October 21, 2005

EX PARTE

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

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

Dear Ms. Dortch:

We are writing to respond to the Supplemental Declaration of Simon Wilkie that XO Communications filed on October 18, 2005.[1] Professor Wilkie's latest declaration purports to demonstrate that it would be in Verizon's and SBC's economic interest to tacitly collude in the "wholesale access market" following these companies' proposed mergers with MCI and AT&T, respectively. Like his previous submissions in this proceeding, Professor Wilkie's latest analysis is flawed in a number of critical respects.

As an initial matter, Professor Wilkie's latest declaration marks a retreat from his prior submissions in that he attempts to prove the likelihood of tacit collusion based solely on economic theory, rather than real-world facts. The reason for this change of approach is obvious – there are no facts to support his theory. As the Attorney General of the State of California recently concluded, a strategy of tacit collusion "would entail enormous opportunity costs . . . would offer little chance of success" and ignores the history of SBC and Verizon "competing out-of-region" against each other.[2] Indeed, we have demonstrated that Verizon and SBC have competed, and continue to compete, extensively with one another.[3] For example, Verizon competes for enterprise customers in 28 out-of-franchise areas, 17 of which are in SBC's service

[1] *See* Supplemental Declaration of Simon Wilkie, attached to Ex Parte Letter from Thomas Cohen, Kelley Drye & Warren LLP, to Marlene Dortch, FCC, WC Docket No. 05-75 (FCC filed Oct. 18, 2005).

[2] Opinion of the Attorney General on Competitive Effects of Proposed Merger of Verizon Communications, Inc. and MCI, Inc. at 17-18, *Joint Application of Verizon Communications Inc. and MCI, Inc. to Transfer Control of MCI's California Utility Subsidiaries to Verizon,* Application No. 05-04-020 (CA PUC filed September 16, 2005). The European Union reached a similar conclusion, finding that because of difficulty of balancing relative costs and "the customized nature" of international customers' demand, there was no clear incentive to engage in tacit collusion and it would be "most unlikely that a stable allocation mechanism" would be possible, which would be a "necessary condition" for a theory of tacit collusion. Commission of the European Communities, Case No. COMP/M.3752 Verizon/MCI, Notification of 2 September 2005 pursuant to Article 4 of Council Regulation No. 139/2004 at ¶¶ 104-106.

[3] Ex Parte Letter from Dee May, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75, at 11-12 (Sept. 9, 2005).

area.[4] Verizon and SBC also compete directly in the provision of wireless services nationwide, and for a number of other services including VoIP.[5] Professor Wilkie does not even attempt to square these facts with his speculative claims.

We have also previously demonstrated that Professor Wilkie's theory is flawed even as a matter of economic theory. It would be economically irrational for Verizon to acquire MCI as a means of competing in the enterprise market nationwide and then to withdraw from competition in large parts of the country, including areas where enterprise customers have multiple locations.[6] It is all the more irrational because any supposed collusion with SBC would result in both companies losing business to competitors willing and able to provide service in both Verizon's and SBC's regions.[7] And as a purely legal matter, this type of unfounded speculation about supposed collusion simply cannot be credited, and that is especially true under the circumstances here.[8] Neither Professor Wilkie nor his clients have offered any response to these showings in the past, and their latest submission likewise ignores them.

Rather than confront the facts, Professor Wilkie attempts to demonstrate the likelihood of tacit collusion "by applying a profits test, which compares profits under tacit collusion to those under competitive behavior."[9] But the key assumptions used in this analysis are flawed and this analysis must therefore be disregarded. First, Professor Wilkie inconsistently calculates the profits that Verizon and MCI could be expected to earn in order to bolster his conclusion. For Verizon's profit in-region, Professor Wilkie assumes that Verizon's operating margin for special access is 36 percent, based on Verizon's ARMIS filings. But as Verizon has previously explained, the Commission has recognized that the accounting rates of return reported in ARMIS "do not serve a ratemaking purpose,"[10] and therefore cannot serve as a baseline for estimating the profits that Verizon can be expected to earn if it were to raise special access prices.[11] When Professor Wilkie addresses the profits MCI earns out of region, he assumes that MCI's margin on special access is 11 percent, which is based on MCI's overall operating margin. The result is an apples-to-oranges comparison, which cannot form the basis for a credible calculation.

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[4] Bruno et al. Reply Decl. ¶ 15.

[5] *See* Verizon/MCI Reply Comments at 24.

[6] *See* Verizon/MCI Reply Comments at 22-23; Carlton et al. Reply Decl. ¶¶ 58-62, 65.

[7] *See* Carlton et al. Reply Decl. ¶ 62.

[8] *Time Warner Entertainment Co. v. FCC*, 240 F.3d 1126, 1130 (D.C. Cir. 2001) (in the absence of evidence that "collusion has in fact occurred or is likely to occur," assumption that parties could collude was impermissible "mere conjecture").

[9] Supplemental Wilkie Decl. ¶ 6.

[10] *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 2637 ¶ 194 (1991).

[11] Professor Wilkie compounds this error by calculating the supposed "profits from collusion" for perpetuity, by taking one year of profits and dividing by a discount rate. He thus assumes that the merger would lead to a permanent price increase, which ignores the possibility of competitive entry at *any* point in the future. As we have demonstrated, however, the possibility of entry is likely to increase even further going forward, particularly with the expansion of cable companies and the advent of new technologies such as fixed wireless. Special Access White Paper at 43-46; Verizon/MCI Reply Comments at 36-37.

Second, even based on Professor Wilkie's own flawed assumption that Verizon would be able to raise special access prices after the merger, Professor Wilkie grossly exaggerates the areas where the merger would make this price-hike more likely. Professor Wilkie assumes that the Verizon would be able to raise special access rates across its entire region by 5 percent. He accordingly multiplies Verizon's total annual special access revenues ($3.7 billion) by 0.05 in order to calculate the supposed benefit that Verizon would capture from the merger. But there is not even a coherent theory (let alone supporting facts) to suggest that the merger would permit Verizon to raise special access prices *everywhere* in its region. Indeed, Professor Wilkie concedes (¶ 10) that MCI's share of wholesale special access sales are no more than "six percent of the ILEC's special access revenues," and it is facially implausible that the acquisition of a six-percent-share company would lead to a permanent five-percent-price-hike across Verizon's entire footprint. And as we have demonstrated, MCI's actual share is closer to 2 percent, which makes this all the more unlikely.[12]

To the extent that Professor Wilkie's argument is that the merger would eliminate MCI as a wholesale supplier of special access, the merger would affect competition only to the extent there exists a subset of buildings where MCI has deployed facilities and where there are no other existing or likely potential entrants. Professor Wilkie does not even attempt to calculate the effect of a price hike for this subset of buildings. This is unsurprising because, as we have previously demonstrated, there are no buildings where this condition exists.[13] Thus, the merger would not enable Verizon to profit from a speculative price hike to the degree that Professor Wilkie claims, and there is no basis to believe any such profits would outweigh the lost revenues that Verizon would suffer by deciding to stop competing in SBC's region.

Finally, Professor Wilkie purports to quantify the difference between MCI's current special access rates and those of Verizon, but he offers no evidence to support this claim. Professor Wilkie instead states that this is based on his "study of winning bids and offer provides for wholesale private line local loops and interoffice transport, which I have discussed before the Commission and the U.S. Department of Justice as part of these agencies' investigations into the proposed mergers."[14] But as we have previously explained, Professor Wilkie and his clients have failed to put this bidding data into the record,[15] despite our requests that they do so.[16]

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[12] Special Access White Paper at 15-18, *attached to* Ex Parte Letter from Dee May, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75 (FCC filed Aug. 25, 2005) ("Special Access White Paper").

[13] Ex Parte Letter from Curtis Groves, MCI, and Dee May, Verizon, to Marlene Dortch, FCC, WC Docket No. 05-75, at 3-5 & Attachment A (Sept. 9, 2005).

[14] Supplemental Wilkie Decl. ¶ 7 & n.11.

[15] Although XO recently submitted data that it claims supports its prior claims, that submission did not include the results of the bidding analysis on which Professor Wilkie claims he relies. *See* Ex Parte Letter from Thomas Cohen, Kelley Drye & Warren LLP, to Marlene Dortch, FCC, WC Docket No. 05-75 (FCC filed Oct. 17, 2005). In addition, as we discussed in a separate ex parte, the data that XO and other CLECs filed on October 3 is inadequate to support Professor Wilkie's claims. *See* Ex Parte Letter from Sherry Ingram, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75 (FCC filed Oct. 18, 2005); Ex Parte Letter from

Accordingly, this bidding data can be given no weight under established law.[17]

Sincerely,

Dee May
Verizon

Curtis Groves
MCI

cc: Michelle Carey
Julie Veach
William Dever
Ian Dillner
Gail Cohen
Tom Navin
Don Stockdale
Gary Remondino

Thomas W. Cohen, Kelley Drye & Warren LLP, to Marlene Dortch, FCC, WC Docket Nos. 05-65 & 05-75, at 1 & Attach. (filed Oct. 3, 2005) ("Joint CLEC Oct. 3, 2005 Ex Parte").

[16] *See* Letter from Sherry Ingram, Verizon, and Alan Buzacott, MCI, to Brad Mutschhelknaus, Kelley Drye & Warren (June 29, 2005) (requesting information from Eschelon Telecom, NuVox Communications, TDS Metrocomm, XO Communications, and Xspedius Communications); Letter from Brad Mutschhelknaus, Kelley Drye & Warren, to Sherry Ingram, Verizon (July 7, 2005) (rejecting request); Ex Parte Letter from Dee May, Verizon, and Curtis Groves, MCI, to Marlene Dortch, FCC, WC Docket No. 05-75, Attachment 5 (Sept. 9, 2005).

[17] *See*, *e.g.*, *International Union, UAW v. NLRB*, 459 F.2d 1329, 1336 (D.C. Cir. 1972) ("[W]hen a party has relevant evidence within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him.").