The dormant Commerce Clause protects the right to engage in interstate commerce such as the interstate merger at issue here, free from unduly burdensome state regulation. The Commerce Clause was adopted in order to foster "the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce." *Healy v. The Beer Institute,* 491 U.S. 324, 335-36 (1989). As a consequence, "it has been settled for more than a century that the Clause prohibits States from taking certain actions respecting interstate commerce even absent congressional action." *CTS Corp. v. Dynamics Corp. of Am.,* 481 U.S. 69, 87 (1987). And it is equally well settled that "[a]ll objects of interstate trade merit Commerce Clause protection" under the dormant Commerce Clause. *Philadelphia v. New Jersey,* 437 U.S. 617, 622 (1978).

The Supreme Court's dormant Commerce Clause jurisprudence establishes a number of constraints on the power of states to impose direct or indirect burdens on interstate commerce. For example, "'[w]hen a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, [the Court] ha[s] generally struck down the statute without further inquiry. When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, [the Court] ha[s] examined whether the state's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.'" *Healy v. The Beer Institute,* 491 U.S. at 337 n.14 (quoting *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 579 (1986)). Moreover, the Supreme Court's "recent Commerce Clause cases also have invalidated statutes that may adversely affect interstate commerce by subjecting activities to inconsistent regulations." *CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. at 88; *see Healy*, 491 U.S. at 336-37 ("the Commerce Clause protects against inconsistent legislation arising from the projection of

one state regulatory regime into the jurisdiction of another state"). And it is well settled that "the 'Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State.'" *Healy*, 491 U.S. at 336 (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982) (plurality opinion)); *see Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. at 584.

In addition, the "remedies" suggested by the parties are so burdensome, and so untethered to any legitimate state interest that may be affected by the transaction, that their imposition would be precluded even if they could be characterized as merely "incidental" burdens on interstate commerce. Under *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970), and its progeny, "[w]here [a] statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits." Under this test, the first inquiry is whether "a legitimate local purpose is found" to support the regulatory burden. *Id.* at 142. If such a legitimate purpose exists, "then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities." *Id.*

The State of New York no doubt has a legitimate interest in ensuring that its citizens have access to reasonably priced, competitive, high quality telecommunications services. That legitimate interest, however, cannot support the heavy burden that Staff's proposed "remedies" would impose on the proposed merger. The record in this proceeding fails to substantiate Staff's conclusory assertions that the merger will lead to higher rates or poorer quality for *any* services than would otherwise be the case if Verizon had decided not to acquire MCI. In the absence of

such a showing, any claim that the proposed remedies are justified by legitimate local concerns created by the merger is implausible, and must be dismissed as a subterfuge. *See Chemical Waste Management, Inc. v. Hunt,* 504 U.S. 334, 343 n.5 (1992) *(Pike* test authorizes state regulation only where, *inter alia,* valid '"legislative objectives are *credibly* advanced"') (emphasis added). *Hughes v. Oklahoma,* 441 U.S. 322, 336 (1979) ("when considering the purpose of a challenged statute, this Court is not bound by '[the] name, description or characterization given it by the legislature or the courts of the State,' but will determine for itself the practical impact of the law").

Moreover, even if Staff's proposed remedies (which are obviously nothing more than conditions they urge the Commission to impose in exchange for approval of the merger) could be found to advance legitimate local interests to some degree, those interests could plainly "be promoted as well with a lesser impact on interstate activities." *Pike v. Bruce Church. Inc.,* 397 U.S. at 142. Rather than targeting an interstate merger involving Delaware corporations and thousands of out-of-state stock transactions, the Commission could instead exert its regulatory efforts to ensure that competition continues to grow in the New York communications market. No legitimate justification exists for erecting costly, state-created hurdles to consummation of the merger, and the Commerce Clause (even under the *Pike* balancing test) therefore precludes any such governmental action.[225]

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[225] In Petitioners' view, of course, the *Pike* balancing test would be inapplicable to a Commission order imposing conditions on approval of the merger, because such an order could not properly be characterized as involving nothing more than "incidental" effects upon interstate commerce. *See Pike*, 397 U.S. at 142. The proposed merger is unquestionably interstate commerce in itself, and thus an order imposing conditions on consummation of the merger would target *only* interstate commerce. *See Chemical Waste Management, Inc. v. Hunt,* 504 U.S. 334, 343 n.5 (1992) (applying strict scrutiny rather than *Pike's* balancing test because "[w]e find no room here to say that the Act presents 'effects upon interstate commerce that are only incidental,' for the Act[] . . . on its face targets *only* out-of-state" materials) (emphasis added).

VI. CONCLUSION

This transaction is occurring at a time when the industry is undergoing unprecedented change. Technological developments have enabled cable companies and wireless carriers to provide a full suite of services that include voice, data, and even video services using their own networks. Other competitors, such as Internet and broadband services providers and VoIP providers, use the Internet to provide communications services. The merger of Verizon and MCI will do nothing to alter this transformation but represents an appropriate response to it.

While Staff recognizes these industry changes, it fails to consider them in its various analyses of the market. The Commission should not make the same mistake. It should not rely on analyses that take no account of numerous competitors, and that depart from one of the central tenets of the Merger Guidelines on which the analyses are purportedly based – that is, to bring a forward-looking perspective to the analysis. As demonstrated above, these White Paper analyses do not provide a reasonable basis on which to conclude that the transaction will harm competition for any customers, whether residential or business customers, or retail or wholesale customers. So, too, do they fail to support any remedies that Staff suggests might be needed to

address the competitive harms that Staff's analyses purportedly show. The Commission should not adopt any such remedies and should allow the transaction to proceed as proposed.

Respectfully submitted

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Dated: August 5, 2005

EXHIBIT 1

[REDACTED]

REDACTED

NEW YORK PUBLIC SERVICE COMMISSION

COMMENTS OF

GUSTAVO E. BAMBERGER,

DENNIS W. CARLTON

and

ALLAN L. SHAMPINE

August 5, 2005

I. INTRODUCTION AND OVERVIEW.

A. Qualifications.

<u>Gustavo E. Bamberger</u>

1. I, Gustavo E. Bamberger, am a Senior Vice President of Lexecon, an economics consulting firm that specializes in the application of economic analysis to legal and regulatory issues. I received a B.A. degree from Southwestern at Memphis, and M.B.A. and Ph.D. degrees from the University of Chicago Graduate School of Business. I have previously provided expert testimony to the U.S. Federal Communications Commission (FCC) and state public utilities commissions on telecommunications issues. I also have provided expert testimony to federal courts, the U.S. Senate, the U.S. Federal Energy Regulatory Commission, the U.S. International Trade Commission, the U.S. Department of Transportation, U.S. state regulatory agencies, the Canadian Competition Tribunal and the High Court of New Zealand. A copy of my curriculum vita is attached as Attachment A to these comments.

Dennis W. Carlton

2. I, Dennis W. Carlton, am Professor of Economics at the Graduate School of Business of The University of Chicago. I have served on the faculties of the Law School and the Department of Economics at The University of Chicago and the Department of Economics at the Massachusetts Institute of Technology. I specialize in the economics of industrial organization, which is the study of individual markets and includes the study of antitrust and regulatory issues. I am co-author of Modern Industrial Organization, a leading textbook in the field of industrial organization, and I also have published numerous articles in academic journals and books. In addition, I am Co-Editor of the Journal of Law and Economics, a leading journal that publishes research applying economic analysis to industrial organization and legal matters, and I am on the editorial board of Competition Policy International.

3. In addition to my academic experience, I am a Senior Managing Director of Lexecon. I have served as an expert witness before various state and federal courts and foreign tribunals and I have provided expert witness testimony before the U. S. Congress. I have submitted testimony before the FCC in a number of matters. In 2004, I was appointed to the Antitrust Modernization Commission, a 12-member commission created by Congress to review U.S. antitrust laws. I have previously served as a consultant to the Department of Justice regarding the Merger Guidelines of the Department of Justice and Federal Trade Commission, as a general consultant to the Department of Justice and Federal Trade Commission on antitrust matters, and as an advisor to the Bureau of the Census on the collection and interpretation of economic data. A copy of my curriculum vita is attached as Attachment B to these comments.

Allan L. Shampine

4. I, Allan L. Shampine, am a Vice President of Lexecon. I received a B.S. summa cum laude from Southern Methodist University, and M.A. and Ph.D. degrees from the University of Chicago. I have been with Lexecon since 1996 and have performed a wide variety of economic studies relating to telecommunications and other industries. I have published a number of articles in professional economics journals on issues relating to telecommunications and technology. I am also editor of Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies (Nova Press, 2003), which addresses from an economic perspective the regulation of new telecommunications technologies. In addition, I have previously testified as an expert on telecommunications matters before the FCC. A copy of my curriculum vita is attached as Attachment C to these comments.

B. Summary of Conclusions.

5. We have previously submitted declarations in this matter before the FCC dated March 9, 2005 and May 24, 2005. In those declarations 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.

6. We have now been asked to evaluate claims made by the New York Department of Public Service Staff ("Staff") in their White Paper dated July 6, 2005. Our comments focus on the Staff's claims that the proposed transaction will increase concentration and harm competition in: (1) the provision of service to mass market

consumers in New York; (2) the provision of services to large business customers in New York; and (3) the provision of special access services in New York.

7. We conclude that it is unlikely that the proposed transaction will harm competition and instead find that the proposed transaction is likely to benefit New York consumers by enabling the merged firm to realize efficiencies. The Staff White Paper does not lead us to alter our prior conclusions contained in our declarations to the FCC.

8. The remainder of this declaration is organized as follows:

- Section II presents a brief overview of the benefits that New York consumers are likely to realize from the proposed transaction.
- Section III responds to the Staff's concerns that mass market consumers in New York will be harmed by the proposed transaction.
- Section IV responds to the Staff's concerns that large business customers in New York will be harmed by the proposed transaction.
- Section V responds to the Staff's concerns that the proposed transaction will harm competition in the provision of special access and wholesale transport services in New York.

II. THE STAFF ADOPTS AN OVERLY NARROW APPROACH TO EVALUATING THE PROPOSED MERGER.

9. Staff limits its analysis to calculating HHIs and looking at benefits from the proposed transaction only in the context of whether Verizon should be required to "pass through" cost savings.[1] Such an approach is overly narrow.

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1. HHI (or Herfindahl-Hirschman Index) is calculated as the sum of the squared shares of market participants. HHI measures are commonly reviewed by the Department of Justice in evaluating mergers.

A. The Staff ignores benefits resulting from the proposed transaction.

10. The proposed merger is likely to result in significant benefits to consumers. The Staff fails to adequately account for consumer benefits that are likely to result from the proposed transaction.[2]

1. The transaction combines firms with complementary networks and business focuses.

11. As discussed in our declaration before the FCC dated March 9, 2005, MCI's and Verizon's operations are highly complementary. For example, MCI operates an extensive national and international long distance network and has limited assets used to provide local services. Verizon operates a dense local network in the service territories formerly served by Bell Atlantic and GTE, and has limited out-of-region and long distance facilities.[3] In addition, each company offers services that the other company does not offer. For example, Verizon offers wireless voice and wireless data services, while MCI has no such offerings. Verizon is also continuing to develop its broadband business by investing heavily in the deployment of fiber to the premises (FTTP).[4] MCI operates a major Internet backbone while Verizon does not.[5]

12. The combination of these networks and service offerings will enable the combined firm to better serve business customers by increasing its ability to provide a broader set of services. In addition, the merged company will be able to provide "end-to-

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2. Staff discusses benefits from the proposed transaction only in the context of whether Verizon should be required to "pass through" cost savings realized as a result of the proposed transaction.
3. See Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005, ¶¶ 32, 55-56.
4. See Verizon Press Release, "Verizon to Open Work Center in Syracuse Area to Support Advanced Fiber-Optic Services, New Center to Support Customers of Broadband Products Offered Over Verizon's Fiber-to-the-Premises Network," February 23, 2005.
5. See Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005, ¶ 32.

end" services to more locations and will be better able to monitor network performance and provide more reliable services.[6]

2. The transaction will accelerate delivery of new services to customers.

13. We understand that because Verizon and MCI have not yet been able to begin joint business planning, detailed plans for new service offerings are not available. Nevertheless, the combined firm is expected to be in a position to provide innovative Internet Protocol-based (IP) services more efficiently and to accelerate the deployment of such services to a broader range of customers.[7] Also, Verizon and MCI intend to make services, such as security services developed for enterprise customers, available to other customers.[8]

3. The proposed transaction is expected to result in significant cost savings.

14. Verizon estimates that the merged firm will incur substantially lower costs than would be incurred if the two firms operated separately. More specifically, Verizon estimates that the transaction will result in annual cost savings of $1 billion by the third year following completion of the transaction.[9]

15. These cost reductions come from a variety of sources.

- Verizon estimates that the combined firm will be able to reduce transport costs by more efficiently using the merged firm's network capacity.[10]

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6. See generally Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005.
7. See Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005, ¶¶ 37-43.
8. See Declaration of Michael K. Hassett, Kathy Koelle, Katherine C. Linder, and Vincent J. Woodbury, FCC 05-75, March 9, 2005, ¶ 28.
9. Verizon, Raymond James 2005 Institutional Investor Conference, March 7, 2005, p. 18.
10. See Declaration of Stephen E. Smith, FCC 05-75, March 9, 2005, ¶ 3.

- Verizon expects that the combined firm will be able to reduce IT expenses by, for example, eliminating duplicate operating centers and eliminating overlapping billing and ordering systems.[11]
- Verizon also expects that the combined firm will be able to reduce overhead costs by eliminating duplicative staff.[12]

16. Verizon has a proven track record of achieving estimated cost savings in prior transactions, which indicates that these estimates are credible. For example, we understand that the actual cost savings achieved by Verizon as a result of the Bell Atlantic/NYNEX and Bell Atlantic/GTE mergers exceeded the projected savings from those transactions.[13] Analysts agree that large savings are likely to result from the transaction. For example, in 2004 J.P. Morgan estimated that a merger between Verizon and MCI would result in savings worth $2.3 billion in the third year.[14]

B. The staff relies excessively on HHI calculations

17. Staff limits its analysis of potential mass market effects from the proposed transaction to calculating HHIs. However, as the Staff recognizes, HHI measures are only the first step in a merger analysis:

> An HHI review is not the sole criterion that should be examined in a merger review. Entry barriers and current trends in the market should also be examined to determine if those factors mitigate the anti-competitive harms of the merger. The most important aspect in merger analysis is whether the proposed transaction will give the merged company market power that can be used to charge prices above competitive levels.[15]

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11. See Declaration of Stephen E. Smith, FCC 05-75, March 9, 2005, ¶ 3.
12. See Declaration of Stephen E. Smith, FCC 05-75, March 9, 2005, ¶ 3.
13. See Declaration of Stephen E. Smith, FCC 05-75, March 9, 2005, ¶ 7.
14. JPMorgan, "MCI Inc.: Sustainable Dividend with Upside Potential from Possible M&A," September 24, 2004, pp. 42-43.
15. White Paper, p. 16.

18. Concentration alone can be a misleading guide for assessing competitiveness and the effect on price of a change in the number of firms. For example, vigorous price competition can lead to high concentration. Also, competition takes place over dimensions other than just the current spot price, and failure to examine those other dimensions can produce misleading results. More generally, concentration measures such as the HHI may be misleading if the future is not expected to look like the present, as it likely to be the case in industries experiencing rapid technological change. In particular, simple concentration measures may not fully capture the relationship between the proposed transaction and the introduction of new products.[16]

III. THE PROPOSED TRANSACTION IS UNLIKELY TO HARM COMPETITION IN THE PROVISION OF SERVICES TO MASS MARKET CONSUMERS IN NEW YORK.

19. In this section of our declaration, we go beyond Staff's HHI analysis and show that the economic evidence is inconsistent with Staff's preliminary conclusion that the proposed transaction will harm competition in the provision of mass market services in New York.

A. Merger analysis should be forward looking.

20. As the Staff recognizes, current trends in an industry should be incorporated in an analysis of the likely competitive effects of a proposed transaction. For this reason, the Horizontal Merger Guidelines of the U.S. Department of Justice and Federal Trade Commission (Revised April 1997) explain that HHIs should be calculated on the basis of forward-looking shares (see Section 1.41). That is, the likely competitive

16. See generally Carlton, Dennis, "Using Economics to Improve Antitrust Policy," Columbia Business Law Review 2:283 (2004); and Dennis W. Carlton and Jeffrey M. Perloff, Modern Industrial Organization, 4th edition (2005), pp. 256-258.

effects of the proposed transaction should be evaluated using as a benchmark estimates of the competitive conditions and market shares that would prevail in the absence of the proposed transaction.

21. As discussed in our initial FCC declaration, MCI's future competitive significance and share of mass market customers likely would be substantially smaller than its current shares in the absence of the proposed transaction. In particular, MCI prior to the proposed transaction cut back substantially on efforts to attract mass market customers.[17] For example, MCI has reduced its New York telemarketing hours from roughly [BEGIN PROPRIETARY]

.[18] [END PROPRIETARY]

22. The reduction in MCI's efforts to attract mass market customers is the result of several factors, including the long-term decline in the demand for MCI services, the growth of new technologies, as well as recent court and FCC decisions.

- The number of ILEC access lines, calls processed by ILECs, and wireline minutes of use has fallen in recent years, while the number of wireless subscribers and wireless minutes of use have increased sharply.[19]
- Analysts expect cable-based VoIP to be available to 87 percent of U.S. households by the end of 2006.[20] Analysts also report that 32 percent of U.S. households have broadband Internet connections and so can readily

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17. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶ 13.
18. MCI.
19. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶¶ 18, 20.
20. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶ 26.

obtain broadband VoIP services such as Vonage.[21]

- In response to court decisions, the FCC decided in February 2004 to eliminate ILECs' obligation to offer UNE-P at regulated rates to MCI and others. Firms such as MCI that wish to continue to offer UNE-P based services will thus need to purchase wholesale service from ILECs at market rates.

23. As a result of these factors, MCI in 2004 reduced its sales efforts with respect to mass market customers and raised residential phone service prices.[22] MCI has also effectively stopped mass media advertising to mass market customers, has laid off 2,000 employees in its small and mid-sized business sales unit and has substantially reduced its telemarketing efforts. Thus, MCI's future shares likely would be substantially smaller than its current shares in the absence of the proposed transaction.

24. Even MCI's smaller future market shares overstate its future competitive significance in the absence of the transaction. The use of market shares to evaluate the competitive impact of transactions is based on the premise that firms of all sizes remain active competitors in the marketplace. Generally, a firm that does not actively compete with its rivals (e.g., does not advertise when its rivals do) has less of an impact on market price than one with the same market share that competes actively. Because MCI would be a less active competitor in the absence of the proposed transaction than it has been in the past, even its lower future share would overstate its future competitive significance.

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21. UBS, HSD and Telephony Update for 1Q05, May 18, 2005, p. 2.
22. See Declaration of Wayne Huyard, FCC 05-75, March 9, 2005, ¶¶ 18, 23.

B. MCI would not significantly constrain Verizon with respect to mass market consumers in the absence of the proposed transaction.

1. MCI accounts for a small and declining share of mass market subscribers in New York.

25. Staff focuses on market shares and HHI alone in tentatively concluding that in the absence of the proposed transaction "MCI would continue to be a mass market competitor to Verizon, and that the increase in concentration should be addressed."[23] However, Staff does not analyze directly whether MCI likely would constrain prices charged by Verizon in the absence of the proposed transaction. As we explain in this section of our declaration, we conclude that MCI would not provide a significant constraint on Verizon's prices.

26. MCI's declining competitive significance, and thus its declining expected significance as a future pricing constraint in the absence of the proposed merger, can be readily seen by examining its New York subscriber base.

- As of December 2004, MCI had nearly [BEGIN PROPRIETARY] [END PROPRIETARY] residential UNE-P lines in New York. In contrast, the FCC reports that there were roughly eight million residential and small business lines in New York as of December 31, 2004. Thus, MCI accounted for roughly [BEGIN PROPRIETARY] [END PROPRIETARY] percent of residential and small business lines in New York.[24]
- MCI has been steadily losing customers. Between June 2004 and June 2005, MCI lost more than [BEGIN PROPRIETARY] [END

23. White Paper, pp. 25-26.
24. FCC, Local Telephone Competition, July 2005, Tables 6 and 11.

PROPRIETARY] bundled service customers in New York, or roughly [BEGIN PROPRIETARY] [END PROPRIETARY] percent of its bundled customers.[25]

- MCI has gone from roughly [BEGIN PROPRIETARY] [END PROPRIETARY] stand-alone long distance accounts in New York as of January 2003 to approximately [BEGIN PROPRIETARY] [END PROPRIETARY] in April 2005, a decline of roughly [BEGIN PROPRIETARY] [END PROPRIETARY] percent.[26]

2. MCI does not significantly constrain pricing of Verizon's mass market services.

27. As we noted earlier, MCI has raised prices for mass market services since announcing its decision to less actively market these services. If MCI were currently a constraint on Verizon for mass market services, then we would expect to see that Verizon would have raised prices in response to the recent increases in MCI's prices. Available data, however, show that Verizon has not responded to MCI's price increases, indicating that Verizon's prices are constrained by factors other than MCI.

28. As shown in Table 1, between September 2004 and July 2005, MCI raised the price of its Neighborhood Unlimited calling plan (which includes unlimited local and long distance calling, voice mail and other vertical features) from $57.86 per month to $61.17, an increase of roughly six percent. In contrast, there was no change over this period in the price of Verizon's roughly comparable Freedom plan (which includes unlimited local and long distance calling, voice mail and other vertical features). Over

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25. MCI.
26. MCI.

this period, Verizon ceased marketing Freedom and replaced it with Freedom Unlimited, at a price of $63.22, a price lower than the Freedom plan.[27] Thus, MCI's price has risen by roughly six percent while Verizon's price has remained roughly the same or fallen by roughly six percent. That is, the evidence suggests that Verizon's prices are constrained by factors other than MCI.

Table 1

Prices of MCI and Verizon Bundled Packages

	Price as of		
Plan	**Sep-04**	**Jul-05**	**Change**
MCI Neighborhood Unlimited	$57.86	$61.17	6%
Verizon Freedom	$66.92	$66.99	0%
Verizon Freedom Unlimited	n/a	$63.22	-6%*

*: Change calculated relative to Verizon Freedom Sept. 2004 price.

Sources: MCI and Verizon.

29. Based in part on a similar analysis, the California Attorney General also recently concluded that the proposed merger of SBC and AT&T would not be expected to result in higher prices to mass market consumers:

> We are also unaware of any evidence that AT&T's ongoing withdrawal from the local market has had any effect – adverse or otherwise – on prevailing prices for resold services.[28]

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27. Freedom Unlimited did not come bundled with voice mail, unlike Freedom. We have added the voice mail charge in reporting the price for Freedom Unlimited.
28. Opinion of the Attorney General on Competitive Effects of Proposed Merger of SBC Communications Inc. and AT&T Corp., Before the Public Utilities Commission of the State of California, July 22, 2005, p. 17.

30. As noted above and discussed in our FCC declaration, MCI and others offering local service in New York based on UNE-P will face higher costs in the future due to the elimination of ILECs' obligation to offer service at regulated rates under the reasonable assumption that the negotiated rates will exceed the regulated UNE-P rates.[29] The establishment of negotiated prices for UNE-P will therefore reduce the ability of MCI and other UNE-P providers to constrain Verizon pricing in the absence of the proposed merger.

31. Under MCI's agreement with Verizon, rates have already increased substantially from their previous regulated UNE-P rates and will continue to increase every six months until July 1, 2008.[30] This evidence supports the proposition that MCI and other firms offering UNE-P based services would likely be even less of a constraint on the pricing of Verizon's mass market services in the future than they are now.

32. While Staff acknowledges the impact of increased UNE-P pricing on MCI's future competitiveness, Staff nonetheless suggests that MCI could be an important mass market competitor in the future by transferring its customers to a VoIP platform.[31] However, MCI is not currently a significant supplier of VoIP services and there are a variety of other firms that currently offer VoIP servces. Currently, MCI is offering resold VoIP on a trial basis in limited areas.[32] We understand that MCI currently has fewer than [BEGIN PROPRIETARY] [END PROPRIETARY] New York customers through this trial.[33] Other established VoIP providers offering service in New York include cable

29. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶ 13.
30. Verizon.
31. White Paper, p. 20.
32. Reply Declaration of Wayne Huyard, FCC 05-75, May 23, 2005.
33. MCI.

firms, Vonage, 8x8, BroadVoice, BroadVox, delta-three, Net2Phone, Primus Lingo and VoicePulse.[34] MCI has no obvious advantages over these many other providers, so that its participation in VoIP likely would be of little competitive significance.

C. Verizon's future mass market prices will be increasingly constrained by intermodal rivals.

33. Verizon's mass market prices in the future likely will be increasingly constrained by intermodal competitors, such as cable and wireless firms. We discuss the growing importance of these providers in our FCC declaration.[35] We understand that cable companies in New York have been rapidly adding residential subscribers.

D. The proposed transaction is likely to benefit MCI consumers.

34. Finally, the Staff ignores that the transaction is likely to benefit MCI consumers that would remain with MCI in the absence of the transaction. As noted above, MCI has already implemented significant price increases and is expected to continue to do so in the future in the absence of the proposed transaction. We understand that all of MCI's residential and business customers will remain MCI's customers after the transaction is completed subject to whatever contractual obligations are in force. Following the transaction, however, Verizon would have stronger incentives than MCI to retain these existing MCI customers and thus incentives to keep their prices lower than those that MCI would be expected to charge. This is due in part to its greater ability to market ancillary services to these customers. More specifically, Verizon markets DSL, video services and wireless services to its telephone subscribers. MCI's customer base

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34. Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶ 26; customer service representatives of the listed VoIP providers.
35. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶¶ 18-30.

provides additional marketing opportunities and Verizon thus has a greater incentive to retain these customers and has less incentive than MCI to raise prices to these customers. Thus, MCI's former customers are likely to be better off as a result of the transaction.

IV. THE PROPOSED TRANSACTION IS UNLIKELY TO HARM COMPETITION IN THE PROVISION OF SERVICES TO BUSINESS CUSTOMERS IN NEW YORK.

35. Staff has tentatively concluded that the proposed transaction would increase concentration and harm competition in the provision of telecommunications services to large business (enterprise) customers.[36] However, Staff's analysis overstates the increase in concentration resulting from the proposed merger. In addition, the Staff fails to address a wide variety of factors which indicate that traditional concentration measures are poor indicators of the extent of competition in the provision of services to enterprise customers.

A. The Staff's HHI analysis ignores a large number of firms that provide enterprise services in Verizon's territory.

36. The Staff's analysis is based on the assumption that only six firms participate in the provision of enterprise services in New York.[37] However, as we discussed in our FCC declaration, available data indicate that a wide variety of providers compete to provide service to enterprise customers, including traditional wireline local and long distance carriers, operators of new fiber networks, CLECs, systems integrators, international carriers, equipment manufacturers and value added resellers (VARs), and ILECs.

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36. White Paper, p. 32. Staff refers to the provision of retail services to large business customers as "enterprise services." We follow their terminology.
37. The Staff identifies AT&T, MCI, Verizon, Sprint, XO and Level 3 as the only providers of enterprise services in Verizon's territory.

37. Staff's calculation of national HHIs for enterprise services finds relatively low concentration – a pre-merger HHI of 764 with a change of 231. They conclude that changes in concentration resulting from the transaction measured on a national basis would be unlikely to raise competitive concerns.[38] Staff also attempts to calculate HHIs for enterprise services within Verizon's footprint. The Staff makes a variety of assumptions that artificially elevate Verizon's share and the change in HHI associated with the proposed transaction.

38. For example, Staff assumes that all of Verizon's enterprise revenue and none of other ILECs' enterprise revenue is derived in states served by Verizon. This assumption necessarily inflates estimates of Verizon's share of enterprise service revenue in New York (and understates other ILECs' shares). In addition, as mentioned above, the Staff limits its analysis only to six competitors and ignores the fact that "other" firms account for more than 30 percent of enterprise service revenue nationally.

39. Some of the major competitors seeking to serve business customers are briefly described below. Most of the companies listed indicate in public materials that they have offices and/or facilities in New York.[39]

1. Traditional IXCs.

40. Historically, the traditional IXCs, including MCI, AT&T and Sprint, have supplied a variety of services to large enterprise and medium-sized business customers.

38. White Paper, p. 29. However, Staff claims that if the SBC/AT&T merger is also included in the calculations, then the transaction "warrants further review."
39. See company web sites.

They have extensive national and international networks and provide a variety of local and long distance voice and data services.

2. Operators of new fiber networks.

41. In the late 1990s a variety of firms deployed extensive long-haul fiber networks in New York as well as throughout the United States and internationally. This capacity is now used by those companies and others to provide voice and data telecommunications services. New network operators have expanded their reach by purchasing or trading fiber on multiple networks.

42. Principal firms in this group include: Qwest, which has a worldwide fiber optic network and also includes U S WEST's local networks in the western United States; Broadwing which has an extensive domestic network and acquired Focal, a CLEC operating in metropolitan areas across the United States; Global Crossing, which has a national and international fiber optic network; and Level 3, which has a national and international network and focuses on providing wholesale services to other carriers. We understand that each of these firms operate in New York.

3. CLECs.

43. CLECs operate local or regional networks and many operate in a number of metropolitan areas. These companies typically deploy facilities in central business districts and offer a variety of voice and data services.[40] Examples of major CLECs operating in New York include XO Communications, US LEC, PaeTec, Cablevision and Time Warner Telecom.[41]

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40. See, generally, NPRG CLEC Report 2005.
41. See company web sites; Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005, ¶ 21.

4. Systems integrators.

44. Systems integrators provide managed services to larger business customers. These services include, among other things, network design, desktop implementation, and network operation. Systems integrators often purchase wholesale transport services from carriers. IBM, EDS, and Accenture are leading systems integrators. We understand that each of these firms operates in New York.

5. International carriers.

45. Firms associated with international carriers also provide business services to U.S. companies, focusing on those with international services needs. Equant, part of the France Telecom Group, serves a variety of multinational corporations, including Ernst & Young and ABN AMRO.[42] Similarly, British Telecom operates a U.S. network and offers managed voice and data network services. Deutsche Telekom, Colt Telecom Group, KPN Telecom, Nippon Telegraph and Telephone, and SingTel are among other international firms that provide service to businesses in the United States.[43] We understand that some or all of these firms offer service in New York.

6. Equipment manufacturers / VARs.

46. Like systems integrators, manufacturers of IP equipment design, implement and manage customer networks that utilize the manufacturers' equipment. Equipment manufacturers maintain organizations that provide these services, principally to larger customers. VARs provide the same types of services to medium-sized business customers. As noted by the Yankee Group, "[c]lose collaboration allows systems

42. Datamonitor, Equant, September 27, 2004.
43. See Declaration of Eric Bruno and Shelley Murphy, FCC 05-75, March 9, 2005, ¶ 23.