

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

Joint Petition of Verizon New York, 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

Joint Petition of SBC Communications Inc.,  
AT&T Corporation, together with its  
Certificated New York Subsidiaries, for  
Approval of Merger.

Case  
05-C-0242

COMMENTS OF THE  
NEW YORK STATE CONSUMER PROTECTION BOARD  
ON DEPARTMENT OF PUBLIC SERVICE STAFF WHITE PAPER

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Dated: August 5, 2005  
Albany, New York

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On February 25, 2005, Verizon Communications Inc. (“Verizon”) and MCI, Inc. (“MCI”; jointly, “Companies”) filed a “Joint Petition” with the Public Service Commission (“PSC” or “Commission”). The Companies requested that the PSC issue a declaratory ruling stating that it lacks jurisdiction to investigate and approve the proposed acquisition of MCI by Verizon, or in the alternative, that it approve the proposed acquisition. The Consumer Protection Board (“CPB”) submitted comments regarding the proposed merger and its implications for New York’s consumers on April 29, 2005.<sup>1</sup> We demonstrated that the PSC has the jurisdiction and the obligation to review the proposed merger.<sup>2</sup> We also showed that the merger would remove a competitor to Verizon and may reduce customer choice and competition in New York’s wireline

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<sup>1</sup> Case 05-C-0237, Comments of the New York State Consumer Protection Board, April 29, 2005. (“CPB Comments”)

<sup>2</sup> Id., pp. 4 – 6.

telephone market.<sup>3</sup> As a result, we concluded that certain balanced conditions should be imposed upon PSC approval of the merger.<sup>4</sup> Those recommendations were designed to offset the potential risks to consumers of the proposed merger, particularly regarding the potential reduction in customer choice and the risk that the quality of Verizon's wireline service could deteriorate.

Staff of the Department of Public Service ("DPS Staff") conducted its own analysis of the merger based on, among other things, the comments submitted by the CPB and other parties as well as the Companies' responses to information requests. That analysis, as well as DPS Staff's tentative conclusions and recommendations, are presented in a White Paper issued July 6, 2005.<sup>5</sup> Pursuant to a PSC Notice,<sup>6</sup> the CPB hereby comments on the DPS Staff White Paper.<sup>7</sup>

DPS Staff found, among other things, that the proposed merger would reduce customer choice in the mass market and may be accompanied by deterioration in Verizon's service quality, particularly in rural, suburban and economically disadvantaged areas of the state.<sup>8</sup> DPS Staff recommended that the PSC consider imposing remedies

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<sup>3</sup> Id., pp. 6 – 18.

<sup>4</sup> Id., pp. 18 – 27.

<sup>5</sup> Cases 05-C-0237, 05-C-0242, Department of Public Service White Paper, July 6, 2005. ("DPS Staff White Paper")

<sup>6</sup> Cases 05-C-0237, 05-C-0242, Notice Soliciting Comments on Staff White Paper, July 6, 2005.

<sup>7</sup> The DPS Staff White Paper also addresses the proposed merger between SBC Communications Inc. ("SBC") and AT&T Corporation ("AT&T"). The CPB did not submit comments on that proposed merger, and does not comment on that portion of the DPS Staff White Paper that addresses that proposal. That is because the proposed merger between SBC and AT&T would not remove an active competitor in New York's mass market retail wireline telephone market and is not expected to reduce customer choice and competition in that market.

<sup>8</sup> DPS Staff White Paper, p. 51.

to offset these risks, as a condition of approving the proposed merger.<sup>9</sup> In general, the CPB agrees with DPS Staff’s comprehensive analysis of the impact of the proposed merger on consumers. In our view, however, the PSC should consider measures in addition to those recommended in the DPS Staff White Paper; in particular, those that we previously recommended, to offset the expected impact of the merger on mass market customers.

We address the PSC’s legal authority and obligation to address the merger in Point I. In Point II, we evaluate the DPS Staff analysis of the impact of the proposed merger on mass market competition. Conditions that should be imposed on the proposed merger are addressed in Point III.

I. THE PSC HAS THE AUTHORITY AND THE OBLIGATION TO APPROVE OR DISAPPROVE THE PROPOSED MERGER.

The CPB thoroughly explained in our initial comments that “the Commission has ample authority to approve or disapprove the proposed merger under both Public Service Law §99(2) and 100.”<sup>10</sup> We also demonstrated that “the Commission has previously and unambiguously concluded that it has authority to approve or disapprove proposed mergers”<sup>11</sup> such as the acquisition of MCI by Verizon, and that “Verizon’s predecessors have not successfully challenged those determinations.”<sup>12</sup>

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<sup>9</sup> DPS Staff White Paper, p. 5.

<sup>10</sup> CPB Comments, p. 4.

<sup>11</sup> Id., p. 5.

<sup>12</sup> Id.

The DPS Staff White Paper reflects full agreement with CPB's position on this matter. As DPS Staff concludes, "jurisdiction to investigate and approve or deny the proposed acquisition of MCI by Verizon is vested in the Commission by the statutory authority conferred pursuant to Public Service Law Sections 99 and 100."<sup>13</sup>

For the reasons cited by DPS Staff and by the CPB, there is no merit to Verizon's contentions regarding the absence of PSC authority in this matter. The PSC has repeatedly determined that it has ample authority over acquisitions such as the proposal in this case,<sup>14</sup> and the Companies have provided no reason why such conclusions are not applicable here.

## II. ANALYSIS DEMONSTRATES THAT THE PROPOSED MERGER WOULD REDUCE COMPETITION IN THE MASS MARKET.

We explained in our initial comments that the merger would remove a competitor to Verizon from New York's wireline market, and would also foreclose the possibility that MCI could use its own facilities, or develop an internet-based telephone service, to continue and expand its competition with Verizon in the mass market.<sup>15</sup> The elimination of an active competitor is what distinguishes the proposed Verizon/MCI merger from previous mergers involving Verizon. As we stated:

Previous mergers considered by the PSC, including those involving Verizon's predecessors, only removed potential competitors to Verizon, not actual competitors such as MCI.<sup>16</sup>

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<sup>13</sup> DPS Staff White Paper, p. 12.

<sup>14</sup> A sample of relevant PSC Opinions and Orders concluding that the Commission has authority over acquisitions such as proposed in this case, is included in CPB Comments, p. 5, footnote 6.

<sup>15</sup> CPB Comments, p. 10.

<sup>16</sup> Id., p. 7.

Based only on publicly available information, we explained that it “appears that the proposed merger will impact competition for residential and small business customers in New York.”<sup>17</sup> We also stated that “it appears that the proposed merger may reduce competition in the market for enterprise (large business) customers” and could “reduce competition in the market for high capacity local services.”<sup>18</sup> To precisely assess the impact of the proposed merger on competition in New York, the CPB recommended that the PSC conduct “a market-by-market analysis of the extent to which Verizon and MCI actually compete for the same customers.”<sup>19</sup>

The CPB recognizes that analysis of the impact of the merger on mass market customers should consider alternatives to the merged company’s wireline telephone service. We explained, however, that such services are not realistic alternatives to Verizon’s wireline telecommunications services for most consumers for several reasons.<sup>20</sup> First, some of these services are not available to consumers in certain areas of the state. Second, competition from CLECs has decreased markedly as a result of rulings by the Federal Communications Commission and courts that have limited CLECs’ use of UNE-P, which had been the principle method used by CLECs to provide wireline service. Third, cable-based telephone service, VoIP and wireless service are not adequate substitutes for wireline access line service at this time.<sup>21</sup>

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<sup>17</sup> Id., p. 9.

<sup>18</sup> Id.

<sup>19</sup> Id., p. 8. The information necessary for this evaluation was not contained in the Joint Petition.

<sup>20</sup> Id., pp. 9 – 15.

<sup>21</sup> Cable-based telephone service does not generally work when power goes out and is often not available unless purchased with a bundle of other related services. In addition, cable-based telephone service is not available

In its White Paper, DPS Staff generally agrees with CPB's conclusion that even recognizing intermodal competition, the elimination of a major competitor to Verizon would affect competition and consumer choice in the mass market. DPS Staff concluded:

We tentatively conclude that while the Verizon/MCI merger will impact the mass market (residential and small business), and while there is significant mass market intermodal competition providing voice and data alternatives in most parts of New York, the Verizon/MCI merger will increase the concentration in that market.<sup>22</sup>

DPS Staff also reached a similar conclusion regarding the enterprise, transport and special access/high capacity loop markets.<sup>23</sup>

DPS Staff's conclusion regarding the impact of the proposed merger on the mass market is based on two analyses using different data.<sup>24</sup> Both analyses show that "the merger will result in a lower level of mass market competition in the mass market for voice."<sup>25</sup>

DPS Staff also supports CPB's conclusions that Petitioners have inaccurately claimed that MCI's business is in a "continuing and irreversible decline."<sup>26</sup> In addition,

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statewide. VoIP requires the purchase of a broadband access line, does not usually work when power goes out, has voice quality that is suspect, is not reliably connected to E911, and may be affected by computer viruses, worms, etc. Wireless service can be plagued by bad reception and dropped calls, E911 is not universal, and service is usually accompanied by a long-term contract. As a result of these and other factors, these services are not currently adequate substitutes for landline telephone access line service.

<sup>22</sup> DPS Staff White Paper, p. 5.

<sup>23</sup> Id., pp. 26 – 46. DPS Staff believes cable-based telephony is not currently a realistic substitute in the enterprise market since most small and medium-sized businesses are not "cabled-up." Regarding the transport and special access markets, DPS Staff concludes that the acquisition of the second largest wholesale provider (MCI) by the largest provider of high-capacity loop access services (Verizon) significantly increases market concentration.

<sup>24</sup> Id., p. 19. The first analysis used data from FCC's June 2004 Local Competition Report. The second analysis was based on April 2005 data from Verizon's Performance Assurance Plan (PAP).

<sup>25</sup> Id., p. 20.

<sup>26</sup> Id., p. 20. See also CPB Comments, p. 9.

the DPS Staff White Paper supports CPB's conclusions that intermodal competition is not sufficient to provide effective market discipline of Verizon's wireline telecommunications services throughout New York State. DPS Staff found that Petitioner's assertion that wireless service has replaced traditional wireline service is unfounded.<sup>27</sup> Furthermore, DPS Staff concludes that Verizon's lack of a stand-alone DSL offering precludes VoIP over DSL from being considered a legitimate substitute for voice service and makes the voice market much more concentrated.<sup>28</sup>

Overall, CPB commends DPS Staff for its detailed, thorough and accurate analysis of the impact of Verizon's acquisition of MCI on market concentration throughout New York State. DPS Staff used the proper analytical framework for assessing the merger, as set forth in the Horizontal Merger Guidelines of the Department of Justice and the Federal Trade Commission. DPS Staff also properly defined the relevant markets and conducted its analysis using the most recent data available. In addition, where data from two sources are available, DPS Staff conducted separate analyses based on the two sets of data. For all these reasons, we recommend that the Commission rely heavily on the extremely high quality market analysis of the proposed merger conducted by DPS Staff, and the DPS Staff conclusion that the proposed merger would reduce competition in the mass market.

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<sup>27</sup> Id., p.23, citing an FCC Report on wireless competition which concludes that the percentage of people substituting wireless service for wireline service is between 3% and 6%. DPS Staff also cites a Wall Street Journal report that wireless-only homes are not increasing as rapidly as many experts predicted.

<sup>28</sup> Id., p. 23.

III. THE PSC SHOULD IMPOSE CONDITIONS UPON APPROVAL OF THE PROPOSED MERGER.

To help ensure that the proposed merger is in the public interest in consideration of its likely impacts identified above, the PSC should approve the merger only with the conditions identified herein.

A. Competition

As shown in Point II, the approval of this merger would have a negative impact on competition in most telecommunications markets in New York State. The PSC has repeatedly declared that robust competition enhances the state's economy and benefits consumers.

We have frequently stated our belief that dynamic local exchange competition will provide benefits to ratepayers and to the economy of this state, and therefore, as a general matter, our preference would be for more, rather than fewer, competitors.<sup>29</sup>

The PSC also stated:

The goal of ensuring the provision of quality telecommunications services at reasonable rates is primary....Where feasible competition is the most efficient way by which the primary goal may be achieved.<sup>30</sup>

In reviewing previous proposed mergers, the Commission has adopted measures to help offset the diminution of competition that was expected to result from those proposals. Such measures should also be considered here, in view of the fact that the

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<sup>29</sup> Case 96-C-0603, Proceeding on Motion of the Commission as to the Joint Petition of New York Telephone Company, NYNEX Corporation and Bell Atlantic Corporation for a Declaratory Ruling That the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic, or in the Alternative, for Approval of the Merger, et al., Opinion Approving Proposed Merger Subject to Conditions, Opinion No. 97-8, May 30, 1997, ("NYNEX/Bell Atlantic Merger Opinion") p. 29.

<sup>30</sup> DPS Staff White Paper, p. 15.

merger would eliminate an actual competitor to Verizon. DPS Staff correctly concluded that

Any anticompetitive impacts of the [merger] must be balanced with a combination of remedies and/or benefits before the Commission can conclude that [it is] in the public interest.<sup>31</sup>

To partially mitigate the increased market concentration that would result from the proposed merger, CPB recommended that Verizon provide “naked” or stand-alone DSL throughout all of New York State, where DSL is available, to both existing and new DSL customers. Verizon’s decision not to offer “naked” DSL requires customers who want VoIP service using Verizon’s DSL service, to also purchase Verizon’s voice service, thereby hindering customer choice and competition in the voice and high speed internet access markets.

In its White Paper, DPS Staff also proposed that Verizon make an unrestricted offering of “naked DSL.”<sup>32</sup> Since the CPB first made this recommendation in April 2005, we understand that Verizon has begun to offer stand-alone DSL service to its existing customers. Yet new Verizon DSL customers who choose to switch their voice service to VoIP, are still required to purchase Verizon’s local telephone service. The Commission should require that Verizon provide “naked DSL” to all of its customers in New York where DSL is available, no later than the date of merger approval.<sup>33</sup>

DPS Staff also identified two other remedies that might help offset the mass market concentration that would result from the merger: (1) elimination of any

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<sup>31</sup> DPS Staff White Paper, p. 12.

<sup>32</sup> DPS Staff White Paper, p. 26.

<sup>33</sup> We understand that Qwest Communications International Inc., Verizon’s counterpart in portions of the western U.S., has voluntarily provided this capability since February 2005.

impediments which impair a customer's ability to switch between intermodal providers, and (2) freezing MCI's rates, terms and conditions for MCI mass market customers for 12 months from the date of the merger.<sup>34</sup> In our view, neither of these conditions would adequately offset the likely impact of the merger on mass market customers.

Although DPS Staff suggested that impediments that prevent or impede consumers from switching to intermodal telephone service providers should be eliminated, it did not identify any such impediments. Further, DPS Staff did not explain whether, and how, those impediments are related to any actions taken by Verizon and/or MCI. In our view, most of the factors that impede consumers from switching to intermodal telephone service providers cannot be addressed by Verizon in the context of this proceeding. Those factors include technological issues; such as the weakness of wireless signals in certain locations, the absence of cable telephony in an area, the absence of reliable E-911 service from VoIP and wireless service providers, and the intermittent quality of VoIP telephone service; as well as policy decisions that are beyond Verizon's control, such as decisions by cable telephone service providers to offer their service only in bundles with other services. Overall, these primary impediments to intermodal telephone competition would not be removed by the PSC imposing requirements on Verizon or MCI as a condition of merger approval.

DPS Staff's suggestion that the negative impacts of the merger on mass market competition could be offset by freezing the rates, terms, and conditions for MCI mass market customers for 12 months from the date of the merger would provide limited, if any, benefits to consumers. Under this proposal, the Company would be free to increase rates and change the terms and conditions of its service, up to one day before

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<sup>34</sup> White paper, p.26.

the merger is consummated, as well as immediately upon expiration of the one-year freeze. Instead, we recommend that the Commission adopt conditions to address the expected impact of the loss of an active competitor, on service quality.

## B. Service Quality

As explained in Point II, approval of the merger would result in a significant increase in the concentration of providers in the mass market and a loss of customer choice. The CPB and DPS Staff recognize that this reduction in choice might be accompanied by reduced service quality, particularly in rural, suburban and economically disadvantaged areas of the state.<sup>35</sup> The PSC has previously approved some mergers with conditions to help ensure that wireline service quality does not deteriorate.<sup>36</sup>

The CPB identified two recommendations to help offset the risks to Verizon's wireline service quality that may be posed by the merger. First, we proposed prompt implementation of certain recommendations of an independent audit of Verizon's retail service quality processes and programs, particularly those that would have a significant impact on the quality of wireline service in suburban, rural and economically disadvantaged areas of the state.<sup>37</sup> Second, we recommended that the PSC consider ways to more rapidly identify service quality deficiencies and ensure that Verizon take corrective action. That approach should focus on suburban, rural and economically

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<sup>35</sup> CPB Comments, pp. 15 – 17; DPS Staff White Paper, p. 51.

<sup>36</sup> Some Orders in which the PSC has approved proposed mergers subject to service-quality related conditions are identified in CPB Comments, pp. 21 – 22.

<sup>37</sup> CPB Comments, pp. 25 – 26.

disadvantaged areas of the state where the Company is not deploying fiber-to-the-curb.<sup>38</sup>

In its White Paper, DPS Staff shares our concern that the merger may pose a risk to retail service quality for mass market customers.<sup>39</sup> However, DPS Staff tentatively concluded that remedies to help ensure that service quality does not decline as a result of the merger, should not be pursued at this time. Instead, DPS Staff concluded that “the Commission’s recently announced initiative, the Comp III proceeding, which will undertake a broad review of telephone regulation in New York, presents an appropriate forum to consider these issues.”<sup>40</sup>

The CPB disagrees with that DPS Staff recommendation. The CPB and DPS Staff recognize the unambiguous nexus between the proposed merger and a potential reduction in wireline service quality. The Companies have stated that the objective of the merger is to “accelerate Verizon’s continuing transformation into a premier wireless and broadband provider.”<sup>41</sup> That goal, along with the Companies’ enhanced focus on large business and government customers,<sup>42</sup> is inconsistent with a focus on maintaining high quality wireline telephone service for mass market customers. Moreover, an objective of the merger is to reduce costs, which could affect wireline service quality. DPS Staff also cited a concern that “Verizon may dedicate investment to more

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<sup>38</sup> Id., pp. 26 – 27.

<sup>39</sup> DPS Staff White Paper, pp. 50 – 51.

<sup>40</sup> DPS Staff White Paper, p. 6, referring to Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services.

<sup>41</sup> Joint Petition, p. 9.

<sup>42</sup> Id., p. 8.

competitive areas at the expense of less competitive areas,” due in part to the loss of choice resulting from the merger.<sup>43</sup> Reduced investment in less competitive areas could affect wireline service quality.

As a result of the clear nexus between the merger and the potential reduction in wireline service quality, the Commission should impose service-quality related remedies in this proceeding. Approving the proposed merger without any conditions related to service quality, would not be in the public interest, for the reasons explained above.

Accordingly, the CPB continues to recommend that the PSC adopt the two service-quality-related recommendations identified in our Comments, as conditions upon its approval of the merger. In particular, the recommendations of the independent audit of Verizon’s retail service quality processes and programs should be implemented promptly. The final report on that audit was issued October 29, 2004, approximately nine months ago. The CPB understands that many of those recommendations have been implemented. As a condition of approval of the merger, the Commission should direct the Company to promptly implement the remaining recommendations of that independent audit.

Second, the PSC should consider other measures to ensure that Verizon’s service quality does not deteriorate, particularly in those areas of the state where competition is not vigorous and Verizon is not deploying a fiber-based network. DPS Staff agrees that such an approach is appropriate, but that “additional analysis on this issue, including the identification of the areas of limited competitive choice” should be

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<sup>43</sup> DPS Staff White Paper, p. 51.

undertaken in Case 05-C-0616.<sup>44</sup> The CPB recommends that as a condition of merger approval, the Commission establish the broad parameters of a program to help ensure rapid identification and correction of service quality deficiencies in areas of the state where competition is not vigorous. To the extent the Commission concludes that some details of that program cannot be developed within the time constraints of this proceeding, those refinements could be developed subsequently.

Finally, DPS Staff concluded that MCI's retail service quality performance data should continue to be reported separately from that of Verizon's.<sup>45</sup> The CPB disagrees with this conclusion. After a reasonable period of time to allow for integration of systems and reports, the merged company should provide a single report of its retail service quality. Separate reports would serve no useful purpose, and may create a misleading impression of the service quality provided by the merged company.<sup>46</sup>

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<sup>44</sup> Id., pp. 50 – 51.

<sup>45</sup> Id., pp. 49 -50.

<sup>46</sup> This is of particular concern given the waiver from routine reporting of certain service quality metrics that was granted to MCI affiliates in 2001.

## CONCLUSION

The New York State Consumer Protection Board recommends that the Public Service Commission condition approval of the proposed acquisition of MCI, Inc. by Verizon Communications Inc. upon adoption of the recommendations we identify herein.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Teresa A. Santiago". The signature is written in a cursive style with a large, sweeping initial "T".

Teresa A. Santiago, Chairperson and Executive Director  
Douglas W. Elfner, Director of Utility Intervention  
Gregg Collar, Telecommunications Project Manager

Dated: August 5, 2005  
Albany, New York