitrust at DOJ, said in 1996 that DOJ does "not approach merger analysis mechanistically" and that, after defining markets and assessing market concentration, DOJ then determines "whether anticompetitive effects are likely, given the[] concentration levels and other characteristics of the market."[12]

The deemphasizing of simple arithmetic calculations in merger analysis is not just a matter of words. It is plainly reflected in the enforcement decisions of the federal antitrust agencies, in both Democratic and Republican administrations. A study of DOJ and FTC merger challenges from 1999 to 2003 confirms that "a gap exists between the Merger Guidelines as written and actual enforcement practice."[13] So when Cingular and AT&T Wireless merged, DOJ sought remedies only with respect to a handful of 450 Component Economic Areas and Cellular Market Areas where strict application of the HHI thresholds identified suggested that the merger warranted further scrutiny.[14] And those few areas had post-merger HHIs that "range[d] from

[10] Guidelines § 1.5.

[11] Thomas B. Leary, The Essential Stability of Merger Policy in the United States (Jan. 17, 2002) (emphasis added).

[12] Lawrence R. Fullerton, *Recent Developments in Merger Enforcement* (Mar. 13, 1996).

[13] John Kwoka, *Some Thoughts on Concentration Market Shares, and Merger Enforcement Policy* at 7, presented at FTC/DOJ Workshop on Merger Enforcement (Feb. 14, 2004).

[14] See Final Judgment at 3-7, United States v. Cingular Wireless Corp., No. 04-CV-1850 (D.D.C. Nov. 3, 2004); see also Memorandum Opinion and Order, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corp., For Consent to Transfer Control of Licenses and Authorizations, 19 FCC Rcd 21522, ¶¶ 104, 110 (2004)

(continued . . .)

approximately 4400 to more than 8000, with increases in the HHI as a result of the merger ranging from approximately 1100 to more than 3500."[15]

In short, there is no basis in economic theory, antitrust law, or the enforcement policies of the expert federal antitrust enforcement agencies for treating HHI calculations as more than one of many relevant factors in assessing the competitive significance of a merger. The White Paper is fundamentally flawed because it gives virtually dispositive weight to such calculations.

2. HHIs Are Especially Inapt Predictors Of The Effects Of A Merger In Rapidly Changing Markets

Even aside from the fact that the White Paper places far too much weight on its HHI calculations, there is little reason to believe that HHI calculations provide any probative information in the communications markets defined by Staff here. That is because the HHIs that Staff calculated reflect the *past* while the question concerning whether a transaction will injure competition is necessarily predictive and *forward-looking*.

Therefore, to be relevant to any antitrust issues raised by a transaction, HHI calculations and other measures of concentration must enable a comparison of the market structure that will exist after the merger with that which would exist in the future absent the merger.[16] Indeed, for this reason the DOJ/FTC Guidelines state that the shares used to calculate HHIs should

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(. . . continued)

("AT&T Wireless-Cingular Order"). The FCC similarly found that remedies should be imposed with respect to very few of the markets identified through HHI calculations as warranting further investigation. See id. ¶ 184 ("we have concluded that, as a general matter, even the markets identified for further review by our preliminary HHI and spectrum analysis are unlikely to suffer anticompetitive effects as a result of the merger"). And, where the FCC did impose remedies, it did so only after an extensive and detailed analysis. See id. ¶¶ 193-200 & App. D.

[15] Competitive Impact Statement at 11, *United States v. Cingular Wireless Corp.*, No. 04-CV-1850 (D.D.C. filed Oct. 29, 2004).

[16] *See* Guidelines § 0 ("[T]he picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines.").

themselves "be calculated using the best indicator of firms' *future* competitive significance."[17] For many mergers, analysis of the structure and performance of the market in the recent past provides a sound basis for predicting the structure and performance of the market in the future. For such mergers, HHI and other data from the recent past serve, in effect, as proxies for a more direct examination of likely future attributes of the market.

In other situations, however, past is not prologue. Where markets are characterized by rapid technological or other changes, or individual firms are either declining or rising rapidly, sound merger analysis requires either that past data not be used for calculations of market structure or that calculations based on such data be used for only limited and tentative purposes.

The Verizon/MCI transaction presents just such a situation. As described in detail in Petitioners' Reply Comments, submitted on May 13, 2005, technological changes are profound and rampant. Old-fashioned voice telephony over twisted-pair copper wire – the core of Verizon's business to date – is becoming obsolete. New wireless, cable, and Internet technologies are rapidly gaining customers who leave the public switched telephone network altogether. Technological and regulatory changes are making the core of MCI's mass-market local and long-distance businesses no longer viable. New firms – wireless providers, cable providers (whether offering circuit-switched or VoIP service), and unaffiliated VoIP providers – are making major inroads into the telephony market.

In these circumstances, it is unsound to rely on HHI calculations that are based entirely on data about the past, and to ignore these changes in the market. It is simply incorrect to say, as the White Paper does, that "market concentrations, measured by HHIs, are traditionally

[17] *Id.* § 1.41 (emphasis added).

calculated based on current data, not projected data."[18] HHI calculations are based on "forward-looking" shares – that is, the shares that would prevail in the absence of the proposed transaction.[19] And there is certainly no sound basis – in law, economics, or public policy – for calculating HHIs, and basing competitive analysis, on *past* data that is already so patently obsolete. The White Paper is thus also fundamentally flawed because it relies on a backward-looking analysis when the market is in the midst of a period of rapid and profound change.

Staff's focus here on the past stands in stark contrast to the Commission's views expressed in other proceedings. Thus, in comments to the FCC, this Commission urged that agency to "recognize current market conditions by expressly placing substantial weight on intermodal competition."[20] More recently, the Commission acknowledged that consumers in New York "are already benefiting from a vigorous marketplace and have considerable choice," as "[i]ntermodal forms of competition are quickly gaining acceptance in the marketplace and thus are creating substantial facilities-based competition."[21] The Commission further acknowledged that "[t]echnical changes require that the Commission again re-examine the way it regulates telecommunications services."[22] Although the Commission is properly looking to the future (even in the context of this transaction), Staff's preliminary analysis of the transaction remains mired in the past.[23]

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[18] White Paper at 24.

[19] *See* Guidelines § 1.521.

[20] Comments of the New York State Department of Public Service at 4, WC Docket No. 04-313, CC Docket No. 01-338 (FCC filed Oct. 4, 2004).

[21] Case 05-C-0616, Order Initiating Proceeding and Inviting Comments (June 29, 2005), at 1 ("*Intermodal Services Proceeding Order*").

[22] *Id.* at 3.

[23] Indeed, as explained further below, Staff's rationales for excluding consideration of intermodal competition, *see* White Paper at 22-24, cannot be squared with this Commission's own determination that intermodal competition has brought New Yorkers the benefits of robust, facilities-based competition.

B. Staff's HHI Calculations And The Remedy Proposals Derived From Those Calculations Are Fundamentally Flawed

Even where HHI calculations can provide useful information in analyzing a transaction, it is essential that the calculation be performed correctly. As the leading antitrust law treatise explains, use of the HHI "places a premium on accuracy in market definition" and on calculating the shares of the companies in that market.[24] That is because the "squaring" of market shares that constitutes the calculation of the HHI "exaggerates any error that may have been committed in initial measurement [of market shares], especially of larger firms"[25] As a result, the "HHI of a poorly defined market can yield *gross errors* in prediction."[26] As shown below, that is precisely what happened here. Staff's calculations of HHIs are based on incomplete data and improper market definitions, rendering the calculations worthless as predictions of the effect of this transaction on competition, even aside from the flaws in the use of HHI discussed above.

1. This Transaction Will Not Reduce Competition For Mass-Market Customers

a. Staff Fails To Give Proper Weight To The Irreversible Decline Of MCI's Mass-Market Business

The assumed elimination of MCI as a competitor for mass-market customers will have no material effect on the mass market competition that already exists in New York, particularly given the pervasiveness and growth of intermodal competition which will not be impacted in any way by the transaction. As an initial matter, it is noteworthy that the Commission's conclusion in early 2004 that 85% of Verizon's mass-market customers already have a "robust mixture[]" of competitive choices assigned no weight at all to MCI's UNE-P offering to mass-market

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[24] Areeda, *supra* note 9, ¶ 929d, at 129.

[25] Id.

[26] *Id.* ¶ 930b, at 136 (emphasis added).

customers in New York.[27] Accordingly, the elimination of MCI as a competitor could have no effect on the extent of competition in those wire centers, and any hypothetical price increases by the combined company would only accelerate the flight of customers to these competitive choices. MCI *is essentially distributing* Verizon's *services when it uses a commercially* negotiated replacement for UNE-P to provide local service, and courts have recognized that pure reselling is "more akin to mere 'substitution' than to competition," and therefore of little, if any, competitive significance in antitrust analysis.[28]

But regardless of the merger, MCI's mass-market business is in a continuing and irreversible decline. As a result of numerous factors – including the elimination of the UNE Platform, state and federal "Do Not Call" legislation, and increased competition from wireless, cable and other intermodal competitors – MCI made the decision, unrelated to this transaction, to manage the decline of its mass-market business and to shift its business focus elsewhere. Indeed, MCI's national mass-market revenues shrank by **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** from 2003 to 2004. In the first quarter of 2005, MCI's reported mass-market revenue was down **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** from the same period one year earlier. In New York, MCI's residential local access line count fell from a peak of **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in May 2004 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in June 2005. MCI monthly *net* losses in May and June 2005 averaged more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** mass-market local access lines.

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[27] Intermodal Services Proceeding Order at 9.

[28] *Almeda Mall, Inc. v. Houston Lighting & Power Co.*, 615 F.2d 343, 353 (5th Cir. 1980); *see Hypoint Tech., Inc. v. Hewlett-Packard Co.*, 949 F.2d 874, 878 (6th Cir. 1991) (a mere reseller is a "'non-competitive middleman'").

These losses are due, in part, to the fact that MCI has increased the cost of its mass-market offerings. More specifically, MCI increased its property tax surcharge from 1.4 percent of interstate usage to 2.3 percent, imposed a paper billing charge of $.99 and imposed a carrier access charge of $1.90 in every state in the nation. In addition, MCI's Neighborhood Unlimited is substantially more expensive than competing plans from Time Warner ($39.95) and Cablevision ($34.95).

MCI's current business plan is to manage – rather than embark on the futile effort to reverse – this decline.[29] To that end, MCI's marketing efforts have been slashed dramatically. Telemarketing is down **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**, from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours per month at its peak to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours per month in May 2005. Telemarketing in New York is also down from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours in July 2002 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours in May 2005. MCI has closed **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** call and customer service centers, cutting its number of such centers 55 and 46 percent, respectively. MCI also cut its mass-market employee base by roughly two-thirds, from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in January 2002 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in February 2005. MCI's spending on direct mail, print, and media advertising have all declined precipitously, from more than **[BEGIN CONFIDENTIAL]**

[29] Like dozens of other CLECs, MCI has entered into a commercial agreement with Verizon under which Verizon will provide MCI with end-to-end wholesale voice services. This agreement permits MCI to continue to manage its mass-market voice business consistent with its business plan. MCI has entered into similar commercial agreements with each of the RBOCs. Had Verizon and MCI not reached such an agreement, federal law would have required that all of MCI's existing UNE-P customers be migrated to much more expensive resale service no later than March 11, 2006.

[END CONFIDENTIAL] per month in early 2003 to just over **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in April 2005.

Because MCI's mass-market business is in a continuing and irreversible decline and because intermodal competitors such as cable, wireless, and VoIP providers already are providing the most significant competition to mass market customers, the elimination of MCI as an independent competitor through this transaction is of no import in standard merger analysis.[30] Staff, however, claimed that MCI "would continue to be a mass market competitor to Verizon but for the merger," based on its view that "it does not appear that MCI, for at least the short term, had a concerted plan to quickly exit the market post UNE-P."[31] Staff, however, asks the wrong question. The relevant inquiry is not whether MCI would have been *a* competitor in the mass market or whether MCI would completely exit the market in the near future, but instead whether the transaction is "likely to substantially lessen competition."[32]

The possibility that MCI might have remained in the mass market for some period of time using "wireline resale or . . . a VoIP platform," as Staff suggests,[33] is hardly an answer to that question. MCI, in that capacity, would merely be one of many resellers or VoIP providers – two modes of competition with extremely low barriers to entry – with no unique capabilities not found among the dozens of existing resellers and VoIP providers. But for the merger, moreover, MCI's business plan would not be subjected to the kind of regulatory scrutiny undertaken by Staff in its White Paper; nor would the Commission be micromanaging MCI's business decisions. The Commission should avoid micromanaging MCI's business plan now.

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[30] *See, e.g.,* Guidelines § 5.0.

[31] White Paper at 25-26.

[32] Guidelines § 0.1.

[33] White Paper at 20.

In any event, the evidence that led the Staff to dispute MCI's statement that its mass-market business is in a continuing and irreversible decline does not contradict that statement. First, Staff noted that "MCI's new customer additions show little sign of abating."[34] In fact, MCI's monthly gross additions are declining substantially – MCI added only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** new residential local access lines in New York in June 2005, less than half of the **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines it added in April 2004. The total number of MCI customers is also declining. For example, in New York, MCI's total residential local access line count fell by more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines from June 2004 to June 2005, *despite adding* more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines during that same period. Such declines are the inevitable result of marketplace and regulatory changes that have forced MCI to recognize that its only option is to try to manage the continuing decline of its mass market business.

Nor will MCI's limited trial of VoIP service, initiated in June 2005,[35] reverse MCI's mass-market fortunes or make it one of a small group of most significant competitors. Indeed, MCI not only is behind others that entered the market months or years ago, but also is *reselling* another provider's VoIP service and customer premises equipment, which demonstrates that MCI has no unique capabilities in the mass-market provisioning of VoIP service. In addition, MCI expects a limited number of sales based on its limited amount of marketing, and its preliminary findings are that both outbound telemarketing and sales through inbound calls have

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[34] *Id.*

[35] Thus, there is no conflict between Petitioners' statement in their February and May 2005 filings with the Commission. *See id.* at 25 n.64.

not been efficient means of customer acquisition, especially in light of the current Do-Not-Call restrictions.[36]

b. Staff's Analysis Ignores Intermodal Competition

In assessing the effect of this transaction on the retail mass-market segment, the Staff performed "two analyses" – "both [of which] rely on HHI calculations."[37] In both cases, however, the data set that Staff reviewed contained information on *wireline* competition only, ignoring the intermodal options that this Commission has recognized are "creating substantial facilities-based competition" for mass-market customers in New York.[38] In addition, the wireline data in both data sets were incomplete – the data sets were outdated and did not contain information on all wireline competitors for mass-market customers. For these reasons, and as explained in detail in Section II.B.1.b below, the HHI calculations Staff performed provide no basis for its conclusion that this transaction will "result[] in a significant increase in the concentration of providers in the mass market."[39]

The record here is replete with evidence that intermodal competition for mass-market customers already is transforming – and will continue to transform – competition for these customers. This includes competition from cable companies such as Cablevision and Time Warner, which have for some time been offering cable telephony and are now aggressively offering VoIP in conjunction with their cable modem service. Cablevision, RCN, and Time Warner already offer telephony to all the homes they pass in the state.[40] Although state-specific

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[36] In New York, MCI has made only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** sales since the limited VoIP trial began.

[37] White Paper at 19.

[38] Intermodal Services Proceeding Order at 1.

[39] White Paper at 25.

[40] *See* Petitioners' Reply Comments at 8 (Table 1).

data are unavailable, Time Warner added 150,000 net new subscribers in the first quarter of 2005, while Cablevision added nearly 100,000 during that period.[41] Indeed, analysts have ascribed Verizon's "worse-than-peer access line trend" to the presence in its territory of these cable companies, and expect that Verizon "is again likely to lead the access line declines" in 2005 among incumbent carriers.[42]

Intermodal competition is likewise provided by VoIP providers unaffiliated with a broadband provider, such as Vonage, Skype, Packet8, and AT&T. These VoIP providers are also making serious inroads into the mass market, with Vonage signing up 15,000 customers per week and all such providers adding 400,000 subscribers per quarter.[43]

Considering all of this, the Commission has recognized that VoIP is "widely available in New York" and that "95% of New Yorkers" already have access to the "broadband capability necessary to avail themselves of VoIP telephony."[44] Staff likewise acknowledged that VoIP is an "increasingly viable alternative to traditional wireline services" and that its market penetration is "expect[ed] . . . to accelerate,"[45] yet it gave virtually no weight to VoIP in its assessment of the effect of this transaction on competition for mass-market customers. That failing cannot be

[41] *See* Thomson StreetEvents, *TWX – Q1 2005 Time Warner Inc. Earnings Conference Call,* Conference Call Transcript at 3 (May 4, 2005); Cablevision Presentation at the Deutsche Bank Securities Media Conference at 29 (June 6, 2005), available at http://library.corporate-ir.net/library/10/102/102703/items/154595/deutsche_final.pdf.

[42] J. Halpern et al., Bernstein Research Call, US Telecom 1Q05 Review: Broadband, Wireless Growth Highlight Positives; Access Lines Start to Show VoIP Impact at 4 (May 9, 2005); David Barden et al., Banc of America Securities Research Brief, Setting the Bar: Establishing a Baseline for Bell Consumer Market Share at 2 (June 14, 2005) ("We believe Verizon, facing Time Warner and Cablevision, has been most affected, both as a company and as a stock, by the presence of VoIP competition in its territory.").

[43] Vonage Press Release, *Vonage Contracts with Verizon for Nomadic VoIP E9-1-1 Service* (May 4, 2005); Viktor Shvets & Andrew Kieley, Deutsche Bank, *VoIP: State of Play* at 4, 6 (June 22, 2005).

[44] Intermodal Services Proceeding Order at 8.

[45] White Paper at 23.

squared with either the state of the market today or with the forward-looking view necessary for review of this transaction.[46]

Competition also comes from wireless service, which is "almost ubiquitously available in New York and exhibit[s] very high subscription rates."[47] Wireless competes – and therefore disciplines prices for circuit-switched, wireline service – in two ways. First, there is what this Commission correctly characterized as "growing evidence" that consumers – "especially [the] younger ones" that grew up accustomed to wireless phones – "are willing to forego wireline telephone service, relying solely on wireless."[48] As of year-end 2004, analysts estimate that 7 to 8 percent of wireless users had given up their landline phones altogether.[49] The figures are higher for customers under 24 (18 percent) and between the ages of 25 and 34 (9.6 percent),[50] suggesting that cutting the cord will increase going forward. Indeed, a recent survey found that nearly 40 percent of respondents are likely to give up their wireline phone in favor a wireless

[46] Staff downplayed the importance of cable VoIP providers because they had not reported June 2004 data to the FCC and ignored other VoIP providers because they purportedly "ha[d] not penetrated the [mass] market enough" as of March 2005. White Paper at 22 & n.55. But the relevant question is not the extent of competition five or fifteen months ago – it is the extent of competition that can be expected in the future. As to that question, there can be no serious dispute that VoIP is a major and growing competitor that will be unaffected by this transaction.

[47] Intermodal Services Proceeding Order at 7.

[48] *Id.* at 7.

[49] Michael Balhoff, Managing Director, Telecommunications Group, Legg Mason, Prepared Witness Testimony Before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004); Adam Quinton, Managing Direct & First Vice President, Co-Head of Global Telecom Services Research, Merrill Lynch, Prepared Witness Testimony Before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004); B. Bath, Lehman Brothers, *Final UNE-P Rules Positive for RBOCs* at Figure 2 (Dec. 10, 2004); D. Barden *et al.*, Banc of America Securities, *Setting the Bar: Establishing a Baseline for Bell Consumer Market Share* at 1 (June 14, 2005). One analyst puts the number even, higher, stating that "[b]etween 10% and 15% of the total market is now using wireless exclusively." *Dialing into Wireless Stocks; As Wireless Builds Momentum Against Wireline, S&P's Kenneth Leon Points to the Best Companies in Service and Equipment*, Business Week Online (Mar. 10, 2005).

[50] *See* Household Telephone Service and Usage Patterns in the United States at 23; *see also* F. Louthan *et al.*, *VZ, SBC, BLS, Q: Cable Threat Comparison for RBOCs* at 2 (July 11, 2005) (citing households headed by people 24 and under as well as 1-2 person households as likely candidates for wireless substitution).

phone in the next two years.[51] Staff discounted this substitution – and gave no weight to wireless in its analysis of the mass market – based on two older FCC reports and a news article stating that the pace of wireline customers cutting the cord for wireline service is not "accelerating as quickly as many experts predicted."[52] Yet, even assuming the news article is correct that displacement of wireline lines by wireless lines is not growing as fast as predicted, none of the evidence to which Staff points refutes the fact that wireless displacement is growing and is expected to continue to do so, or justifies Staff's absolute exclusion of wireless competition from its analysis.

Nor does Staff consider the extensive displacement by wireless *minutes* of formerly revenue-generating wireline minutes. Wireless traffic was estimated to account for approximately 30 percent of all voice minutes in 2004, and as much as 60 percent of long distance calls.[53] The ability of customers to replace wireline calls with wireless calls on a call-by-call basis thus also disciplines pricing for wireline services. Indeed, a recent analysis found that a 1 percent wireline price increase would result in a nearly 2 percent increase in wireless demand.[54]

Finally, Staff failed to consider how the mere availability of wireless service constrains wireline pricing. If the price of wireline service were to increase to anti-competitive levels, wireline customers can move to use wireless service (or any other mode of communication such

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[51] HarrisInteractive, Consumers and Communications Technologies: Current and Future Use at 11 (June 29, 2005).

[52] White Paper at 23-24 & n.58.

[53] *See* David Janazzo *et al.*, Merrill Lynch, *The Next Generation VIII: The Final Frontier?* at 5 (Mar. 15, 2004); Philip Marshall *et al.*, The Yankee Group, *Divergent Approach to Fixed/Mobile Convergence* at 7 & Exh. 4 (Nov. 2004).

[54] See Stephen B. Pociask, Competitive Enterprise Institute, Wireless Substitution and Competition: Different Technology but Similar Service – Redefining the Role of Telecommunications Regulation at 15 (Dec. 15, 2004).