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August 5, 2005

VIA HAND DELIVERY

Honorable Jaclyn A. Brilling
Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Case No. 05-C-0237 – 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; and Case No. 05-C-0242 – Joint Petition of SBC Communications Inc., AT&T Corporation, together with its Certificated New York Subsidiaries, for Approval of Merger

Dear Secretary Brilling:

On behalf of Level 3 Communications, LLC, enclosed please find an original and five (5) copies of Comments in the above-referenced cases.

If you have any questions regarding this filing, please contact me.

Sincerely,

Brian T. FitzGerald

BTF/rsb
cc: Mr. Bill Hunt (via e-mail)
Mr. Greg L. Rogers (via e-mail)
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AL 91693.1

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 No. 05-C-0237
Joint Petition of SBC Communications Inc., AT&T Corporation, together with its Certificated New York Subsidiaries, for Approval of Merger	)	Case No. 05-C-0242

COMMENTS OF LEVEL 3 COMMUNICATIONS, LLC

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Dated: August 5, 2005

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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COMMENTS OF LEVEL 3 COMMUNICATIONS, LLC

Level 3 Communications, LLC ("Level 3"), through its undersigned counsel, respectfully submits these Comments in response to the New York State Department of Public Service Staff's ("Staff") White Paper ("White Paper") regarding the proposed merger applications of Verizon New York, Inc. ("Verizon") and MCI, Inc. ("MCI") and SBC Communications Inc. ("SBC") and AT&T Corporation ("AT&T"), respectively, under consideration in the above-referenced cases.

I. INTRODUCTION

In comments filed by Level 3 on April 29, 2005, the Company urged the New York State Public Service Commission ("Commission") to exercise its authority by undertaking a thorough review of the mergers in light of the significant negative impact on local exchange and intraLATA toll competition in the State of New York. Level 3 explained that unless adequate conditions were placed on the mergers to mitigate anti-competitive impacts, it opposes the mergers, particularly the Verizon/MCI merger given the nature of the transaction (i.e., the largest incumbent in the state proposes to merge with one of the largest competitors in the state).

Staff utilized, in a rigorous fashion, one of the best and most recognized methodologies for analyzing market power and anti-competitive impacts. Staff identified multiple areas of possible anti-competitive harm following the methodology set out in the Department of Justice ("DOJ")/Federal Trade Commission ("FTC") Horizontal Merger Guidelines. White Paper at 15. Staff utilized data collected from various sources, including data from Verizon's New York Performance Assurance Plan, as a starting point to calculate market shares and Herfindahl-Hirshman Indices ("HHIs") relevant to the proposed mergers. Id.

Nothing in Staff's White Paper changes Level 3's positions. In fact, the Staff White Paper verifies Level 3's prior comments. Staff correctly rejected Verizon's position in finding that the mergers are subject to the Commission's jurisdiction. Given the significant impact on competition amply revealed in the White Paper, the Commission must impose adequate remedies and/or conditions before the proposed mergers will be in the public interest.

In particular, the White Paper validates that, without verifiable and effective conditions, the merger is not in the public interest. The White Paper demonstrates that the merger would be contrary to the Commission's long-term goal of encouraging competition.[1] Level 3 agrees with Staff's conclusion that the Commission has jurisdiction over the transactions and must review them. Id. at 4. Level 3 also fully supports Staff's finding that the Verizon/MCI merger will impact the mass market by increasing the concentration in that market. Id. at 5. Level 3 agrees with Staff's conclusion that with respect to the large business (enterprise) and medium size business markets, the Verizon/MCI merger will produce significant consolidation. Id. at 6. Level 3 also concurs in Staff's analysis of the anti-competitive impact of the mergers on

[1] See Case 94-C-0095 – Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market, Opinion No. 96-13, Opinion and Order Adopting Regulatory Framework (May 22, 1996).

the transport, id. at 34, 37, and special access and high capacity loop markets. Id. at 40. Accordingly, these Comments address Staff's proposed mitigation measures for the Verizon/MCI merger and propose additional conditions necessary to protect the transport and special access markets. Further, while the White Paper proposed various mitigation measures, perhaps as a result of the range of identified potential remedies, it did not identify the impact of each remedy on the anti-competitive nature of the merger. Regardless of the combination of remedies adopted, further rigorous and quantitative analysis is necessary to demonstrate that the remedies, if implemented, would counterbalance the harms that will be caused by the mergers. Such an analysis should properly utilize the identical dataset underlying the Staff's finding of competitive harm. In other words, for the Commission ultimately to approve the mergers with necessary remedial conditions as in the public interest, additional qualitative analysis must be performed to ensure that the harm identified by Staff in the White Paper would, in fact, be addressed by the proposed conditions and remedies.

Level 3 disagrees, however, with the White Paper's conclusion that remedies are not needed regarding the SBC/AT&T merger. Although the potential impact of the Verizon/MCI merger on the telecommunications market is much greater than the SBC/AT&T merger, the market impact of the SBC/AT&T merger in combination with the Verizon/MCI merger must be considered and recognized by the Commission. The simultaneous occurrence of the SBC/AT&T and Verizon/MCI mergers creates the potential for future collusion on availability, price, terms and conditions of crucial services, particularly in the transport and special access services markets. Accordingly, the SBC/AT&T merger deserves a closer review than would be applied to the merger of AT&T under other circumstances and at a different time. Contrary to the White Paper's tentative conclusion, the imposition of certain conditions is appropriate. This is particularly true in the wholesale special access/high capacity loop market where the Staff acknowledged that AT&T is a "significant player." Id. at 73. Given the anti-competitive impact of the two proposed mergers on New York's transport and special access markets, and the lack of competition in the interoffice transport and local access market, the Commission should adopt the Level 3 Network Divestiture and Customer Retention Plan ("Level 3 Plan" or the "Plan"), which requires divestiture of overlapping transport and special access facilities, while allowing Verizon/MCI to retain their customer contracts. The Commission should also impose a short term freeze for 24 months on the prices, terms and conditions of the services offered by the combined SBC/AT&T entity while expressly retaining the ability to impose future price constraints should anti-competitive behavior arise. This type of limited pricing restraint is necessary to prevent SBC/AT&T from immediately raising rates on essential facilities that would otherwise be available through resellers of those facilities. The Commission should also reserve its right to reevaluate at a future date the SBC/AT&T transaction to determine if additional conditions are warranted should the combined SBC/AT&T entity, despite SBC and AT&T's assurances to the contrary, withdraw from competing with the combined Verizon/MCI entity in New York.

II. SPECIFIC COMMENTS ON REMEDIES

A. Staff's White Paper Raises Significant Concerns Regarding The Verizon/MCI Merger Which Justify Conditions

Contrary to Verizon and MCI's assertions that the merger will cause little competitive harm because MCI is just one among many competitors in the market, Staff demonstrated that the merger will competitively harm the telecommunications markets in New York State, a point repeatedly made in the White Paper.

First, Staff fully acknowledges that "the proposed mergers are taking place at a critical juncture in the telecommunications market. . . ." Id. at 4. Second, throughout the White Paper, Staff identifies numerous negative implications of the Verizon/MCI merger. Despite Verizon and MCI's attempts to downplay the significance of the merger, Staff's White Paper confirms that the merger represents nothing less than a historic change in the marketplace. Staff correctly concludes, based on a market power review, that the proposed merger raises "significant concerns regarding market concentration" in the mass market, enterprise, transport and special access market segments. Id. at 15. Overall, Staff's analysis demonstrates that the Verizon/MCI merger raises significant concerns and represents a definitive step backward in the development of competitive markets in New York. Given Staff's findings, it is clear that the Commission is required to place conditions on the merger for it to be in the public interest.

In light of its anti-competitive findings, Staff proposes a variety of mitigation measures for the Verizon/MCI merger. Id. at 17. Level 3 supports Staff's conclusions regarding remedies. Level 3 agrees that the Commission should require the combined entity to offer stand-alone DSL in order to mitigate impacts on the mass markets. Id. at 14. Level 3 also agrees that intervention is not needed in the Internet backbone market. Id. at 18. However, additional protections, above and beyond the measures proposed by Staff, are necessary for the transport and special access markets. As more fully set forth below, Level 3 urges the Commission to adopt the Level 3 Plan for those particular markets.

1. Internet Backbone

While Level 3 agrees with Staff that the Internet backbone market is robust and competitive and that intervention is not needed at this time, it also agrees with Staff that the future of a competitive Internet backbone rests on the ability to obtain special access facilities on a competitive basis. By ensuring competitive pricing for special access and last-mile facilities, as discussed below, the Internet backbone will be kept competitive. Thus, no Internet backbone-related conditions are necessary for the merger. However, if a carrier with a significant backbone presence is allowed to leverage it's dominance in the special access market, that carrier will have a powerful incentive to "tip" the Internet's competitive balance by leveraging its dominate position on the public switched telephone network.

2. Transport Market

In the White Paper, Staff found that the "transport market concentration is problematic even in the most competitive subset of routes in the New York and metropolitan LATA." Id. at 34. Staff properly raises concerns over the post-merger transport market given that Verizon's and MCI's transport facilities would be under control of a single entity. Id. at 35. Staff likewise notes that the anti-competitive impacts of the merger are most troubling on the transport routes where Verizon, MCI, SBC and AT&T are the only transport providers. Id. at 36. Staff concluded that "the level of overlapping transport facilities, and the concomitant lack of additional transport providers on some of those routes with overlaps, indicates a significant anti-competitive impact of the merger(s) upon the New York transport market" and that remedies should be imposed on the merger. Id. at 36-37 (emphasis added). Staff's analysis of the transport market coincides with Level 3's experience.

Level 3 is a leading provider of data, network and Internet protocol services in the United States and Europe. As a wholesaler, Level 3 provides services to Internet service providers, ILECs, interexchange carriers, competitive local exchange carriers, and wireless providers. However, despite the size of its network, Level 3 must use third-party vendors to reach many traffic aggregation points in metro and suburban areas.

The market for local and intermediate distance (i.e., intrastate transport from major urban areas to surrounding suburban, ex-urban communities and smaller cities and towns, where business customers are migrating) transport facilities is highly concentrated. Only a few companies own the physical local networks which are essential to connecting long-haul or backbone networks to the end-user customer's buildings or traffic aggregation points such as carrier hotels and RBOC central offices. Verizon and SBC are the dominant providers of in-region transport services. As a result of network scale, MCI and AT&T have developed the physical network footprint, off-net supply contracts and operational support to make them the most capable alternative suppliers for in-region transport. Level 3 spends more than $100 million a year for purchase of transport services from Verizon, MCI, SBC and AT&T, which are Level 3's four largest vendors in terms of payment. Unfortunately, the proposed mergers will eliminate half of Level 3's options.

Moreover, barriers to entry for new facilities-based transport providers are high in light of the cost of construction in metropolitan and suburban areas, local franchise issues and costs (which often discriminate against new entrants), difficulty in gaining access to buildings, and capital constraints. In light of these facts, it seems unlikely that any entity will, at least in the near term, construct networks replicating those previously owned by MCI and AT&T. The elimination of MCI and AT&T from the market, the lack of competitive alternatives, and high prices significantly increase the risk of anti-competitive conduct and above-market pricing by the dominant provider.

As mentioned in the introduction to these Comments, the mergers significantly increase the risks of coordinated anti-competitive effects from the merged entities. It is unlikely that SBC and Verizon will compete against one another, as they have not traditionally done so despite pledges of competition and being well-positioned in some key markets. It appears that neither carrier is willing to challenge the other's stronghold. After closing of the mergers, Level 3 does not expect AT&T to be a significant competitor within Verizon's territory for the provision of transport services on a wholesale basis. Thus, the mergers could mean the effective loss of both of the best-positioned alternative providers in the local transport market in Verizon's territory.

To mitigate this impact on the transport market, Staff proposes four remedies: 1) a requirement that MCI provide smaller carriers the same rates, terms and conditions for wholesale services provided pre-merger, or which are currently tariffed or offered under special pricing arrangements, for a period of thirty-six months from the date of the merger; 2) availability of standard competitive rates, terms and conditions in commercial agreements between Verizon and competitive carriers; 3) expansion of metric definitions for transport market-related retail and wholesale performance; and 4) divestiture of the MCI transport network. Id. at 37. Level 3 supports all of these options and urges Staff, and ultimately the Commission, to treat them as components of an adequate remedy rather than stand-alone alternatives. For example, simply attempting to ensure competitive pricing in the transport market is not sufficient to protect it from the anti-competitive impacts of the mergers. At a minimum, such a measure must be combined with effective monitoring of the market and the ability to correct any problems.

With that said, Level 3 strongly supports the divestiture option. Divestiture of in-region overlapping network assets is required in order to preserve existing competitive balance. It is the only remedy that will continue to function long term. To mitigate adequately the anti-competitive impact of the merger on the transport market, the Commission must adopt the Level 3 Plan, which is similar in concept to Staff's proposed remedies but includes additional, important elements. The Level 3 Plan combines divestiture of in-region facilities with a revenue commitment from the combined entity for a period of five years in order to promote a competitive landscape. Level 3 believes its Plan is superior because it will not require post-merger monitoring by regulatory authorities because the new owner of the facilities will have a economic incentive to provide competitive services.

Level 3's Network Divestiture and Customer Retention Plan consists of three parts, each of which is necessary to protect and promote competition in the transport market. Specifically, the Level 3 Plan includes: 1) divestiture of overlapping "In-Region Transport Assets"; 2) payment to new network owner(s) for a five-year period; and 3) retention of customer contracts by the combined entity.

The first part of the Level 3 Plan involves divestiture of "In-Region Transport Assets," which includes tangible assets such as fiber, transport equipment and collocation space and intangible assets such as MCI's off-net transport purchase agreements or rights owned, leased or operated by MCI in Verizon New York territory.[2] It would not include MCI's interstate intercity backbone.

The divestiture of the identified In-Region Transport Assets has a number of advantages. First, the divestiture would involve a conveyance of assets to new owner(s), which would promote competition in that the new owner(s) would be able to quote pricing, terms and conditions for wholesale services that were offered prior to the merger and to use the facilities to provide services directly to end-user retail customers.

Second, the conveyance of assets would permit MCI customers to continue the direct contractual relationship with the combined Verizon/MCI entity so that there would be no

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[2] Several carriers, including Level 3, have publicly expressed some interest in purchasing these assets. Level 3 believes it is more important to preserve the existing competition in this highly concentrated marketplace than who purchases the assets.

interruption, except as might otherwise occur as a result of the merger, in customer support, billing and contractual terms.

Third, the provisioning interfaces between the new owner(s) and MCI would be the same that companies use when they buy off-net circuits from LECs and other network providers. No support from or interfaces with the sellers would be necessary for more complex services.

Finally, the conveyance of assets would deliver numerous benefits to Verizon that it publicly claimed as reasons for the merger, including serving the largest business customers with a full range of products and services.

There is one additional protection that needs to be considered to assure the effectiveness of the divestiture aspect of Level 3's Plan. Any divestiture requirement should include a limitation on the number of entities to whom the In-Region Transport Asset can be conveyed.

Although at first blush limiting the number of entities that purchase MCI's divested assets may seem counter-intuitive to the development of competition, this approach would allow the new owner(s) to compete for transport business in the same manner as MCI did prior to the merger. If, for example, divestiture occurred such that 15 different entities purchased assets in 15 different metro areas, the new owners of those assets would not be able to compete for transport business in the same manner as MCI prior to the merger. Accordingly, Level 3 recommends that there be no more than two purchasers of the In-Region Transport Assets so as to assure that the new owner(s) is/are able to compete in an effective manner.

The second component of the Level 3 Plan, a commitment from Verizon to continue to purchase services from the new owner(s) for a period of five years, would allow the buyer to match its costs and revenues in the first few years. The revenue commitment made to each new owner would be clear and set based on some reference to actual usage of the underlying transport assets being sold. This approach would prevent Verizon from attempting to undermine the divestiture process by offering a more favorable revenue commitment to certain favored and compliant buyers who are less likely to compete with Verizon. It would also allow the new owner(s) sufficient time to build a customer base – both wholesale and retail – on the In-Region Transport Assets so that the new owner(s) would be able to compete with the incumbent even after expiration of the purchase commitment. Such an arrangement would not be unduly burdensome for the Combined Entity, which will continue to service customers on their respective networks for some period of time until it can consolidate its network operations.

The third component of the Level 3 Plan, customer retention, is self-explanatory. The combined Verizon/MCI entity would keep all of MCI's customer contracts. Although divestiture of MCI customer agreements might be preferable from the standpoint of reducing the retail market concentration of the merged entity, it is operationally difficult for several reasons.

First, the division of MCI's customer contracts would be exceedingly difficult as most of the contracts are likely Master Service Agreements ("MSAs"), pursuant to which customers buy a wide variety of multiple services (e.g., voice, internet, virtual private networks, transport, systems integration) from MCI in a number of locations throughout the United States and other countries. For contract (not asset) divestiture to be successful, the contracts would need to be separated into multiple agreements, with pricing allocated to each separate service and potentially to each separate circuit. Customers would likely find this compelled transfer of their agreements unattractive.

Second, if customer contracts are divested and conveyed to a third-party, the new owner(s) of the In-Region Transport Assets would have to rely heavily on billing systems, provisioning systems, Network Operations Center support and other Operational Support Systems/Business Support Systems that would have to be retained by MCI so that MCI could continue to provide service under the retained portions of the contracts. Significant and long-term cooperation between the combined Verizon/MCI entity and the new owner(s) would be necessary for the divestiture of contracts to be successful. Such an approach would hamstring the new owner's ability to compete effectively with the incumbent upon which it relies.

Third, it is also highly likely that many of MCI's more sophisticated customers receive proprietary services or service level agreements from MCI that would be difficult for a competitor to replicate quickly. Likewise, given that the customers would be involuntarily conveyed to the new owner(s), the risk of the new owner(s) losing that customer base appears to be great.

Level 3's Network Divestiture and Customer Retention Plan contains numerous benefits for the competitiveness of the transport market. The Plan would restore the pre-merger landscape and promote competition by allowing the new owner(s) to offer services on the same terms and conditions as MCI. At the same time, MCI would continue to have direct contractual obligations with minimal customer interruption. The combined Verizon/MCI entity and the new owner(s) would be able to utilize existing interfaces for procurement. The Plan also delivers merger benefits to Verizon, including large business customers. Overall, the Plan fosters competition in the transport market through a narrowly tailored divestiture requirement, which does not require significant intrusive regulation of conduct of the merger parties or the purchaser(s) of the divested assets. Accordingly, at a minimum, Level 3 respectfully requests that the Commission adopt Level 3's Network Divestiture and Customer Retention Plan as a condition to the Verizon/MCI merger.

3. Special Access Market

Contrary to Verizon and MCI's argument that the merger would not result in significant overlapping of special access and high capacity loops, Staff found large overlaps between Verizon's and MCI's local loop facilities. Id. at 42. Staff tentatively concluded that "the acquisition of the second (MCI is roughly tied for second place with AT&T) largest wholesale provider by the largest provider of high capacity loop access services (Verizon) will significantly increase market concentration in the transport and special access markets." Id. at 44 (emphasis added). Staff also acknowledged that the combination of the Verizon/MCI and SBC/AT&T mergers increases the potential for price or rate collusion or discrimination in the provision of access for transport or special access facilities to the detriment of small carriers and business customers. Id. Staff confirmed Parties' concerns that the merger could increase T1 prices and/or cause a deterioration of retail service quality. Id.

In light of its findings, Staff proposed five remedies, "in part to avoid a situation where large business customers are harmed by the impacts of less competitive enterprise rates post-merger, regardless of the precision in how the market is defined." Id. The five remedies include: 1) a requirement that MCI provide smaller carriers the same rates, terms and conditions for wholesale services provided pre-merger, or which are currently tariffed or offered under special pricing arrangements, for a period of thirty-six months from the date of the merger; 2) extension for thirty-six months from the date of expiration of any Verizon interconnection agreement with other carriers that are due to expire within twelve months of the merger; 3) expansion of special services market-related retail and wholesale carrier-to-carrier performance metric definitions; 4) availability of standard competitive rates, terms and conditions in commercial agreements between Verizon and competitive carriers; and 5) divestiture of MCI's New York fiber loop network. As with the transport market, Level 3 supports all of these options and urges Staff, and ultimately the Commission, to treat them as components of an adequate remedy rather than stand-alone alternatives. With that said, Level 3 strongly supports the divestiture option.

While the divestiture of MCI facilities is necessary to preserve access competition where it exists today, it is important to emphasize that for the vast majority of buildings in their respective regions (both traffic aggregation points such as central offices as well as end-user buildings), no provider exists other than Verizon. As such, it is critical that the Commission take aggressive steps to ensure that special access prices are reasonable and non-discriminatory for these monopoly destinations. Thus, Level 3 respectfully requests that, at a minimum, the Commission adopt Level 3's Network Divestiture and Customer Retention Plan, as outlined in more detail above in relation to the transport market, and conditions to ensure reasonable and non-discriminatory prices in the special access market.

4. Mass Market

Staff found various weaknesses in Verizon/MCI's position regarding mass markets. Id. at 20-25. Contrary to Verizon and MCI's claims that the merger would not impact the mass market, Staff's HHI calculations reveal significant anti-competitive concerns. Id. at 25. Even in the unlikely event that the Staff's analysis was incorrect by an order of magnitude, the mergers would still raise such concerns. Based on its analysis, Staff determined that the concentration will increase in the mass market (residential and small business). Id. at 23. The impact can not be understated. As Staff explained, the merger would result "in a significant increase in the concentration of providers in the mass market." Id. at 25 (emphasis added).

Staff explained in the White Paper that despite the existence of Internet VoIP providers, cable company-based VoIP services and wireless services, the proposed merger makes an already concentrated residential and small business market even more concentrated. Id. at 22-23. Staff proposed three remedies that "might offer an avenue to offset the anti-competitive harm associated with the highly concentrated post-merger mass market." Id. at 26. One of the remedies proposed by Staff requires Verizon to offer unrestricted "naked DSL" in an effort to stimulate inter-modal competition.

Level 3 supports a merger condition requiring Verizon to offer a stand-alone DSL product. Stand-alone DSL provides customers with the ability to purchase broadband service without having to maintain or purchase a primary telephone line or other service from Verizon. To be effective, the DSL product would need to be priced lower than the combined DSL and basic service offered by the incumbent.

Such a product is a crucial step to injecting competition into the residential and small business markets. VoIP offers the best chance for competition in the residential market. In the past, customers had to obtain access via cable modem or over bundled DSL connections to access VoIP providers. Additional competition from VoIP providers is dependent upon ready access to broadband connections, including Verizon's DSL service. If Verizon requires customers to bundle DSL with basic local exchange service, it will discourage consumers from using VoIP application providers. Without a stand-alone DSL product, the combined Verizon/MCI entity has the ability to leverage its ownership of last mile facilities in the retail market to impede broadband access and, thus, hamper innovation and competition.

Further, the combined Verizon/MCI entity must not be able to prohibit the flow or block any packets across last mile facilities. If the combined entity is allowed to discriminate against competitors' packets in favor of its own in any way, it will impact the quality of VoIP services and eliminate the benefit of the stand-alone DSL product.

For these reasons, Level 3 respectfully requests that the Commission condition the Verizon/MCI merger by requiring the combined entity to offer a stand-alone DSL product and to agree not to discriminate in favor of its own services in the use of its Internet backbone.

III. CONCLUSION

For the foregoing reasons, Level 3 respectfully requests that the Commission condition the Verizon/MCI and SBC/AT&T mergers as proposed herein.

Dated: August 5, 2005

Respectfully submitted,

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