Before the
PUBLIC SERVICE COMMISSION
Albany, N.Y.

Joint Petition of Verizon New York Inc. and MCI, Inc. for A Declaratory Ruling Disclaiming Jurisdiction over or in Alternative for Approval of Agreement and Plan of Merger	)))	CASE 05-C-0237
Joint Petition of SBC Communications Inc., and AT&T Corporation, together with its Certificated New York Subsidiaries, for Approval of Merger	))	CASE 05-C-0242)

COMMENTS OF

ASSEMBLYMAN RICHARD L. BRODSKY, CHAIR, NEW YORK STATE ASSEMBLY STANDING COMMITTEE ON CORPORATIONS, AUTHORITIES AND COMMISSIONS

At the outset, we wish to indicate our support for the Public Service Commission staff's (the "Commission" or "Staff") conclusion that the Commission has jurisdiction over the Verizon-MCI pursuant to sections 99(2) and 100 of the Public Service Law. The Committee on Corporations, Authorities and Commission ("Committee") has examined the relevant law and facts, and concluded that the Commission not only has the requisite statutory authority to investigate such proceeding, but that the public interest demands such an investigation.

Summary

On July 8, the PSC released a 78-page "white paper," authored by advisory staff, setting forth the agency's tentative conclusions and proposed structural remedies with regard to the Verizon-MCI (and SBC-AT&T) merger(s). The White Paper sets forth seven significant determinations (described as "tentative conclusions"), as follows:

- the PSC has jurisdiction over the merger and must review it
- the Verizon-MCI merger will "increase concentration" in the residential & small business telephone services markets in NYS
- the issue of residential service quality has been set aside to be examined in the deregulatory proceeding ("Comp III")

- concerning the medium-size and large (enterprise) business markets, the Verizon-MCI merger will "produce significant consolidation and is, therefore, more troubling"
- Staff concludes that given the competitive environment, there is no basis for a rate proceeding that would require Verizon to pass on some portion of savings and revenue enhancements to customers
- Staff concludes that it is reasonable for New York customers, however, to be insulated from any costs arising from the merger
- Staff also concludes that New York consumers must be protected from any MCI accounting – or other – improprieties that come to light during the merger

Although the White Paper also analyzed the proposed SBC-AT&T merger, the Committee's comments will focus primarily on the proposed Verizon-MCI merger.

I. Merger Rationale

Verizon and MCI ("Petitioners") assert that the transaction is "in the public interest" and will have no "adverse effect on the rates or the quality of service of VNY, or the regulated MCI subsidiaries."[1] Petitioners argue that the merger will enhance Verizon's ability to provide a full array of telecommunications services (i.e., competitive ability), and will generate significant revenues and cost savings for both entities.[2] Finally, Petitioners argue the merger will increase the stability and market/business plan certainty for both companies.[3]

Petitioners' rationales make, essentially, a business case for the merger. The public interest however, despite Petitioners' nod in that direction, rests upon a different

[1] Department of Public Service Staff White Paper, Cases 05-C-0237 and 05-C-0242, 6 July 2005, p. 9 ("White Paper"); Joint Petition of Verizon New York Inc and MCI for a Declaratory Ruling, Disclaiming Jurisdiction over or in the Alternative for Approval of Agreement and Plan of Merger, 25 February 2005, pp. 2-9 ("Merger Petition").
[2] White Paper at 9; Merger Petition at 2-9.
[3] White Paper at 9; Merger Petition at 14.

calculus. Telephone corporations have a statutory duty in New York to provide adequate service at just and reasonable rates.[4] It is axiomatic therefore that the public interest is furthered by a merger that meets or exceeds the statutory requirements for telephone corporations, and harmed by a merger that erodes the protections of such requirements.

II. New York Public Service Commission Jurisdiction

As the Commission Staff acknowledge in the White Paper, Petitioners characterize the proposed transaction in a manner apparently designed to avoid the Commission's jurisdiction.[5] Based upon such characterization, Petitioners assert the Commission has no jurisdiction over the proposed transaction.[6] The Commission's jurisdiction however is based upon substance not form. Therefore as Staff concludes, jurisdiction over the transaction derives from sections 99 and 100 of the Public Service Law ("PSL").[7]

Section 99(2) of the PSL confers broad jurisdiction to the Commission over telephone franchises, agreements affecting telephone corporations and agreements or transfers concerning such telephone corporations' "works or systems." Under §99(2), transactions such as that proposed by Petitioners, for example, are barred absent Commission approval. Additionally, Section 100 of the PSL specifically conditions stock

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[4] See, generally, PSL §91.
[5] White Paper at 10-12.
[6] See Merger Petition.
[7] See also § 5 of the PSL which states in pertinent part: "the jurisdiction, supervision, powers and duties of the public service commission shall extend under this chapter . . . to every telephone line which lies wholly within the state and that part within the state of New York of every telephone line which lies partly within and partly without the state and to the persons or corporations owning, leasing or operating any such telephone line."

transactions in New York telephone corporations upon prior approval by the Commission.[8]

Petitioners describe the proposed merger as a transfer of a non-regulated holding company's stock (i.e., the stock of MCI, Inc.) to another Delaware holding company, Verizon Communications, Inc. Consequently, Petitioners assert, such transaction is outside of the Commission's jurisdiction because §§ 99(2) and 100 only apply to telephone corporations regulated by the Commission.[9] Irrespective of such sophistry however, control of MCI's regulated subsidiaries (and the lines and systems belonging to such entities) will transfer from MCI to Verizon. And, as Staff notes, a similar fact pattern[10] and transfer was found to be within the Commission's jurisdiction in the Bell Atlantic/NYNEX merger.[11]

III. MARKET POWER

Review of Market Power

Commission Staff has identified two different methodologies that it has used for analyzing the potential anti-competitive effects of the proposed mergers. The federal Department of Justice ("DOJ") guidelines posit that where competition declines, the

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8 New York telephone corporations are, for the purpose of this section, telephone corporations organized under or existing under the laws of New York State.

9 See Merger Petition.

10 Similarly to the NYNEX/Bell Atlantic merger, the relevant holding companies control regulated New York State subsidiaries. Control of the MCI subsidiaries' franchises and assets will transfer from MCI to Verizon, which will affect how the MCI subsidiaries operate as telephone corporations in New York State. Consequently, prior Commission approval under §99(2) is required for the Verizon/MCI merger just as such approval was required in the Bell Atlantic/NYNEX merger. Additionally, it is settled law in New York that §99(2) applies broadly to any party to a contract affecting operation of a telephone company in New York State, irrespective of whether a party is a telephone company.

11 See White Paper at 10; Case 96-C-0603 et. al., NYNEX Corporation and Bell Atlantic Corporation-Merger, Opinion 97-8 issued May 30, 1997. See also Case 98-C-1443, Petition of Bell Atlantic for Approval of Agreement and Plan of Merger with GTE Corporation, Issued and Effective August 12, 1999.

likelihood for anti-competitive behavior increases, and focuses upon identifying market changes that diminish competition. The Federal Communications Commission's ("FCC") guidelines on the other hand focus upon identifying sufficient competition in a given market or markets,[12] and on the interplay between such competition and barriers to entry.[13] To state the difference between these two approaches simply: the DOJ's approach is a realistic, "glass half-empty" approach, which examines market concentrations for appropriate remedies to impose, while the FCC's approach is an optimistic, "glass half-full" approach which examines putatively competitive situations to determine if they are ripe for regulatory relief.

As Staff notes in the White Paper, "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 . . . [and it] would be unreasonable to allow additional market power that accrues from post- merger market concentration to remain unchecked."[14] Such an approach is consistent with the Staff and Commission's duty to protect the public interest against any potential negative effects from a proposed merger by "addressing the immediate anti-competitive impacts which the merger may engender."[15] As a consequence, the Committee believes that the Commission's adoption of the DOJ's guidelines is an appropriate approach to the merger analysis.

IV. Verizon/MCI Merger Analysis

[12] See FCC Triennial Review Order ("TRO"), FCC-04-290A1, and Triennial Review Remand Order ("TRRO"), FCC-03-36A1.
[13] TRO, FCC-03-36A1, at pp. 51-72. Commission Staff also note that barriers to entry should be weighed in the analysis of the proposed merger's effects upon competition. White Paper at 16.
[14] White Paper at 16.
[15] White Paper at 17.

As Staff notes in the White Paper, the Verizon merger with MCI would affect virtually every aspect of the New York telecommunications market no matter how one defines the relevant components of such market.[16] The Staff analysis divides the affected areas into four primary categories: (1) Mass Market - Retail; 2) Enterprise - Retail; (3) Transport - Wholesale; and (4) Special Access and High Capacity Loops - Retail and Wholesale.[17] Staff also addresses retail/wholesale service quality issues, infrastructure investment, consumer issues and financial issues. Finally, although Staff "recognizes the potential impact of the merger on the Internet backbone market,"[18] it forbears from analyzing such impact in favor of deferring to the Department of Justice and/or the FCC. Such forbearance however is misplaced to the extent that the Commission has jurisdiction over such backbone elements within New York State.

Much of Commission Staff's analysis depends upon the asserted current or potential competition from "inter-modal" carriers.[19] However, since much of the putative competitors' carriage will occur over Internet backbone, control of and potential bottlenecks in backbone transport are vitally important and unsuitable for deferral to solely federal considerations.

Based upon its Herfindahl-Hinschman Indices analysis ("HHI"), it is Staff's conclusion that the Verizon-MCI merger will significantly lower competition for voice

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[16] White Paper at 18.

[17] In the interest of consistency the Committee will adopt identical terminology for the purposes of these comments.

[18] White Paper at 18.

[19] Inter-modal competition is identified in the White Paper as cable companies, wireless, Internet and Broadband services, VoIP and Wi-Fi, Wi-Max, broadband over power lines (BPL) and satellite broadband. Notably, except for wireless, all such competitors require unfettered access to the Internet backbone to compete in the business of providing voice telephony; the very backbone whose control will be concentrated in the hands of Verizon/MCI after the merger.

telephony in the "mass market."[20] Such a result would be cause for concern even if one accepted the Commission's proposition that competition is a proxy for regulation, rather than maintaining as the Committee does that properly crafted regulation is a key bulwark of the public interest where there is no objectively verifiable evidence that prophylactic regulation is no longer necessary.

a) Remedies to Increased Concentration in the Mass Market/Retail Area

As a consequence of its conclusion that the proposed merger will diminish competition in the mass market, Staff proposes several potential remedies designed to create or spur competition.

- "naked DSL"
- removal of any impediments that prevent customers from switching between wireline, DSL and cable modem based telephone service
- freezing MCI's rates, terms and conditions for mass market consumers for 12 months from the merger's completion[21]

With regard to the issue of offering unbundled or "naked DSL," there are several larger issues to consider before positing whether it will promote competition. First, there are the current physical limitations upon the availability of DSL; e.g., customers must be seeking service within a specific distance of a central office ("C.O.") in order to receive broadband speeds. Second, it is likely that given the poor state of significant sections of Verizon's outside plant, even customers sufficiently close to a C.O. for DSL may be unable to receive service because of poor quality and/or obsolete outside plant facilities. Third, taking into account Verizon's professed goal of re-targeting its capital expenditures away from copper plant construction, maintenance and repair, promoting

[20] White Paper at 20.
[21] White Paper at 26.

"naked DSL" as a way to spur competition would result in inter-modal competitors' products being carried on lines that will be neglected by Verizon – hardly a healthy competitive prospect. Fourth, neither Verizon nor MCI have evidenced a strong willingness to sell DSL broadly in New York State and it is likely that a massive internal retraining effort will be required to develop a sales force capable of discerning where DSL can be sold. Consequently, the Committee doubts that offering "naked DSL" would be a panacea to the problem of diminished competition, but in conjunction with other remedies may be a useful supplemental remedial action.[22]

Concerning the presence of impediments to switching between wireline, DSL and cable modem based telephone service providers, the Committee notes that the White Paper presents no empirical data documenting the presence or absence of such impediments, and no such data has been made available to the parties. Absent empirical data, parties may only speculate or provide anecdotal evidence, neither of which furthers the public interest. The Committee calls therefore, as part of this proceeding, for the Commission to obtain and provide to the parties – accompanied by a period in which to comment – the data necessary to comment upon impediments to switching between telephone service providers.

Turning to a matter that will become a major impediment to switching between telephone services providers however, it has come to the Committee's attention that Verizon policy associated with FIOS installations is to remove the copper loop between a

[22] Additionally, since SBC has been much more aggressive than Verizon in DSL rollout, it would be sensible to require SBC to also offer "naked DSL" in New York in the hope of further increasing competition.

consumer service location and the demarcation point.[23] As a practical matter, once the copper local loop is removed, a customer's competitive choices are reduced to cable modem derived services or Verizon's fiber-based product; DSL and wireline competition require copper lines, and it is unlikely at best that a copper-based overbuild (i.e., the creation of a facilities-based competitive system) would occur in any but the most limited circumstances. More significantly, the copper local loop is powered remotely from the PSTN and functions during power outages and public safety problems, whereas fiber-based communications are at best locally powered and offer only short-term battery backups to maintain service.

Additionally, although the FCC has ordered the Voice over Internet Protocol ("VoIP") service providers and common carriers to effectuate E-911 services over VoIP, such solutions are neither proven to be fully functional nor available in all areas of the state. Consequently, the Committee believes that the Commission should forbid by order or regulation the removal of the copper local loop from the premise to the demarcation point (or further), and that such order would be in support of the public interest in a secure telephone system and in public safety, and would assist in preserving consumer choice in telecommunications providers.

Finally, Staff suggested potential "price controls" and terms of service limitations so that contracts entered into by MCI subsequent to the merger would remain as competitive with "Verizon prices" as such contracts would have been but for the merger. As a structural remedy, setting aside consideration of the practical difficulties of

[23] Although the Committee's preliminary discussions on this matter have focused upon private residences, there is evidence to suggest that Verizon will follow similar policy with some business customers.

implementing such a remedy, the Committee is supportive of maintaining the current MCI terms of service and pricing structures offered to the retail and wholesale markets. The term proposed for such "price freeze" however should not be twelve months, but should be for a minimum of thirty-six months, provided however that the Commission should hold a biannual proceeding where Verizon could adduce evidence of sufficient competition in a pre-determined region (or regions) that such price freeze could be phased out over a six month period.

b) Enterprise Market-Retail

The Committee notes Staff's dissonant conclusions with regard to this market: first, that the proposed merger results in an increase in concentration in the enterprise market which exceeds the threshold levels in the DOJ/FTC Guidelines and, therefore, requires countervailing remedies; and second, that a direct retail based remedy is not required, [because of a belief that it is] preferable to ensure reasonable retail enterprise market competitiveness by focusing on the terms and conditions associated with wholesale market offerings (such as the carriers systems mentioned above) that are used by competitive carriers to provide retail services to enterprise customers.[24] Maintenance of such a logically inconsistent position does not serve the public interest. Where increased concentration creates the specter of market distortion, the Commission should consider behavioral and/or structural remedies. Absent sufficient empirical proof of robust, ubiquitous competition that could offset the overwhelming market power of the merged entity, the Commission should not rely upon competition to substitute for remediatory measures.

[24] White Paper at 32-33.

c) Wholesale Transport Market

The Committee states herein that it concurs with the following Staff conclusions:

- **The short run impacts of the merger on the competitiveness of transport markets should be addressed by merger-related remedies.**
- **The level of overlapping transport facilities, and the concomitant lack of additional transport providers on some of those routes with overlaps, indicates a significant anticompetitive impact of the merger(s) upon the New York transport market.**
- **The proposed merger substantially reduces the number of competitive transport routes.**
- **The anti-competitive impacts of the merger are most troubling on those transport routes where Verizon, MCI, SBC and AT&T are the only transport providers.**
- **Further, the impact of the merger on competition is significant even for many of the routes considered to be the most competitive under the TRRO procedures.**[25]

With regard to the Staff's proposed remedies, the Committee believes that structural remedies similar to those it proposed above in section IV (a) would be appropriate. Additionally, the Commission should create or modify a set of metrics that would allow it to monitor price distortions or other market effects of increased concentration resulting from the merger. At this early stage it is difficult to determine what the Commission's enforcement/facilitation role should be, but further development of the record in this proceeding may provide sufficient objective data to derive an empirical basis for such a role. Finally, concerning the issue of the divestiture that Staff raised, the Committee does not believe there is sufficient data available to the parties to comment meaningfully on such a drastic structural remedy.

d) Special Access and High Capacity Loops (Retail and Wholesale)

[25] White Paper at 33-37.

The Committee states herein that it is concerned by the following Staff conclusions:

- **The acquisition of the second largest wholesale provider (MCI) by the largest provider of high capacity loop access services (Verizon) will significantly increase market concentration in the transport and special access markets.**
- **The potential for unequal bargaining positions for small carriers could result in the elimination of the favorable rates, terms and conditions currently offered by MCI to smaller carriers.**
- **The merger may also eliminate or greatly reduce Verizon's incentive to enter into commercial agreements or contracts with small carriers for the provision of these services, or to make the terms of these agreements favorable in the future.**
- **The merger could affect business customers by potentially increasing T1 prices, and/or cause deterioration of retail service quality.**

As Staff appropriately notes, the special access and high capacity market contains such important elements as “engineered circuits” that connect large business customers and large residential buildings to Verizon “end offices” and to “points of presence” operated by competitors.[26] This market was one of the first areas in which competition arose under the Modified Final Judgment (“MFJ”) and is vital to the ability of alarm companies, small competitive local exchange companies (“CLECs”), MCI and AT&T (pre-merger) and other small facilities-based carriers or Internet Services Providers (“ISPs”) to sell competitive services. Staff acknowledges the vital nature of this market in the White Paper, stating “that concentration in the Special Access and High Capacity market, post merger, would be problematic.”[27] As an integral “upstream link” from the “inter-modal competitors” upon which the Commission pins its hopes of competition in New York, this is one of several key areas in which Petitioners must be required to

[26] White Paper at 38.
[27] White Paper at 40.

demonstrate that the proposed merger is in the public interest.[28] To date in this proceeding however, such proof has neither been provided by Petitioners, nor by the Commission.

Among the impediments to competition in this market and, therefore, areas of concern in the context of the proposed merger are the following: cable-based telephony is impractical for many regions of the state and even where the facilities exist, would require extensive modifications to existing office space; the cost of overbuilding high capacity loop circuits parallel to Verizon and MCI's existing plan is prohibitive, and the municipal approvals necessary would be sufficiently time consuming to render the project unachievable; the various forms of VoIP or Internet-assisted telephony rely upon high capacity circuits and thus potential competitors would be bottlenecked by the dominant market position of a merger Verizon-MCI; and finally, wireless and satellite voice solutions are simply not sufficient for widespread and cost effective use as a principal business line.

Acknowledging the practical problems inherent in the reduction of competition that will be caused by the Verizon-MCI merger, Staff suggests several remedies that combine elements of price controls, expanded regulatory monitoring of this market, and divestiture. Again, as noted above, the Committee believes that structural remedies may be of value in addressing the market distortions that are likely to be created by the merger, but will not address the issue of divestiture at this time.

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[28] Carriers use special services/special access to connect Points of Presence (POPs) to Verizon central offices. Wireless carriers use high capacity circuits to connect cell towers to the traditional wireline network (PSTN). Packet cable providers and wireless providers use special arrangements to connect to E911 Public Service Answering Points (PSAPs). White Paper at 40-45.

V. Service Quality

a) Retail Service Quality

With regard to service quality, Verizon has stated that it believes that the merger will have no adverse impact on service quality, and that the Commission need not be concerned about the level of Verizon's service related capital investments or quality of service and as such no conditions are warranted.[29] Furthermore, the company asserts disingenuously that previous mergers did not have negative impacts on service quality in New York, and there is no reason to believe this one will either.[30] Finally, Verizon urges the Commission to reject what it characterizes as attempts to "reinstitute the command-and-control style of regulation" over Verizon, because any service-related penalty plan would be a substantial step backwards.

The Commission appears to agree with Verizon's position, at least as far as Staff's White Paper is concerned. Despite stating that "the quality of telecommunications services is a public interest concern and, [that] in approving previous mergers, [the Commission] has generally incorporated service quality protections,"[31] the Commission has stated that "service quality and regulatory issues will be examined within the context of the Commission's Comp III proceeding,"[32] thereby explicitly foregoing the ability to condition merger approval upon service quality protections.

[29] White Paper at 46.
[30] Left unsaid is that a primary reason prior mergers did not diminish service quality is that such mergers were accompanied by structural service quality remedies. White Paper at 46-47.
[31] White Paper at 46.
[32] White Paper at 50-51.

In previous mergers, the Commission has explicitly protected service quality by instituting structural and behavioral remedies.[33] In the NYNEX-Bell Atlantic merger, for example, the Commission required the following:

- NYNEX to commit to the hiring of between 750 and 1,000 additional employees in order to address existing service quality problems, and to maintain that employment level until service levels met the targets set forth in the PRP.
- NYNEX to invest an additional $1 billion in service-related infrastructure improvements over a five-year period, one-half of which was to be spent on capital projects to improve service quality throughout New York State, in areas where service quality was significantly below standards.

Despite such precedent however, and a ten-year history that underlines the necessity of placing Verizon (and its predecessors) within a performance-based regulatory plan with mandatory penalties,[34] the Staff recommended forbearance.[35] The Committee believes that the conclusion to remove service quality issues from a forum in which remedies may be instituted as a condition of merger approval is arbitrary and capricious, and is defective as a matter of law.

Over time, the Committee and various parties to Verizon service quality proceedings have called for a panoply of remedies and/or prophylactic orders, such as the allocation of specified capital levels targeted to underperforming areas, the addition of consumer rebates to a service quality plan in addition to statewide penalties, comprehensive audits of the company, and the hiring of sufficient new staff to address service quality issues. Each time such remedies were sought in the past, the Commission

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[33] See, e.g., the Bell Atlantic//NYNEX Merger Order and the Commission's Order deciding the Fairpoint Communications, Inc./Berkshire Telephone Corporation merger (Case 03-C-0972, Order Approving Acquisition Subject To Conditions (issued March 18, 2005).

[34] Verizon operated from 1995 to 2002 under the Performance Regulatory Plan. From 2002 to 2005, Verizon was subject to the Verizon Incentive Plan, which, despite having lesser service quality targets than the PRP still resulted in $70 million in fines derived from the failure to provide adequate service.

[35] White Paper at 50-51.

has eventually acceded to the demands of the public interest. In this proceeding however, Staff's conclusion that "the sheer number of inter-modal competitors for telecommunications services has significantly reduced the need for the incorporation/application of a VNY statewide service quality rebate program and the requirement for a VNY statewide service quality rebate plan as part of the merger is not required,"[36] has been substituted for an analysis of what the public interest requires with regard to remedial service quality measures.

The Committee does not accept that unsupported conclusion absent empirical evidence. When requested at the Committee's March 7, 2005 hearing to provide such evidence of competition, the Commission was unable to do so.[37] The Commission has also never provided a well reasoned logical argument for why the price-based competition Verizon is facing in some areas from cable-based, VoIP and wireless carriers – all of whose voice product is inferior to traditional landline telephony – would be an incentive to Verizon to provide high service quality rather than indulge in draconian cost-cutting measures to be able to compete on price. Consequently, the Committee believes that a performance based service quality plan should be reinstituted for a minimum of three years from the completion of the proposed merger. The service quality plan should use the ten metrics set forth in §603 of the NYCRR, and tracked by the PRP and VIP, and should penalize poor service quality with fines and consumer rebates. Furthermore, as a condition of approval for the merger, the Commission should order Verizon to implement all of the unimplemented recommendations from the DCI audit within ninety days of the completion of the proposed merger, and to the extent that such recommendations are

[36] White Paper at 50.
[37] See transcript of the March 7, 2005 hearing on Telephone Service Quality held by the Committee on Corporations, Authorities and Commissions.

relevant to MCI, Verizon should be ordered to institute such best practices recommendations within ninety days in that entity. Finally, either as part of this proceeding or within ninety days after the merger's completion, the Commission should begin an audit of the MCI system equivalent to the DCI audit of Verizon.

b) Wholesale Service Quality

The Committee will forebear from commenting upon this issue until the Reply Comments, other than to note that MCI's service quality performance should be reported as part of Verizon's reporting requirements, and that the Commission should create or modify a set of special services and high capacity metrics to monitor this area.

VI. Consumer Issues

The Committee will not address this issue here, but rather will address consumer issues in the context of the reply comments. That said, as yet there has been no compelling explanation of how the proposed merger will benefit the average consumer, rather than (potentially) benefiting consumers who can afford $100 or larger monthly bills. Among other issues, it also remains unproven how the merger would benefit rural, high cost and lower-income telephone customers, all of whom require adequate service at just and reasonable rates, but who seem to have been forgotten in the rush to provide competitive services to higher-end customers. The Commission should not allow New York's telephone network to become a system where the wealthy can receive high quality and inexpensive telephone services while low-income customers will receive lower quality and expensive services. The Committee also notes here that Commission approval of the merger should be conditioned upon an undertaking by Verizon that will it not divest itself of the upstate lines, since such severing of New York's telephone network is demonstrably not in the public interest.[38]

VII. Financial Issues

There are three key issues here. First, there is the question of how any savings resulting from "synergies" should be treated. Second, there is the question of how the costs of the merger should be determined and allocated. Third, there is the question of how to treat any unrevealed financial issues within MCI that may affect Verizon's or the merged entity's financial health.

As Staff notes in the White Paper, Verizon anticipates that it will derive considerable savings from the merger.[39] Such savings should be reinvested into the sorts of measures that have delivered improvements in service quality and network health in the past, such as infrastructure repairs, staffing levels in the appropriate divisions of the merged entity, and construction (where necessary, or in the case of broadband development, where such construction would benefit the public interest). Such savings should not be allowed to be repatriated from New York, or used other than for network purposes, based solely on Verizon's complaints that one division of a much larger

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[38] Nor, for that matter, would the removal of Verizon's corporate headquarters from New York be in the public interest. Therefore, the Committee recommends that the Commission use this proceeding to clarify Verizon's commitment to retaining its headquarters, headquarters staff and essential corporate functions in New York State. For example, the unspecific commitment of a long-term retention of the headquarters in New York could be clarified to be for no less than twenty-five years from the closing of the merger.

[39] "Potential annual pre-tax operating savings and revenue enhancements following the closing of the merger will reach approximately $500 million in year one, $800 million in year two, and will ramp up to $1.1 billion in year three and beyond . . . [leading to] total benefits with a net present value of $7 billion, reflecting cost savings and incremental revenues." White Paper at 60-61.

enterprise is underperforming financially. With regard to the costs of the merger, the Committee agrees that New York consumers should not be liable, which suggests that the Commission will need to exercise careful scrutiny of, among other things, Verizon's costs for intra-corporate borrowing, price changes to ongoing services agreements, and other ongoing arrangements that could be affected by impairments to Verizon's credit ratings, cost of borrowing and other financial externalities. Finally, as it did in the earlier round of comments, the Committee calls for careful scrutiny of MCI and for the Commission to condition the merger approval upon the institution of measures to protect New York consumers, and Verizon, from any undiscovered problems arising from MCI's accounting and other problems.

Turning to the issue of a potential rate proceeding, which Staff has concluded would not be necessary in the context of the proposed merger, the Committee does not, necessarily, agree. The White Paper, in many places, contains Staff comments that Verizon had not presented sufficient information for analysis, but rather had submitted unsupported anecdotal statements in response to Commission information requests. For example, with regard to the calculation of the "synergy" savings, Staff commented:

> "Thus, absent additional information from Verizon, Staff cannot determine with any precision the amount of synergies applicable to Verizon's New York intrastate operations. To properly evaluate the impact of the synergies on Verizon's New York intrastate operations, a comprehensive understanding is needed of Verizon's New York intrastate financial condition as well as current and projected earnings. Verizon's petition did not include historic or projected financial data for Verizon's New York operations."

If a rate proceeding is the only way therefore that Staff can receive sufficient data upon which the Commission can conduct its merger analysis, then such a proceeding would appear to be required by the public interest.

VII. SBC/AT&T Merger Analysis

The Committee will forbear from commenting on this proposed transaction at this time.