Robert P. Slevin
Associate General Counsel
Legal Department

Verizon New York Inc.
Room 3824
1095 Avenue of the Americas
New York, NY 10036

Phone 212 395-6390
Fax 212 764-2739
robert.p.slevin@verizon.com

August 5, 2005

BY HAND

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

Re: Case 05-C-0237

Dear Secretary Brilling:

In accordance with the Notice Soliciting Comments on the Staff White Paper (issued July 6, 2005), enclosed please find an original and five (5) copies of the REDACTED VERSION of Petitioners' Comments on Department of Public Service Staff White Paper.

REDACTED versions of this filing are being served on the Active Parties List to this proceeding. PROPRIETARY versions are being served on Judge Liebschutz and any party that signs and returns Exhibit 1 to the Protective Order, as subsequently amended.

Respectfully submitted,

Robert P. Slevin

cc: Honorable Elizabeth A. Liebshutz (By E-Mail and By Hand)
Active Parties List (By E-Mail)

***** REDACTED VERSION *****

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of the	)	
	)	
Joint Petition of	)	
	)	
Verizon Communications Inc., and	)	
MCI, Inc.	)	**Case 05-C-0237**
	)	
for a Declaratory Ruling Disclaiming	)	
Jurisdiction Over or, in the Alternative,	)	
for Approval of Agreement and Plan	)	
of Merger.	)	
	)	

PETITIONERS' COMMENTS ON
DEPARTMENT OF PUBLIC SERVICE
STAFF WHITE PAPER

Of Counsel:

SCOTT H. ANGSTREICH
Kellogg, Huber Hansen, Todd
Evans & Figel, P.L.L.C.
Sumner Square
1615 M Street, N.W., Suite 400
Washington, D.C. 20036
202-326-7900

SANDRA DiIORIO THORN
ROBERT P. SLEVIN
1095 Avenue of the Americas
New York, New York 10036
212-395-6390

Counsel for Verizon Communications Inc.

LAURA GALLO
200 Park Avenue
New York, New York 10166
212-519-4436

Counsel for MCI, Inc.

Dated: August 5, 2005

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PETITIONERS' COMMENTS ON DEPARTMENT OF PUBLIC SERVICE STAFF WHITE PAPER

Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI") (collectively, the "Petitioners") hereby submit these comments in response to the Department of Public Service Staff ("Staff") White Paper (the "White Paper").

I. PRELIMINARY STATEMENT

The White Paper "presents *preliminary analyses* and *tentative conclusions* about the impact of [the Verizon/MCI and SBC/AT&T] mergers on New York consumers."[1] Although Staff forthrightly acknowledges that its preliminary analyses are based on incomplete information, Staff nevertheless tentatively concludes that the Verizon/MCI transaction will impact what it describes as the "markets" for residential and small business customers (the "mass market"), for medium and large business customers (the "enterprise market"), and for wholesale services (such as transport and special access services). Believing that the transaction will result

[1] White Paper at 4.

in a competitively significant increase in market concentration, as measured in most cases by the Herfindahl-Hirschmann Index (or "HHI"), Staff offers for the parties' consideration and comment a number of remedies ostensibly designed to address the harms that Staff believes might flow from this increased concentration. As described more completely below, Staff's preliminary analyses in fact are fundamentally flawed in numerous material respects and all of its suggested remedies are unnecessary, prohibited by law and contrary to sound public policy in a rapidly changing communications industry, and therefore, should not be adopted.

As a general matter, Staff's analyses of the various "markets" are internally inconsistent and contradictory. For instance, Staff on the one hand acknowledges (accurately and often) that "there is significant mass market intermodal competition providing voice and data alternatives in most parts of New York,"[2] yet on the other fails to account for much or all of this competition when analyzing the transaction's effect on mass market competition. Staff also acknowledges that an HHI analysis "is not the sole criterion that should be examined in a merger review."[3] And yet Staff's tentative conclusions that the transaction will harm mass market, enterprise and wholesale customers because it will increase concentration in the markets for those customers are premised almost *entirely* on Staff's HHI analyses of those "markets." Moreover, despite its admission that the data used in the analyses are incomplete and in some respects inaccurate, Staff relies on those data as if they were complete and accurate. These errors render Staff's analyses of the transaction's effect on competition nearly meaningless. They also render unnecessary the various remedies Staff suggests might be needed to address the harms that the flawed analyses indicate would result from the transaction.

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[2] *Id.* at 5.

[3] *Id.* at 16.

Staff's suggested remedies should be rejected for other reasons as well. Most of the suggestions are beyond the Commission's authority to adopt, and not merely because the Commission has no jurisdiction to review the transaction or to impose conditions on its approval.[4] The remedies either relate to interstate services provided under federal tariff or contract or they would, if adopted, require Verizon to take action that is inconsistent with the Telecommunications Act of 1996 (the "1996 Act"), as authoritatively construed by the Federal Communications Commission (the "FCC") and the federal courts. Moreover, many of Staff's suggested remedies are unnecessary in that they purport to address problems that do not currently exist and that will not arise as a result of the transaction. Adopting such remedies would impose unreasonable burdens on Verizon New York at a time when its financial condition is already suffering from the effects of the very competition that makes the transaction necessary and that protects against the kinds of harms that Staff tentatively – and erroneously – concludes will result from the transaction.

In the discussion that follows, Petitioners demonstrate the various flaws in each of Staff's preliminary analyses of the transaction's effect on competition. Petitioners show that there is no factual basis for Staff's tentative conclusions that the transaction will affect competition in a way that requires adoption of competitive remedies. And Petitioners show why the remedies themselves are either inappropriate, unnecessary, or both, such that the Commission should reject them entirely.[5]

[4] *See* Section V, *infra.*

[5] Along with these Comments, Petitioners are also providing Comments prepared by Gustavo E. Bamberger, Dennis W. Carlton and Allan L. Shampine, economists from Lexecon. The Lexecon Comments support these Comments and are annexed as Exhibit 1.

II. STAFF'S PRELIMINARY ANALYSES OF THE TRANSACTION'S EFFECT ON COMPETITION ARE FLAWED AND PROVIDE NO BASIS FOR ADOPTING REMEDIES FOR PURPORTED COMPETITIVE HARMS

The White Paper discusses Staff's preliminary views of the transaction's potential impacts on competition in New York for several customer segments – specifically, the mass market, the enterprise market and the wholesale markets for transport and special access and high-capacity loops. The White Paper's preliminary analysis of each segment is fundamentally flawed in numerous material respects. First, with respect to virtually all of the segments, Staff improperly uses HHI calculations as its sole criterion for gauging the transaction's possible effects on competition. The HHI calculation was never intended to be – and, when used by the Department of Justice ("DOJ") and the Federal Trade Commission ("FTC"), is not – the sole criterion, and in fact is of little (if any) use in evaluating a rapidly changing market.

Second, aside from the flaws inherent in Staff's reliance on HHI calculations, Staff's calculations are fundamentally flawed in numerous material respects. They are based on incomplete and stale data, rendering the calculations worthless as predictions of the effect of this transaction on competition. As discussed in the sections below, none of Staff's analyses provides any basis for adopting any of the remedies that Staff offers for consideration. Moreover, the specific remedies about which Staff has sought comment are flawed for numerous reasons, including that they would exceed the Commission's jurisdiction, cause unwarranted customer disruption, or address matters that are unrelated to this transaction.

A. HHI Analysis Cannot Be Applied Mechanically To The "Markets" Defined By Staff Here

1. HHIs Do Not Provide, And Are Not Used By The Federal Agencies That Review Mergers As, Conclusive Evidence Of Competitive Harms From A Transaction

Staff's preliminary analysis places far more weight on its HHI calculations than is warranted under either economic theory or actual DOJ and FTC practice. Although Staff appears to recognize the inherent limitations of the HHI review,[6] it nevertheless tentatively concludes, time and again, that the transaction "warrant[s] further review" and "requires countervailing remedies" because – and *only* because – Staff calculated "an increase in [HHI] . . . [that] exceeds the threshold levels in the DOJ/FTC Guidelines."[7] HHI calculations, however, cannot soundly be relied upon in such a mechanical manner, even in such a preliminary analysis.

The HHI – or Herfindahl-Hirschmann Index – is seductive because it is an apparently simple arithmetic calculation, summing the squares of the market shares of the various firms in the market.[8] But as the leading antitrust treatise explains, "the HHI should always be used tentatively," because "although the HHI appears to give definitive answers to how markets respond to increasing variations in the number and size disparities among firms, such responses are in fact far more complex and depend on" a variety of other factors.[9]

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[6] Staff expressly recognized that an "HHI review is not the sole criterion that should be examined in a merger review." *Id*. at 16. Staff, moreover, correctly stated that any "presumption" of competitive harm that might arise from HHI review "could be overcome" based on "factors affecting the competitiveness of the market," including the extent of "[e]ntry barriers and current trends in the market." *Id*. And Staff also acknowledged that "[a]ny anticompetitive impact of the merger[] must be balanced" against the "benefits" from the transaction. *Id*. at 12.

[7] *Id.* at 29, 32; *see id.* at 25-26, 30, 37. Although Staff did not perform HHI calculations when it considered the effect of the transaction on special access and high-capacity loops, its consideration of that segment is flawed for other reasons, as discussed below.

[8] Thus, for example, if there is only one firm in the market, with a 100 percent market share by definition, the HHI is 10,000 (100 x 100); if there are five equal-sized firms, the HHI is 2000 (20 x 20 x 5); if there are five firms, one with 40 percent and four each with fifteen percent, the HHI is 2500 ((40 x 40) + (15 x 15 x 4)).

[9] P. Areeda *et al.*, IV *Antitrust Law* ¶ 930b at 136-37 (1998).

Not surprisingly, the DOJ's and FTC's Horizontal Merger Guidelines ("Guidelines"), on which the White Paper relies heavily in drawing conclusions from its HHI calculations, suggests only a limited role for HHI calculations, as merely "an aid to the interpretation of market data."[10] More important, since the Guidelines were issued, HHIs "have, if anything, become *progressively less significant*," as FTC Commissioner Thomas Leary explained in 2002.[11] In a similar vein, Lawrence Fullerton, then-Deputy Assistant Attorney General for Antitrust at DOJ, said in 1996 that DOJ does "not approach merger analysis mechanistically" and that, after defining markets and assessing market concentration, DOJ then determines "whether anticompetitive effects are likely, given the[] concentration levels and other characteristics of the market."[12]

The deemphasizing of simple arithmetic calculations in merger analysis is not just a matter of words. It is plainly reflected in the enforcement decisions of the federal antitrust agencies, in both Democratic and Republican administrations. A study of DOJ and FTC merger challenges from 1999 to 2003 confirms that "a gap exists between the Merger Guidelines as written and actual enforcement practice."[13] So when Cingular and AT&T Wireless merged, DOJ sought remedies only with respect to a handful of 450 Component Economic Areas and Cellular Market Areas where strict application of the HHI thresholds identified suggested that the merger warranted further scrutiny.[14] And those few areas had post-merger HHIs that "range[d] from

[10] Guidelines § 1.5.

[11] Thomas B. Leary, The Essential Stability of Merger Policy in the United States (Jan. 17, 2002) (emphasis added).

[12] Lawrence R. Fullerton, *Recent Developments in Merger Enforcement* (Mar. 13, 1996).

[13] John Kwoka, *Some Thoughts on Concentration Market Shares, and Merger Enforcement Policy* at 7, presented at FTC/DOJ Workshop on Merger Enforcement (Feb. 14, 2004).

[14] See Final Judgment at 3-7, United States v. Cingular Wireless Corp., No. 04-CV-1850 (D.D.C. Nov. 3, 2004); see also Memorandum Opinion and Order, Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corp., For Consent to Transfer Control of Licenses and Authorizations, 19 FCC Rcd 21522, ¶¶ 104, 110 (2004)

(continued . . .)

approximately 4400 to more than 8000, with increases in the HHI as a result of the merger ranging from approximately 1100 to more than 3500."[15]

In short, there is no basis in economic theory, antitrust law, or the enforcement policies of the expert federal antitrust enforcement agencies for treating HHI calculations as more than one of many relevant factors in assessing the competitive significance of a merger. The White Paper is fundamentally flawed because it gives virtually dispositive weight to such calculations.

2. HHIs Are Especially Inapt Predictors Of The Effects Of A Merger In Rapidly Changing Markets

Even aside from the fact that the White Paper places far too much weight on its HHI calculations, there is little reason to believe that HHI calculations provide any probative information in the communications markets defined by Staff here. That is because the HHIs that Staff calculated reflect the *past* while the question concerning whether a transaction will injure competition is necessarily predictive and *forward-looking*.

Therefore, to be relevant to any antitrust issues raised by a transaction, HHI calculations and other measures of concentration must enable a comparison of the market structure that will exist after the merger with that which would exist in the future absent the merger.[16] Indeed, for this reason the DOJ/FTC Guidelines state that the shares used to calculate HHIs should

(. . . continued)

("AT&T Wireless-Cingular Order"). The FCC similarly found that remedies should be imposed with respect to very few of the markets identified through HHI calculations as warranting further investigation. See id. ¶ 184 ("we have concluded that, as a general matter, even the markets identified for further review by our preliminary HHI and spectrum analysis are unlikely to suffer anticompetitive effects as a result of the merger"). And, where the FCC did impose remedies, it did so only after an extensive and detailed analysis. See id. ¶¶ 193-200 & App. D.

[15] Competitive Impact Statement at 11, *United States v. Cingular Wireless Corp.*, No. 04-CV-1850 (D.D.C. filed Oct. 29, 2004).

[16] *See* Guidelines § 0 ("[T]he picture of competitive conditions that develops from historical evidence may provide an incomplete answer to the forward-looking inquiry of the Guidelines.").

themselves "be calculated using the best indicator of firms' *future* competitive significance."[17] For many mergers, analysis of the structure and performance of the market in the recent past provides a sound basis for predicting the structure and performance of the market in the future. For such mergers, HHI and other data from the recent past serve, in effect, as proxies for a more direct examination of likely future attributes of the market.

In other situations, however, past is not prologue. Where markets are characterized by rapid technological or other changes, or individual firms are either declining or rising rapidly, sound merger analysis requires either that past data not be used for calculations of market structure or that calculations based on such data be used for only limited and tentative purposes.

The Verizon/MCI transaction presents just such a situation. As described in detail in Petitioners' Reply Comments, submitted on May 13, 2005, technological changes are profound and rampant. Old-fashioned voice telephony over twisted-pair copper wire – the core of Verizon's business to date – is becoming obsolete. New wireless, cable, and Internet technologies are rapidly gaining customers who leave the public switched telephone network altogether. Technological and regulatory changes are making the core of MCI's mass-market local and long-distance businesses no longer viable. New firms – wireless providers, cable providers (whether offering circuit-switched or VoIP service), and unaffiliated VoIP providers – are making major inroads into the telephony market.

In these circumstances, it is unsound to rely on HHI calculations that are based entirely on data about the past, and to ignore these changes in the market. It is simply incorrect to say, as the White Paper does, that "market concentrations, measured by HHIs, are traditionally

[17] *Id.* § 1.41 (emphasis added).

calculated based on current data, not projected data."[18] HHI calculations are based on "forward-looking" shares – that is, the shares that would prevail in the absence of the proposed transaction.[19] And there is certainly no sound basis – in law, economics, or public policy – for calculating HHIs, and basing competitive analysis, on *past* data that is already so patently obsolete. The White Paper is thus also fundamentally flawed because it relies on a backward-looking analysis when the market is in the midst of a period of rapid and profound change.

Staff's focus here on the past stands in stark contrast to the Commission's views expressed in other proceedings. Thus, in comments to the FCC, this Commission urged that agency to "recognize current market conditions by expressly placing substantial weight on intermodal competition."[20] More recently, the Commission acknowledged that consumers in New York "are already benefiting from a vigorous marketplace and have considerable choice," as "[i]ntermodal forms of competition are quickly gaining acceptance in the marketplace and thus are creating substantial facilities-based competition."[21] The Commission further acknowledged that "[t]echnical changes require that the Commission again re-examine the way it regulates telecommunications services."[22] Although the Commission is properly looking to the future (even in the context of this transaction), Staff's preliminary analysis of the transaction remains mired in the past.[23]

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[18] White Paper at 24.

[19] *See* Guidelines § 1.521.

[20] Comments of the New York State Department of Public Service at 4, WC Docket No. 04-313, CC Docket No. 01-338 (FCC filed Oct. 4, 2004).

[21] Case 05-C-0616, Order Initiating Proceeding and Inviting Comments (June 29, 2005), at 1 ("*Intermodal Services Proceeding Order*").

[22] *Id.* at 3.

[23] Indeed, as explained further below, Staff's rationales for excluding consideration of intermodal competition, *see* White Paper at 22-24, cannot be squared with this Commission's own determination that intermodal competition has brought New Yorkers the benefits of robust, facilities-based competition.

B. Staff's HHI Calculations And The Remedy Proposals Derived From Those Calculations Are Fundamentally Flawed

Even where HHI calculations can provide useful information in analyzing a transaction, it is essential that the calculation be performed correctly. As the leading antitrust law treatise explains, use of the HHI "places a premium on accuracy in market definition" and on calculating the shares of the companies in that market.[24] That is because the "squaring" of market shares that constitutes the calculation of the HHI "exaggerates any error that may have been committed in initial measurement [of market shares], especially of larger firms"[25] As a result, the "HHI of a poorly defined market can yield *gross errors* in prediction."[26] As shown below, that is precisely what happened here. Staff's calculations of HHIs are based on incomplete data and improper market definitions, rendering the calculations worthless as predictions of the effect of this transaction on competition, even aside from the flaws in the use of HHI discussed above.

1. This Transaction Will Not Reduce Competition For Mass-Market Customers

a. Staff Fails To Give Proper Weight To The Irreversible Decline Of MCI's Mass-Market Business

The assumed elimination of MCI as a competitor for mass-market customers will have no material effect on the mass market competition that already exists in New York, particularly given the pervasiveness and growth of intermodal competition which will not be impacted in any way by the transaction. As an initial matter, it is noteworthy that the Commission's conclusion in early 2004 that 85% of Verizon's mass-market customers already have a "robust mixture[]" of competitive choices assigned no weight at all to MCI's UNE-P offering to mass-market

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[24] Areeda, *supra* note 9, ¶ 929d, at 129.

[25] Id.

[26] *Id.* ¶ 930b, at 136 (emphasis added).

customers in New York.[27] Accordingly, the elimination of MCI as a competitor could have no effect on the extent of competition in those wire centers, and any hypothetical price increases by the combined company would only accelerate the flight of customers to these competitive choices. MCI is essentially distributing Verizon's services when it uses a commercially negotiated replacement for UNE-P to provide local service, and courts have recognized that pure reselling is "more akin to mere 'substitution' than to competition," and therefore of little, if any, competitive significance in antitrust analysis.[28]

But regardless of the merger, MCI's mass-market business is in a continuing and irreversible decline. As a result of numerous factors – including the elimination of the UNE Platform, state and federal "Do Not Call" legislation, and increased competition from wireless, cable and other intermodal competitors – MCI made the decision, unrelated to this transaction, to manage the decline of its mass-market business and to shift its business focus elsewhere. Indeed, MCI's national mass-market revenues shrank by **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** from 2003 to 2004. In the first quarter of 2005, MCI's reported mass-market revenue was down **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** from the same period one year earlier. In New York, MCI's residential local access line count fell from a peak of **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in May 2004 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in June 2005. MCI monthly *net* losses in May and June 2005 averaged more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** mass-market local access lines.

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[27] Intermodal Services Proceeding Order at 9.

[28] *Almeda Mall, Inc. v. Houston Lighting & Power Co.*, 615 F.2d 343, 353 (5th Cir. 1980); *see Hypoint Tech., Inc. v. Hewlett-Packard Co.*, 949 F.2d 874, 878 (6th Cir. 1991) (a mere reseller is a "'non-competitive middleman'").

These losses are due, in part, to the fact that MCI has increased the cost of its mass-market offerings. More specifically, MCI increased its property tax surcharge from 1.4 percent of interstate usage to 2.3 percent, imposed a paper billing charge of $.99 and imposed a carrier access charge of $1.90 in every state in the nation. In addition, MCI's Neighborhood Unlimited is substantially more expensive than competing plans from Time Warner ($39.95) and Cablevision ($34.95).

MCI's current business plan is to manage – rather than embark on the futile effort to reverse – this decline.[29] To that end, MCI's marketing efforts have been slashed dramatically. Telemarketing is down **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]**, from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours per month at its peak to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours per month in May 2005. Telemarketing in New York is also down from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours in July 2002 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** hours in May 2005. MCI has closed **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** call and customer service centers, cutting its number of such centers 55 and 46 percent, respectively. MCI also cut its mass-market employee base by roughly two-thirds, from **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in January 2002 to **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in February 2005. MCI's spending on direct mail, print, and media advertising have all declined precipitously, from more than **[BEGIN CONFIDENTIAL]**

[29] Like dozens of other CLECs, MCI has entered into a commercial agreement with Verizon under which Verizon will provide MCI with end-to-end wholesale voice services. This agreement permits MCI to continue to manage its mass-market voice business consistent with its business plan. MCI has entered into similar commercial agreements with each of the RBOCs. Had Verizon and MCI not reached such an agreement, federal law would have required that all of MCI's existing UNE-P customers be migrated to much more expensive resale service no later than March 11, 2006.

[END CONFIDENTIAL] per month in early 2003 to just over **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in April 2005.

Because MCI's mass-market business is in a continuing and irreversible decline and because intermodal competitors such as cable, wireless, and VoIP providers already are providing the most significant competition to mass market customers, the elimination of MCI as an independent competitor through this transaction is of no import in standard merger analysis.[30] Staff, however, claimed that MCI "would continue to be a mass market competitor to Verizon but for the merger," based on its view that "it does not appear that MCI, for at least the short term, had a concerted plan to quickly exit the market post UNE-P."[31] Staff, however, asks the wrong question. The relevant inquiry is not whether MCI would have been *a* competitor in the mass market or whether MCI would completely exit the market in the near future, but instead whether the transaction is "likely to substantially lessen competition."[32]

The possibility that MCI might have remained in the mass market for some period of time using "wireline resale or . . . a VoIP platform," as Staff suggests,[33] is hardly an answer to that question. MCI, in that capacity, would merely be one of many resellers or VoIP providers – two modes of competition with extremely low barriers to entry – with no unique capabilities not found among the dozens of existing resellers and VoIP providers. But for the merger, moreover, MCI's business plan would not be subjected to the kind of regulatory scrutiny undertaken by Staff in its White Paper; nor would the Commission be micromanaging MCI's business decisions. The Commission should avoid micromanaging MCI's business plan now.

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[30] *See, e.g.*, Guidelines § 5.0.

[31] White Paper at 25-26.

[32] Guidelines § 0.1.

[33] White Paper at 20.

In any event, the evidence that led the Staff to dispute MCI's statement that its mass-market business is in a continuing and irreversible decline does not contradict that statement. First, Staff noted that "MCI's new customer additions show little sign of abating."[34] In fact, MCI's monthly gross additions are declining substantially – MCI added only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** new residential local access lines in New York in June 2005, less than half of the **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines it added in April 2004. The total number of MCI customers is also declining. For example, in New York, MCI's total residential local access line count fell by more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines from June 2004 to June 2005, *despite adding* more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** lines during that same period. Such declines are the inevitable result of marketplace and regulatory changes that have forced MCI to recognize that its only option is to try to manage the continuing decline of its mass market business.

Nor will MCI's limited trial of VoIP service, initiated in June 2005,[35] reverse MCI's mass-market fortunes or make it one of a small group of most significant competitors. Indeed, MCI not only is behind others that entered the market months or years ago, but also is *reselling* another provider's VoIP service and customer premises equipment, which demonstrates that MCI has no unique capabilities in the mass-market provisioning of VoIP service. In addition, MCI expects a limited number of sales based on its limited amount of marketing, and its preliminary findings are that both outbound telemarketing and sales through inbound calls have

[34] *Id.*

[35] Thus, there is no conflict between Petitioners' statement in their February and May 2005 filings with the Commission. *See id.* at 25 n.64.

not been efficient means of customer acquisition, especially in light of the current Do-Not-Call restrictions.[36]

b. Staff's Analysis Ignores Intermodal Competition

In assessing the effect of this transaction on the retail mass-market segment, the Staff performed "two analyses" – "both [of which] rely on HHI calculations."[37] In both cases, however, the data set that Staff reviewed contained information on *wireline* competition only, ignoring the intermodal options that this Commission has recognized are "creating substantial facilities-based competition" for mass-market customers in New York.[38] In addition, the wireline data in both data sets were incomplete – the data sets were outdated and did not contain information on all wireline competitors for mass-market customers. For these reasons, and as explained in detail in Section II.B.1.b below, the HHI calculations Staff performed provide no basis for its conclusion that this transaction will "result[] in a significant increase in the concentration of providers in the mass market."[39]

The record here is replete with evidence that intermodal competition for mass-market customers already is transforming – and will continue to transform – competition for these customers. This includes competition from cable companies such as Cablevision and Time Warner, which have for some time been offering cable telephony and are now aggressively offering VoIP in conjunction with their cable modem service. Cablevision, RCN, and Time Warner already offer telephony to all the homes they pass in the state.[40] Although state-specific

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[36] In New York, MCI has made only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** sales since the limited VoIP trial began.

[37] White Paper at 19.

[38] Intermodal Services Proceeding Order at 1.

[39] White Paper at 25.

[40] *See* Petitioners' Reply Comments at 8 (Table 1).

data are unavailable, Time Warner added 150,000 net new subscribers in the first quarter of 2005, while Cablevision added nearly 100,000 during that period.[41] Indeed, analysts have ascribed Verizon's "worse-than-peer access line trend" to the presence in its territory of these cable companies, and expect that Verizon "is again likely to lead the access line declines" in 2005 among incumbent carriers.[42]

Intermodal competition is likewise provided by VoIP providers unaffiliated with a broadband provider, such as Vonage, Skype, Packet8, and AT&T. These VoIP providers are also making serious inroads into the mass market, with Vonage signing up 15,000 customers per week and all such providers adding 400,000 subscribers per quarter.[43]

Considering all of this, the Commission has recognized that VoIP is "widely available in New York" and that "95% of New Yorkers" already have access to the "broadband capability necessary to avail themselves of VoIP telephony."[44] Staff likewise acknowledged that VoIP is an "increasingly viable alternative to traditional wireline services" and that its market penetration is "expect[ed] . . . to accelerate,"[45] yet it gave virtually no weight to VoIP in its assessment of the effect of this transaction on competition for mass-market customers. That failing cannot be

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[41] *See* Thomson StreetEvents, *TWX – Q1 2005 Time Warner Inc. Earnings Conference Call,* Conference Call Transcript at 3 (May 4, 2005); Cablevision Presentation at the Deutsche Bank Securities Media Conference at 29 (June 6, 2005), available at http://library.corporate-ir.net/library/10/102/102703/items/154595/deutsche_final.pdf.

[42] J. Halpern et al., Bernstein Research Call, US Telecom 1Q05 Review: Broadband, Wireless Growth Highlight Positives; Access Lines Start to Show VoIP Impact at 4 (May 9, 2005); David Barden et al., Banc of America Securities Research Brief, Setting the Bar: Establishing a Baseline for Bell Consumer Market Share at 2 (June 14, 2005) ("We believe Verizon, facing Time Warner and Cablevision, has been most affected, both as a company and as a stock, by the presence of VoIP competition in its territory.").

[43] Vonage Press Release, *Vonage Contracts with Verizon for Nomadic VoIP E9-1-1 Service* (May 4, 2005); Viktor Shvets & Andrew Kieley, Deutsche Bank, *VoIP: State of Play* at 4, 6 (June 22, 2005).

[44] Intermodal Services Proceeding Order at 8.

[45] White Paper at 23.

squared with either the state of the market today or with the forward-looking view necessary for review of this transaction.[46]

Competition also comes from wireless service, which is "almost ubiquitously available in New York and exhibit[s] very high subscription rates."[47] Wireless competes – and therefore disciplines prices for circuit-switched, wireline service – in two ways. First, there is what this Commission correctly characterized as "growing evidence" that consumers – "especially [the] younger ones" that grew up accustomed to wireless phones – "are willing to forego wireline telephone service, relying solely on wireless."[48] As of year-end 2004, analysts estimate that 7 to 8 percent of wireless users had given up their landline phones altogether.[49] The figures are higher for customers under 24 (18 percent) and between the ages of 25 and 34 (9.6 percent),[50] suggesting that cutting the cord will increase going forward. Indeed, a recent survey found that nearly 40 percent of respondents are likely to give up their wireline phone in favor a wireless

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[46] Staff downplayed the importance of cable VoIP providers because they had not reported June 2004 data to the FCC and ignored other VoIP providers because they purportedly "ha[d] not penetrated the [mass] market enough" as of March 2005. White Paper at 22 & n.55. But the relevant question is not the extent of competition five or fifteen months ago – it is the extent of competition that can be expected in the future. As to that question, there can be no serious dispute that VoIP is a major and growing competitor that will be unaffected by this transaction.

[47] Intermodal Services Proceeding Order at 7.

[48] *Id.* at 7.

[49] Michael Balhoff, Managing Director, Telecommunications Group, Legg Mason, Prepared Witness Testimony Before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004); Adam Quinton, Managing Direct & First Vice President, Co-Head of Global Telecom Services Research, Merrill Lynch, Prepared Witness Testimony Before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004); B. Bath, Lehman Brothers, *Final UNE-P Rules Positive for RBOCs* at Figure 2 (Dec. 10, 2004); D. Barden *et al.*, Banc of America Securities, *Setting the Bar: Establishing a Baseline for Bell Consumer Market Share* at 1 (June 14, 2005). One analyst puts the number even, higher, stating that "[b]etween 10% and 15% of the total market is now using wireless exclusively." *Dialing into Wireless Stocks; As Wireless Builds Momentum Against Wireline, S&P's Kenneth Leon Points to the Best Companies in Service and Equipment*, Business Week Online (Mar. 10, 2005).

[50] *See* Household Telephone Service and Usage Patterns in the United States at 23; *see also* F. Louthan *et al.*, *VZ, SBC, BLS, Q: Cable Threat Comparison for RBOCs* at 2 (July 11, 2005) (citing households headed by people 24 and under as well as 1-2 person households as likely candidates for wireless substitution).

phone in the next two years.[51] Staff discounted this substitution – and gave no weight to wireless in its analysis of the mass market – based on two older FCC reports and a news article stating that the pace of wireline customers cutting the cord for wireline service is not "accelerating as quickly as many experts predicted."[52] Yet, even assuming the news article is correct that displacement of wireline lines by wireless lines is not growing as fast as predicted, none of the evidence to which Staff points refutes the fact that wireless displacement is growing and is expected to continue to do so, or justifies Staff's absolute exclusion of wireless competition from its analysis.

Nor does Staff consider the extensive displacement by wireless *minutes* of formerly revenue-generating wireline minutes. Wireless traffic was estimated to account for approximately 30 percent of all voice minutes in 2004, and as much as 60 percent of long distance calls.[53] The ability of customers to replace wireline calls with wireless calls on a call-by-call basis thus also disciplines pricing for wireline services. Indeed, a recent analysis found that a 1 percent wireline price increase would result in a nearly 2 percent increase in wireless demand.[54]

Finally, Staff failed to consider how the mere availability of wireless service constrains wireline pricing. If the price of wireline service were to increase to anti-competitive levels, wireline customers can move to use wireless service (or any other mode of communication such

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[51] HarrisInteractive, Consumers and Communications Technologies: Current and Future Use at 11 (June 29, 2005).

[52] White Paper at 23-24 & n.58.

[53] *See* David Janazzo *et al.*, Merrill Lynch, *The Next Generation VIII: The Final Frontier?* at 5 (Mar. 15, 2004); Philip Marshall *et al.*, The Yankee Group, *Divergent Approach to Fixed/Mobile Convergence* at 7 & Exh. 4 (Nov. 2004).

[54] See Stephen B. Pociask, Competitive Enterprise Institute, Wireless Substitution and Competition: Different Technology but Similar Service – Redefining the Role of Telecommunications Regulation at 15 (Dec. 15, 2004).

as VoIP) in place of wireline service. The threat of such defections serves to constrain the pricing behavior of traditional wireline providers.

Further competition is provided by cable companies that provide circuit-switched telephony, as well as by other modes of communication such as e-mail and instant messaging.[55] Considering the state of competition using these alternative forms in late 2003 and early 2004, the Commission found that more than "85% of Verizon's access lines are located in wire centers that have [a competition] index of at least 2.75," which the Commission found "reflects a suitably robust mixture of alternatives."[56] There can be no doubt that, in the last 18 months, competitive alternatives have increased, as cable, VoIP and wireless providers have made aggressive competitive inroads into the mass market.

Verizon is losing tens of thousands of lines per month in New York, with intermodal competitors the primary beneficiaries. Verizon's Wholesale Markets group has examined the shift of consumers away from UNE Platform lines and to alternatives, in New York and across the Verizon East footprint. Over the first five months of 2005, there has been a substantial reduction in the number of new UNE Platform lines in New York, dropping from nearly **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in January 2005 to just over **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** in May 2005, a reduction of 45

[55] *See Intermodal Services Proceeding Order* at 5 & n.3, 6-7. Consistent with its failure in other respects to take a forward-looking view, Staff acknowledged the "growing evidence that consumers increasingly view these new [Internet] technologies as substitutes for wireline voice service," but ignored them in analyzing the effect of this transaction on competition for mass-market consumers. White Paper at 24. Like wireless service, e-mail and instant messaging are undoubtedly substituting for wireline voice minutes, as "[c]onsumers are using e-mail and instant messaging in place of a phone call." In-Stat/MDR, *State of the U.S. Carrier Market* at 6 (Oct. 2003).

[56] *Intermodal Services Proceeding Order* at 9. The competition index considered each Verizon wire center and assigned varying weights based on the presence of different types of competitors. The maximum index value was 3.25, which would be assigned to a wire center where circuit-switched cable telephony (1), residential UNE loop service (1), wireless service (0.5), and VoIP (0.75) are all available. *See id.*

percent.[57] Over that same period, the number of customers moving from UNE-P back to Verizon's retail service in New York has remained stable, at about **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** per month. Thus, in May 2005, Verizon line losses to UNE-P in New York roughly equaled its returns from UNE-P. However, total UNE-P lines in service for May 2005 shows a *net loss* of **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** access lines. That is because nearly **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** customers in New York left their UNE-P provider and moved off of Verizon's network, presumably to an intermodal competitor. This figure has stayed roughly constant from January through May 2005, with an average of more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** customers per month in New York moving off of and not returning to Verizon's network in New York. And this figure understates Verizon's total line losses in May 2005 **–** which are estimated at more than **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL] –** as it does not include customers that are switching directly from Verizon retail (rather than from UNE-P) to VoIP or wireless, or moving to New York and signing up with one of those providers in the first instance.

c. The Flaws In Staff's HHI Calculations

Calculation Based on FCC Form 477 Data. Staff's first calculation is based on data submitted to the FCC twice each year using its Form 477. The primary flaw in Staff's use of this data set is that the data are from June 2004. In the 14 subsequent months, the communications industry has undergone substantial changes. These include legal changes, such as the Supreme Court's decision to deny petitions for a writ of certiorari from the D.C. Circuit's *USTA II*[58]

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[57] "New" UNE-P lines are existing Verizon retail customers that moved to a UNE-P provider and customers not currently served by Verizon retail or a CLEC using resale, UNE-P, or UNE-L that move to a UNE-P provider.

[58] *USTA v. FCC*, 359 F.3d 554, 594 (D.C. Cir.) ("*USTA II*"), *cert. denied*, 125 S. Ct. 313, 316, 345 (2004).

decision, the FCC's release of the *Interim Rules Order*,[59] the release of the *Triennial Review Order*,[60] this Commission's approval of tariff revisions reflecting those legal changes, and the release of the FCC's decision regarding porting of numbers between wireline and wireless carriers. There have also been substantial technological changes, as both cable companies and other competitors have moved aggressively and successfully to offer VoIP service throughout New York and the nation, and wireless providers have continued to take wireline customers and wireline minutes away from incumbents and traditional IXCs. In this rapidly changing industry, where even the recent past is not prologue, there is no basis for drawing any meaningful conclusions from data that are 14 months old. Cablevision, for example, more than tripled its total number of voice customers between the second quarter of 2004 (115,050) and May 5, 2005 (400,000), with net gains of nearly 130,000 customers through May 5, 2005 alone.[61]

The data on which Staff relied, moreover, are plainly incomplete. As even Staff acknowledges, wireless carriers do not fill out Form 477, nor do VoIP providers.[62] And, although cable telephony providers can submit Form 477, Staff admits that the data on which it relied did not include "*any* voice grade lines" for the "largest cable VoIP provider in New York."[63] As explained above, any analysis that does not include the extensive (and growing) intermodal competition in the mass market is flatly inconsistent with this Commission's

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[59] Order and Notice of Proposed Rulemaking, Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, 19 FCC Rcd 16783 (2004) ("Interim Rules Order") (subsequent history omitted).

[60] Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 18 FCC Rcd 16978 (2003) ("*Triennial Review Order*") (subsequent history omitted).

[61] *See* Cablevision Presentation at the Deutsche Bank Securities Media Conference at 29 (June 6, 2005), available at http://library.corporate-ir.net/library/10/102/102703/items/154595/deutsche_final.pdf.

[62] *See*, *e.g.*, White Paper at 22.

[63] *Id.* (emphasis added).

precedent, as well as the policies it has implemented to foster facilities-based, intermodal competition, and Staff provides no justification for this inconsistency. In addition, carriers that serve fewer than 10,000 lines in a given state are not required to file a Form 477, and the FCC has explained that, while it is not "certain about the extent to which . . . lines . . . as reported by CLECs are understated as a result" of this cut-off, it "expects such understatement to be larger, on a percentage basis, than for [independent] ILECs."[64] These omissions render the Form 477 data unsuitable for assessing the effects of this transaction on a "Wireline Voice Market" – as if there were such a market – let alone in the actual, intermodal mass market where Verizon is "losing over 75,000 [lines] a month" – nearly double its losses a year earlier, and despite the elimination of the UNE Platform.[65] Indeed, Staff explicitly recognized, albeit with considerable understatement, that the omissions from the Form 477 data "may overstate the mass market concentration."[66]

Finally, the predictions Staff made of the effect of this transaction on market concentration are based on the same Form 477 data as Staff's HHI calculation for the June 2004 data.[67] Therefore, the predictions suffer from the same flaws as discussed above. In addition, Staff did not factor in the more recent competitive trends, making no effort to adjust the prediction to account for the fact that New York cable companies recently completed their network upgrades, and are making steady gains in their subscriber base, the current and likely future dramatic gains by VoIP providers, the trends in wireless substitution for wireline lines and

[64] FCC Wireline Competition Bureau, Local Telephone Competition: Status as of June 30, 2004, at 1 n.3 (Dec. 2004) ("*June 2004 FCC Report*").

[65] White Paper at 53.

[66] *Id.* at 22. Because of the difficulty in obtaining reasonably accurate data with which to estimate forward-looking shares of all meaningful competitors in the mass market, Verizon has not attempted to recalculate HHIs for the mass market.

[67] *See id.* at 21-22 (Figure 1).

usage, or the decline of MCI that began before the transaction and would have continued regardless of the transaction.

Calculation Based on PAP Data. The Staff also performed HHI calculations on data from Verizon's April 2005 Performance Assurance Plan ("PAP") report. Although these four-month-old data are more recent than the June 2004 Form 477 data, they are equally incomplete. The PAP data Staff used were limited to considering competition through UNE-P, resale, and UNE loops. Accordingly, these data do not even reflect all wireline competition, let alone the extensive intermodal competition that exists today from cable providers, wireless providers, VoIP providers and others. Recognizing this flaw, Staff modified the PAP data to include "a single Cable/VoIP provider with a 5% [market] share."[68] This assumption, however, does not track the actual entry of numerous cable and unaffiliated VoIP providers.[69]

Because the base calculation using the PAP data provides no meaningful information on the likely effects of this transaction on the mass market, there is no reason to consider Staff's "Scenario 2," where it assumed that MCI's (and AT&T's) UNE-P customers would have migrated to Verizon and other competitors.[70] In any event, Scenario 2 is based on the inexplicable assumption that MCI would retain one-third of its mass-market customers, while AT&T would lose *all* of its customers – half to Verizon and half to other CLECs.

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[68] *Id.* at 24-25.

[69] Staff states that its 5 percent adjustment is "conservative" because Cablevision reported that at year-end 2004, "it had almost 273,000 customers, or 6% of our homes passed," and Time Warner served 1.9% of homes passed in its territory. Staff Response to Verizon's July 20, 2005 White Paper Questions at 3. Staff overlooks, however, that both of these companies' voice services have been growing extremely rapidly. Cablevision was up to 364,000 customers or 8% of homes passed by the end of the first quarter 2005, adding customers at the rate of 7,100 per week. *See* Cablevision Press Release, *Cablevision Systems Corporation Reports First Quarter 2005 Results,* (May 5, 2005). In addition, Time Warner reported 614,000 Digital Phone subscribers by the end of the second quarter of 2005, a 4% penetration of serviceable homes passed, and a quarterly growth rate of 65%. *See* Time Warner 2Q 05 Presentation, *available at* http://ir.timewarner.com/downloads/Q205presentation.pdf. Ignoring such tremendous growth is anything but conservative.

[70] *See* White Paper at 25 & n.63.

d. The Remedies Offered For Consideration Are Unnecessary And Should Not Be Adopted As Conditions To Approval

Because there is no basis on which to conclude that this transaction will have a material, negative effect on competition for mass-market customers, there is no legal or factual basis for adopting any of the remedies that Staff proposes for consideration. Indeed, although Staff stated that it has "attempt[ed] to comport with the[] principles" for remedies set forth by the DOJ,[71] two of the three remedies Staff has suggested are squarely at odds with those principles because they are entirely unrelated to this transaction. The FCC has likewise held that it "will impose conditions only to remedy harms that arise from the transaction" and "will not impose conditions to remedy pre-existing harms or harms that are unrelated to the transaction."[72]

1. Stand-Alone DSL. Staff seeks comments on whether it would be appropriate to require Verizon to offer an "unrestricted" stand-alone DSL product to mass-market customers. It would not be appropriate to do so for several reasons. First, Staff's suggestion that Verizon might be required to offer stand-alone, or "naked," DSL has nothing to do with this transaction. Whatever the benefits for intermodal competition that might result from Verizon's offering of stand-alone DSL, those benefits are entirely unrelated to this transaction. Similarly, whatever impediments some might claim exist when customers seek to switch among intermodal competitors will not change upon the completion of this transaction. Accordingly, it would be inappropriate (and unwarranted) for this Commission to consider either requiring Verizon to provide stand-alone DSL or to take steps that purport to facilitate customers' switching among intermodal competitors.

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[71] *Id.* at 17.

[72] AT&T Wireless-Cingular Order ¶ 43.

Second, Staff's suggestion takes no account of the fact that more than 90 percent of U.S. households are now able to obtain a broadband connection from a provider other than their incumbent local telephone company, principally cable modem service. Consumers can use those broadband connections to obtain VoIP either from cable companies or independent providers such as Vonage, regardless of the availability of naked DSL.

Third, as Petitioners explained in their May 13 Reply Comments, Staff's suggestion is largely moot because Verizon is already offering in New York several forms of "stand-alone DSL" services now and expects to be able to offer nearly all varieties in New York by September. Verizon realizes that offering such a product is imperative as a business matter, as customers are increasingly relying on broadband services to communicate and, in the process, are rapidly subscribing to VoIP services provisioned over broadband lines.[73] Verizon has moved to respond to this demand and is working on overcoming the technical issues that have thus far prevented it from offering stand-alone DSL service to all customers, as it wants to do.

In April 2005, Verizon began offering stand-alone DSL service to existing New York customers who port their voice line to a facilities-based carrier (including a VoIP provider) or wireless carrier but who want to retain their DSL service without the voice service. In June, Verizon expanded its offering to New York customers who have never had voice service with Verizon.[74] Therefore, for example, Verizon's DSL customers can cancel voice service from Verizon, obtain voice service from an independent VoIP provider such as Vonage, and retain their DSL line provided by Verizon. And new customers who do not currently have Verizon

[73] Thomson StreetEvents, VZ – Q2 2005 Verizon Earnings Conference Call, Final Transcript at 7 (July 26, 2005) ("In the next few months we will be more actively marketing 'DSL over dry loop,' or 'naked DSL.' We believe this presents a significant new opportunity for us to provide a data solution for the large number of wireless-only households.") (statement of Doreen Toben, Verizon CFO).

[74] *See* FCC Tariff No. 1, Access Services, § 16.8(D)(4)(b); FCC Tariff No. 20, Communications Services, § 5.1.2(D)(2).

voice service can purchase stand-alone DSL and, for example, obtain service from an independent VoIP provider. The last principal type of stand-alone service – for those using the commercial replacement for UNE Platform – should be implemented by September.

As discussed in the Petitioners' Reply Comments, it would be inappropriate (and unlawful) for the Commission to use its regulatory authority to interfere with Verizon's diligent efforts to offer stand-alone DSL to the remaining group of customers who cannot currently obtain stand-alone DSL service and to require Verizon to make the service available sooner than it is operationally possible to do so. The market is already motivating Verizon to provide the service to all customers and the Commission should allow Verizon to continue its efforts to do precisely that without imposing an artificial deadline. Such an approach is consistent with Commission's own thinking, as articulated in its Order initiating the "Comp III" proceeding:

> New York has long been on record stating its strong preference for competitive markets as the most effective approach to ensure the provision of reasonably priced and reliably provided telecommunications services… Where competition is robust, regulatory restraint is the best approach; where it is not, some intervention may be required to restrain the exercise of market power and ensure adequate consumer protections.[75]

Given that there is clearly strong, intermodal competition for mass market customers and Verizon is responding to it by, among other things, expanding its stand-alone DSL offering as soon as it is operationally possible to do so, it would be contrary to the Commission's stated goals to increase regulation at this time.

Finally, requiring Verizon to offer stand-alone DSL service would violate federal law. Just today, the FCC adopted an order declaring wireline broadband Internet access to be an

[75] See 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, Order Initiating Proceeding and Inviting Comments (June 29, 2005) at 2.

unregulated information service.[76] And this Commission has no jurisdiction to regulate the rates, terms, and conditions on which Verizon offers this *interstate* service, including regulation of whether Verizon offers this service separate from its retail voice product.

Furthermore, to the extent Staff contemplated requiring Verizon to provide retail DSL service on the same line over which an end-user customer obtains voice service from a CLEC, such an obligation would be unlawful for still another reason. In the *BellSouth Preemption Declaratory Ruling*, the FCC explicitly held that states violate federal law to the extent they require incumbents to provide DSL service to customers that purchase voice service from CLECs that use unbundled loops.[77] That is because such a requirement would impose on incumbents an obligation to "do exactly what the [FCC] expressly determined was not required by the Act" – namely, to provide DSL service over the high-frequency *portion* of a loop – and is "therefore inconsistent with federal law."[78]

2. Switching Among Intermodal Service Providers. Staff seeks comment on whether there exist any "impediments which impair a cust[o]mer's ability to switch between wireline, DSL and cable modem based telephone service providers."[79] As an initial matter, any such impediments would not be specific to this transaction and, therefore, it is inappropriate to consider this question in the context of this proceeding. In any event, there are no meaningful issues – certainly none that must be overcome by additional regulation, rather than market-based solutions. More than 70 percent of New Yorkers with broadband connections subscribe to *cable modem* providers, so these customers need do little more than sign up for VoIP – provided by

[76] FCC News Release, *FCC Eliminates Mandated Sharing Requirement on Incumbents' Wireline Broadband Internet Access Services* (Aug. 5, 2005).

[77] *See id.* ¶¶ 17, 25-26.

[78] *Id.* ¶ 27.

[79] White Paper at 26.

either their cable company or one of many other firms – to switch from their existing wireline service.[80] And 95 percent of New Yorkers have access to broadband service from the dominant cable modem providers or from other providers, and could obtain broadband service and switch to a VoIP provider as well.[81] Verizon's voluntary retail, stand-alone DSL offering will also enable consumers easily to switch from wireline service to VoIP-over-DSL. In short, there are no meaningful impediments for those customers that wish to switch from wireline service to VoIP service, as evidenced by the rapid penetration of VoIP into the residential market. Finally, imposing conditions solely on Verizon's DSL product – which provides a distinct minority of broadband services in the state – would only alter the competitive landscape by further strengthening cable's (unregulated) broadband lead in New York.

3. Freezing MCI's Rates, Terms, and Conditions. Staff also questions whether it would be appropriate to "freez[e] MCI's rates, terms and conditions for MCI mass market customers for 12 months from the date of the merger."[82] Staff suggests this might be appropriate to "insulate [these] customers from the short term negative effects of the merger."[83] But Staff does not explain what those effects could be. In any event, it would not be appropriate to freeze MCI's rates as suggested.

The condition that Staff tentatively suggests is tantamount to rate regulation of a competitive carrier without the corresponding benefit of a guaranteed rate of return. This is flatly contrary to the regulatory regime and policies the Commission has long applied to

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[80] *See* FCC Wireline Competition Bureau, *Local Telephone Competition: Status as of June 30, 2004* at Table 7 (July 2005) (reporting data as of December 31, 2004). This compares to less than 23 percent of New Yorkers having chosen DSL.

[81] Intermodal Services Proceeding Order at 8.

[82] White Paper at 26.

[83] Id.

competitive carriers, and ignores the fact that MCI's mass-market customers have freely chosen MCI (instead of Verizon or another competitor) and remain free to choose a different provider in the future. The concern animating Staff's tentative proposal is a vestige of monopoly regulation that has no place in a competitive market, where protection to consumers comes in the form of services offered by facilities-based and intermodal competitors. And a proposed governmentally mandate "rate freeze" ignores the fact that MCI will face increases in the costs of providing service to mass market customers.

Moreover, because MCI's existing retail packages include bundles of intra- and *inter*state services, this Commission lacks jurisdiction over all of MCI's rates, terms, and conditions for those packages.[84] For these reasons, there is no basis for the Commission to impose additional regulation on MCI's current plans.

2. Enterprise Customers – Retail

a. This Transaction Will Not Reduce The Intense Competition For Enterprise Customers Or For The High-Capacity Facilities Used To Serve Those Customers

Petitioners have demonstrated that the combination of their highly complementary operations would have significant benefits for large enterprise and other commercial and institutional customers by creating a strong new competitor with the network reach and financial resources to compete in this market segment nationwide. The two companies have highly complementary – rather than overlapping – core competencies, with MCI a primary provider of global business communications services and IP-based services and Verizon a provider of local

[84] *See, e.g.*, *Dreamscape Design, Inc. v. Affinity Network, Inc.*, ___ F.3d ___, No. 04-3035, 2005 WL 1560330, at *9 (7th Cir. July 5, 2005) ("state law cannot operate to invalidate the rates, terms, or conditions of a long-distance service contract"); *Boomer v. AT&T Corp.*, 309 F.3d 404, 417-24 (7th Cir. 2002) (holding that 47 U.S.C. §§ 201 and 202 "demonstrate a congressional intent that individual long-distance customers throughout the United States receive uniform rates, terms and conditions of service" and that state law regulation of such interstate services is preempted).

bandwidth, CPE and related services, and network integration. Indeed, in more than 96 percent of the more than 800 instances between October 1, 2004 and April 20, 2005 in which MCI bid on enterprise contracts, Verizon was not among the competing bidders.[85]

Although MCI and Verizon rarely compete head-to-head in bidding for the business of enterprise customers, there is extensive competition for all different types and sizes of such customers, and for various services they purchase. There are large numbers of providers competing for these customers today, none of which has a dominant share, including traditional interexchange carriers such as AT&T, Sprint, and Qwest; CLECs like XO and Level 3; cable companies such as Time Warner and Cablevision; systems integrators and managed service providers like IBM, EDS, Accenture, Northrop Grumman, and Lockheed Martin; major global telecommunications providers such as Equant, British Telecom, Deutsche Telekom, COLT, KPN Telecom, and NTT; equipment vendors like Lucent and Nortel; and, most recently, major application providers such as Microsoft. The combined company will be just one among many other competitors in this segment of the industry, which is widely recognized as the most competitive.[86]

b. The Flaws In The Staff's HHI Calculations

In reaching the contrary conclusion, Staff again relied exclusively on HHI calculations. And, again, Staff relied on incomplete and out-of-date data. Staff also made numerous errors in its HHI calculations and drew the wrong conclusions from the results of those calculations. For these reasons, and as set forth in further detail below, nothing in the White Paper supports the

[85] *See* Ex Parte Letter from Verizon and MCI to FCC, WC Docket No. 05-75, at 2-3 n.5 (filed July 1, 2005) ("July 1, 2005 Ex Parte Letter").

[86] *See* Petitioners' Reply Comments at 34-38.

view that this transaction will result in any material concentration in the market for retail enterprise services.

Calculation Based on FCC Form 477 Data. Staff first used the June 2004 FCC Form 477 to calculate an HHI for the "Wireline Voice Market" for enterprise customers. As explained above, the data are both outdated and incomplete – because there is no "*wireline voice*" market for enterprise customers – which necessarily means that any calculations of HHIs from the data is not probative. Indeed, the Form 477 data measures only "*Switched* Access Lines" obtained by enterprise customers, and only from those ILECs and CLECs required to submit Form 477.[87] Enterprise customers, however, do not merely purchase switched access services. Instead, these customers purchase a wide array of communications services, including voice (domestic and international), data (Frame Relay, ATM, IP/VPN), CPE, ancillary services, and network integration services. Large enterprise and other commercial and institutional customers now spend more on data and wireless than they spend on wireline voice, and data and wireless are growing considerably, while wireline voice spending is declining.[88] Enterprise customers also obtain voice services through other technologies, such as VoIP, without obtaining switched access lines. Any analysis of competition for this customer segment, therefore, must analyze the full array of services and facilities that large enterprise customers and medium businesses purchase, and cannot focus solely on switched access, wireline services.[89]

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[87] *June 2004 FCC Report* at Table 2 (emphasis added).

[88] See Kneko Burney, InStat/MDR, Share of Wallet?: Telecom Trends and Expenditures in the US Business Market; Part One: US Enterprises (1,000+ Employees) at Table 7 (Aug. 2004); Kneko Burney, InStat/MDR, Share of Wallet?: Telecom Trends and Expenditures in the US Business Market; Part Two: Mid-Sized Businesses (100-999 Employees) at Table 7 (Sept. 2004).

[89] For these same reasons, Staff's prediction of HHIs after this transaction provides no meaningful data on the consequences of this transaction. *See* White Paper at 32. In addition, as explained above, Staff's projection is based on a simple time series extrapolation that ignores technological trends and the expected growth of various alternatives.

Calculation Based on Lehman Brothers Data. Staff also performed HHI calculations on Lehman Brothers' estimations of the share of national enterprise revenues.[90] As Staff recognized, these data indicate that this transaction "only would result in a relatively unconcentrated market that might not warrant further review."[91] It is only by considering both this transaction and the proposed combination of SBC and AT&T that Staff could find a "change in HHI" that it contends means this transaction "warrants further review" – even while reaching no such conclusion with respect to the combination of SBC and AT&T.[92] In fact, using the Lehman Brothers data, it is the AT&T-SBC merger that increases the national HHI by 414 – from 764 to 1,178 – while this transaction on its own increases the HHI by only 231 points from 764 to 995. Even if one were to assume that the base is one where the AT&T-SBC merger has been completed, the Lehman Brothers data would show this transaction as increasing the HHI by only 231, from 1,178 to 1,409, which is a far cry from the HHIs in transactions that DOJ or the FTC have recently challenged. The 645 point increase shown in the last column of Staff's Table 5 is premised on the erroneous assumption that the two mergers should be considered as a single transaction.

Apparently recognizing that no serious case can be made that this transaction will materially reduce competition for enterprise customers nationwide, Staff attempts to construct an analysis of competition for enterprise customers within Verizon's region. As an initial matter, this approach is erroneous. There is no "regional" market for enterprise customers, which often have locations in the territory of more than one incumbent carrier. The largest of these customers operate internationally. Thus, the enterprise market is national, if not international, in

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[90] *See id.* at 29.

[91] Id.

[92] *Id.*; *see id.* at 73.

scope. Indeed, the FCC has found that the relevant geographic market for enterprise customers is "a single national market."[93] Accordingly, the approach of calculating HHIs based on a Verizon-region enterprise market is mistaken from the outset.

In addition, Staff's efforts to translate Lehman Brothers' nationwide revenue and share estimates into Verizon-region estimates resulted in numerous calculation errors. These range from the trivial to the fatal. On the minor side, Staff failed to use the same revenue figures for the pre- and post-transaction HHI calculation.[94] In a proper HHI calculation, the pre- and post-transaction shares of the non-combining companies should remain constant. Far more serious was Staff's decision to exclude entirely the "Other" category, which included all companies serving enterprise customers other than the *nine* specifically identified by Lehman Brothers, and which account for more than 30 percent of the nationwide revenues from sales to enterprise customers.

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[93] E.g., Memorandum Opinion and Order, Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., 13 FCC Rcd 18025, ¶ 30 (1998); Memorandum Opinion and Order, Applications of NYNEX Corp. and Bell Atlantic Corp. For Consent to Transfer Control, 12 FCC Rcd 19985, ¶ 54 (1997).

[94] For example, Staff derived pre-transaction revenues of $3.86 billion for AT&T, but set AT&T's post-transaction revenues at $3.62 billion. *See* White Paper at 30. Similar reductions occurred for Sprint, Level 3, and XO. *See id.* In any event, Staff's derivations of companies' enterprise revenue within Verizon's region are fraught with error. Staff attempted to derive the revenue figures by using data from a Verizon SEC filing and extrapolating based on the Lehman Brothers market share estimations and an estimate of Verizon's share of switched access lines. Staff apparently did not realize that the actual Lehman Brothers report contained nationwide revenue figures. *See* Declaration of Eric J. Bruno & Shelley Murphy, Exhibit 1 (Attachment 3 to Application for Transfer of Control, WC Docket No. 05-75 (FCC filed Mar. 11, 2005)). In addition, in converting from nationwide to regional figures, Staff used "the percentage of RBOC customer access lines in Verizon's territory." White Paper at 29-30. But because Verizon's service territory is widely regarded to be more competitive than that of other RBOCs, using Verizon's share of RBOC lines as the basis for assigning revenues to different RBOC regions will understate the amount of competition in Verizon's service area. *See* Wachovia Capital Markets, LLC, Equity Research Department, *Verizon Communications* (Mar. 2, 2005) ("The core Verizon region (northeast U.S.) has been one of the primary battlegrounds since the beginning of telecommunications deregulation in 1984. Home to many of the Fortune 500 and particularly the telecommunications-intensive financial services industry; it has always been the first stop for competitors that target business customers."); Banc of America Securities, *Setting the Bar, Establishing a Baseline for Bell Consumer Market Share* (June 14, 2005) ("Among our conclusions divvying up market share loss between wireless and VoIP, we believe Verizon is suffering outsize losses relative to the rest of the Bells."). Assuming that Verizon has lost a larger percent of its lines to competitors than other RBOCs, it is clear that Staff's approach would understate the fraction of enterprise competition taking place in Verizon's area.

Petitioners understand that, based on the discussion of the Lehman Brothers data in the Crandall/Singer declaration Petitioners' submitted to the FCC, Staff concluded that none of the companies in the "Other" category operate in New York or in other Verizon territories.[95] But the Crandall/Singer declaration was not providing an exclusive list of the competitors for enterprise customers "other" than those identified by name in the Lehman Brothers report. Instead, that declaration was providing examples of the numerous companies that operate in the national enterprise market, including in New York. The fact that some of the companies named "were not immediately recognizable to Staff as New York competitors"[96] is hardly reason for presuming, as Staff did, that AT&T, MCI, Verizon, Sprint, Level 3, and XO account for anywhere near 100 percent of the sales to enterprise customers in Verizon's region, let alone in New York. In fact, as this Commission well knows and analysts confirm, New York and the rest of Verizon's northeast region "has always been the first stop for competitors that target business customers."[97]

Nonetheless, Petitioners have identified numerous carriers that compete for enterprise customers in New York that were not identified by name in the Lehman Brothers report. One such competitor is Cablevision, which as far back as 2000 beat out *twelve* other competitors (including then-Bell Atlantic) to win a multi-million dollar contract to serve Westchester County.[98] British Telecom offers ATM and other enterprise services in New York and has

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[95] *See* Staff Response to Verizon's July 20, 2005 White Paper Questions at 4.

[96] Id.

[97] Kevin M. Moore, Wachovia Capital Markets, LLC, *Verizon Communications* at 3 (Mar. 2, 2005).

[98] *See* Brian Quinton, *Scoring in the Suburbs*, Telephony Online (Mar. 13, 2000), *available at* http://telephonyonline.com/ar/telecom_scoring_suburbs/. Cablevision also has won contracts to serve Long Island University and Lenox Hill Hospital. *See* Cablevision Lightpath Press Release, *Lightpath Links Long Island University* (Mar. 8, 2004), *available at* http://www.lightpath.net/Interior33-8.html; Cablevision Lightpath Press Release, *Lenox Hill Hospital Switches to Lightpath for Voice, Data, and Internet Services* (Aug. 11, 2003), *available at* http://www.optimumlightpath.com/Interior187-11.html.

acquired a "New York-based financial services extranet provider."[99] Both British Telecom and AboveNet have won contracts to serve the New York Mercantile Exchange.[100] Broadwing has won a contract to serve Petry Media, which is headquartered in New York City.[101] WilTel has won a contract to provide services to the New York State Education and Research Network.[102] These are just a handful of examples Petitioners were able to glean from press releases and other public sources, which demonstrate that in New York, as across the nation, there are numerous carriers successfully competing to serve enterprise customers, which fit within the "Other" category in the Lehman Brothers data. Therefore, it was plain error for the Staff to exclude the "Other" category in its entirety in its analysis.

Although, as explained above, there is no basis for calculating "Verizon-region" HHIs for enterprise customers, when Staff's calculation is corrected for these errors, using conservative assumptions – as well as the error of assigning SBC and Qwest $0 in enterprise revenue from customers in Verizon's territory[103] – the re-calculated HHI, per the Staff's approach, would have led Staff to conclude that this transaction raises no issues warranting additional consideration.[104]

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[99] *See* BT: Availability, *available at* http://www.btglobalservices.com/business/global/en/products/atm/availability.html; BT:News, *available at* http://www.btglobalservices.com/business/global/en/business/business_zone/issue_04/news_acquisitions.html.

[100] See AboveNet Press Release, New York Mercantile Exchange Selects MFN for Secure, High-Speed Private Optical Network (May 19, 2003), available at http://www.abovenet.com/news/pr051903.html; BT Press Release, New York Mercantile Exchange Upgrades Trading Floor with Digital Voice Trading Technology from BT (Feb. 1, 2005), available at http://www.btplc.com/News/Articles/Showarticle.cfm?ArticleID=1a019352-8e03-4ec8-8e54-9efc75d52ab2. AboveNet has also won a contract to provide service to Cantor Fitzgerald in New York. See AboveNet Press Release, Cantor Fitzgerald Selects AboveNet to Provide Critical Network Services Over Its Private Optical Network (Jan. 18, 2005), available at http://www.abovenet.com/news/pr011805.html.

[101] *See* Broadwing Press Release, *Petry Media Selects Broadwing Communications IP VPN Services* (Apr. 5, 2005), *available at* http://www.broadwing.com/bwngcorp/pressreleases/pr481.html.

[102] *See* WilTel Press Release, *NYSERNet Selects WilTel to Provide Network Solution for Research, Education Institutions in New York* (Dec. 13, 2004), available at http://www.wiltel.com/overview/content/pressreleases/2004/12-13.htm.

[103] SBC and Qwest both successfully compete for enterprise customers in Verizon's region. For example, SBC has recently won contracts to provide services to Bob Evans Farms, Inc., Martiz Inc., and Pillsbury Winthrop LLP in numerous locations, including New York. *See* SBC Press Release, *SBC Communications Announces New*

(continued . . .)

(. . . continued)

Contract with Bob Evans Farms Inc. (Dec. 7, 2004), *available at* http://www.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21491; Bob Evans, Location Guide, *available at* http://www.bobevans.com/; SBC Press Release, *SBC Communications Announces Three-Year, Multimillion-Dollar Contract with Maritz Inc.* (Aug. 13, 2004), *available at* http://www.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21298; SBC Press Release, *SBC Communications Announces New Voice and Data Networking Services Contract with Pillsbury Winthrop LLP* (Jan. 11, 2005), *available at* http://www.sbc.com/gen/press-room?pid=4800&cdvn=news&newsarticleid=21544. Qwest has won contracts to serve Grubb & Ellis, Scotttrade, Hagemeyer North America, and Burlington Coat Factory, including at their locations in New York. *See* Qwest Press Release, *Grubb & Ellis Awards Qwest Communications Network Services Agreement* (Apr. 24, 2003), *available at* http://www.qwest.com/about/media/pressroom/1,1281,1254_archive,00.html; Grubb & Ellis, *Office Locations*, *available at* http://www.grubb-ellis.com/offices/; Qwest Press Release, *Scottrade Signs Multi-Year, Multimillion Dollar Contract with Qwest Communications* (June 17, 2003), *available at* http://www.qwest.com/about/media/pressroom/1,1281,1289_archive,00.html; Scottrade, *Branch Locator*, *available at* http://www.scottrade.com/frame_branchlocator.asp; Qwest Press Release, *Qwest Awarded Multimillion Dollar Contract Renewal by Hagemeyer North America* (Feb. 23, 2004); Hagemeyer North America, *HNA Locator: Branch Locator: New York State*, *available at* http://www.hagemeyerna.com/; Qwest Press Release, *Burlington Coat Factory Expands Contract with Qwest Communications for Advanced Network Services* (June 8, 2004); Burlington Coat Factory, *Find a Store: New York State*, *available at* http://corporate.burlingtoncoatfactory.com/cgi-bin/mqinterconnect?screen=find&smap=map&link=results&closestprox=1&closestn=5&miles=250&streetaddress=&city=&state=NY&zip=&country=US&x=65&y=3.

[104] The corrections of the errors Staff made in its analysis include: using the national revenue data from the Lehman Brothers report as a basis for deriving so-called "Verizon region" data; including the revenue that Lehman Brothers assigns to "Other" carriers; using the more realistic, but still conservative, estimate that 38.9% of AT&T's, MCI's, Sprint's, Level 3's, XO's, and the Other's national revenue is attributable to Verizon's region (*see supra* note 94); using the ratio of the special access lines that SBC and Qwest purchase from Verizon to the sum of their enterprise customer loops from ARMIS data plus those special access lines to determine the SBC and Qwest revenue to allocate to Verizon's region (*see supra* note 103); using the same revenue figures for the pre-transaction and post-transaction HHI calculations.

Adjusted Staff Enterprise Market Share Analysis							
		Change in HHI	=	660			
		Before Merger			After Merger		
Market Total	154.80	57.28		1,220	57.28		1,880
Company	National Revenues	Revenues	Share	HHI	Revenues	Share	HHI
AT&T	24.50	9.54	16.6%	277	9.54	16.6%	277
SBC	20.20	0.65	1.1%	1	0.65	1.1%	1
MCI	18.30	7.12	12.4%	155			
Verizon	15.20	15.20	26.5%	704	22.32	39.0%	1,519
Sprint	9.30	3.62	6.3%	40	3.62	6.3%	40
Qwest	8.70	1.65	2.9%	8	1.65	2.9%	8
Bell South	8.50	-	0.0%	-	-	0.0%	-
Level 3	1.80	0.70	1.2%	1	0.70	1.2%	1
XO	1.20	0.47	0.8%	1	0.47	0.8%	1
Others	47.10	18.33	32.0%	32	18.33	32.0%	32
Total	154.80	57.28	100.0%	1,220	57.28	100.0%	1,880

Sources:
R. Dale Lynch and Blake Bath, *Enterprise Telecom; A Comeback Begins,* Lehman Brothers Equity Research Report, Nov. 11, 2003.
FCC, *Trends in Telephone Service* , as *of April 2005* , Table 7.3 and *Local Telephone Competition: Status as of December 31, 2004,* Tables 6 and 11.
SBC and Qwest Special Access Purchases.
Verizon Lines by State.

	Staff Original	With Changes
Pre-Merger HHI	2,924	1,220
Post-Merger HHI	4,679	1,880
Change in HHI	1,755	660

As shown in the tables above, on Staff's approach, it should have calculated a post-transaction HHI of no more than 1,880, rather than 4,679. Indeed, Staff's figure should have been less than 1,880, as the above table does not allocate any of Verizon's enterprise revenue to out-of-region customer locations and does not account for any enterprise revenue that SBC and Qwest obtain using their own facilities, rather than special access purchased from Verizon. For the same reasons, Staff should have calculated a change in HHI of no more than 660, rather than 1,755. As shown above, HHI numbers such as these are well within the range where the antitrust enforcement agencies do not challenge transactions as a practical matter. And because, as discussed, HHI calculations, when used, are only the beginning of an analysis of competitive effects of a transaction, consideration of other factors – such as the national characteristics of the enterprise segment, the heterogeneity and sophisticated nature of enterprise customers, the complex procurement practices followed in the segment, and the importance of non-price elements of competition for enterprise customers – leads to the conclusion that this transaction will not adversely affect competition for enterprise customers.

Analyst Reports. Staff also pointed to two analyst reports, which it asserted "suggest that the[] mergers [of AT&T and SBC and Verizon and MCI] will cause falling prices in the telecommunication[]s industry to slow."[105] In fact, there is no reason to think that this transaction will result in any lessening of existing vigorous competition for enterprise customers. On the contrary, because both this transaction and the SBC/AT&T transaction will result in significant savings through synergies, and because a core purpose of both transactions is to enhance the ability of the entities to compete aggressively for the business of enterprise customers, there is every reason to think that prices will fall even faster in the future.

c. Staff Correctly Concluded That No Remedies Are Warranted

Despite Staff's erroneous HHI calculations, it reached the correct conclusion that "direct retail based remed[ies] [are] not required."[106] Nor, as explained below, is there any need for indirect remedies that address wholesale services. There is robust retail competition to serve enterprise customers today, and this transaction will do nothing to lessen that competition.

[105] White Paper at 30.

[106] *Id.* at 33.

3. Transport – Wholesale

a. This Transaction Will Not Reduce The Significant Competitive Deployment And Availability Of High-Capacity Transport Facilities

As discussed in Petitioners' May 13 Reply Comments, MCI's local fiber facilities have a very limited overlap with Verizon's facilities in New York and, more important, where they do overlap numerous other providers have deployed facilities as well. As Petitioners have explained, the overlap occurs in only seven wire clusters (totaling 48 wire centers) in New York, virtually all of which have fiber deployed by multiple additional carriers, at both the cluster and individual wire center level.[107] Indeed, there is an average of 12 additional competitors per cluster and 10 additional competitors per wire center where MCI has deployed local fiber networks in New York.[108] The extensive competition in the areas where MCI has deployed fiber should not be surprising, because MCI has focused its fiber deployment on the areas with the greatest demand for high-capacity services and the greatest potential for revenues – factors that obviously also attract other carriers.

The data available to Petitioners about other carriers' fiber deployment, however, are necessarily limited and, therefore, certainly understate the extent of fiber deployment in the areas in which MCI has deployed fiber. Nonetheless, the maps included in Exhibit 2 demonstrate the extensive fiber deployment by carriers other than MCI in the wire center clusters where MCI has local fiber networks in New York.[109] These maps also show that there are extremely few areas

[107] *See* Petitioners' Reply Comments at 29-31.

[108] See id.

[109] The maps are based on data from MCI regarding its fiber network, Verizon's inspection of its central offices to identify fiber-based collocation, and data obtained from a third-party (GeoTel) which has an incomplete list of fiber deployed by other carriers. The maps show fiber in the entire state, as well as detailed sections in the New York Metro, Albany, Buffalo, and Syracuse MSAs. The maps depict fiber deployed by 35 carriers in addition to MCI in the New York Metro MSA, and by 7 carriers in addition to MCI in each of the other three MSAs.

where MCI has deployed fiber that does not overlap with fiber routes deployed by at least one other carrier. In addition, where MCI's fiber does not directly overlap with other carriers' fiber, it is located very close to fiber that is currently deployed by at least one other carrier and that economically could be extended to serve the areas where MCI found it made economic sense to deploy its own fiber. And, again, the maps understate the extent of other carriers' fiber deployment, because Petitioners do not have access to maps of all other carriers' fiber networks.

Moreover, these other carriers offer access to their fiber networks on a wholesale basis. Indeed, operators of competitive fiber networks routinely offer high-capacity services over those networks on a wholesale basis to other carriers, from the DS1 level all the way up to the highest capacity OCn levels. For example, of the seven carriers with fiber networks shown on the map of the Albany MSA, at least five advertise their wholesale services. Thus, MCI is not a unique provider of wholesale access to fiber networks in any part of New York. This transaction, therefore, will have no material effect on the availability of fiber transport in New York.

b. The Flaws In Staff's HHI Calculations And Overlap Analysis

All of the evidence detailed above demonstrates that the combination of Verizon and MCI will not have a material effect on the availability of high-capacity transport facilities in any area in New York. Staff reached the contrary tentative conclusion because it relied on an outdated and incomplete set of data to determine the extent of fiber deployment in New York: the self-reported data obtained in late 2003 and early 2004 in response to the *Triennial Review Order*.[110] As an initial matter, many carriers with fiber networks in New York – including Looking Glass and Neon, among others – were not parties to that proceeding and did not respond to the Staff's requests for data. Indeed, only 17 carriers submitted data in response to Staff's

[110] *See* White Paper at 34.

request.[111] The maps Verizon has attached, however, include more than 20 fiber providers in addition to those that submitted data to Staff. In addition, as even Staff recognized, the data that the carriers submitted "contained numerous inconsistencies," and some companies did not submit data but instead "indicated that they do not maintain data in such a way as to be able to answer [Staff's] questions" or "claimed that answering [Staff's] questions . . . would be cost prohibitive."[112] Because Staff's transport analysis is entirely based on this fundamentally flawed data set, no meaningful conclusions can be drawn from the calculations it conducted, which are discussed in further detail below.

Calculation of Transport HHIs. Staff conducted three HHI calculations.[113] Petitioners understand that, for each calculation, Staff first determined the number of mathematically possible intraLATA transport routes between Verizon's wire centers.[114] Staff then assumed that Verizon has deployed transport on each possible route. Staff then considered the self-reported data from other carriers on their transport routes, considering a route to exist only if the carrier stated that it actually had deployed transport directly between two wire centers. In other words, if a carrier stated that it had deployed transport between points A and B and B and C, but did not state that it had a transport route between A and C, Staff did not count the carrier as having transport on the A to C route. This is in stark contrast to Staff's assumption with respect to Verizon, which often can transport traffic between two wire centers only indirectly, routing it

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[111] *See* Case 03-C-0821, Descriptive Summary of Department of Public Service Staff's Preliminary Data Collection Effort (Nov. 17, 2003), at 4 ("Descriptive Summary").

[112] Descriptive Summary at 4.

[113] *See* White Paper at 34-35.

[114] That number is calculated using the formula n!/[(n-2)!2!], where n is the number of Verizon wire centers in a LATA. Therefore, if Verizon has 5 wire centers in one LATA and 7 wire centers in another LATA, the number of mathematically possible intraLATA routes is 31, with 10 possible in the first LATA (5!/[3!2!]) and 21 possible in the second LATA (7!/[5!2!]).

through other wire centers. Finally, Petitioners understand that Staff used this data to assign "shares" of a "transport market" based on the number of routes it had calculated.

The errors in this approach are many. The primary one is the reliance on the extremely limited self-reporting of transport routes from a more than 15-month-old proceeding. As the maps in Exhibit 2, the data Staff collected dramatically understate the extent of the fiber networks that other carriers have deployed in New York, and of course provide no information on where competitors would be able to provide competitive fiber if MCI's fiber network were no longer available on a wholesale basis. Therefore, regardless of whether Staff performed its calculations on all conceivable routes in Verizon's territory in New York, or only those routes in LATA 132 where two carriers had self-reported that they had deployed transport, or only those routes where Verizon no longer has an obligation to provide DS1 or DS3 transport as a UNE, the results of the calculations are meaningless because they exclude both significant fiber deployment and potential deployment.

Transport Overlap Analysis. Staff also sought to call into question Petitioners' demonstration that MCI's local fiber networks overlap with Verizon's to only a limited extent and that numerous other providers have deployed fiber in the limited areas where there is overlap.[115] To conduct its analysis, Staff reviewed Appendix E of Verizon's PSC NY No. 10 tariff, which lists a total of 41 wire centers: 30 that are "Tier 1" wire centers under the criteria the FCC established in the *Triennial Review Order* and 11 that are "Tier 2" wire centers under those same criteria.[116] There are 487 mathematically possible intraLATA routes between these

[115] *See* White Paper at 35-37 & Table 8.

[116] Verizon is not obligated to provide UNE DS1 or DS3 dedicated transport on routes between two Tier 1 wire centers. *See TRRO* ¶¶ 126, 129. Verizon is not obligated to provide UNE DS3 dedicated transport on routes between a Tier 2 wire center and a Tier 1 or Tier 2 wire center, but must provide UNE DS1 transport on those routes. *See id.*

wire centers: 465 in LATA 132 (New York Metro), 21 in LATA 140 (Buffalo), 1 in LATA 134 (Albany), and 0 in LATA 136 (Syracuse), where there is only one Tier 1 wire center and no Tier 2 wire centers, and therefore no intraLATA routes where Verizon is not required to provide UNE DS1 and DS3 transport.[117]

Staff then asserts – based on the same self-reported data it used to calculate the HHIs – that MCI, AT&T, and/or SBC are the *only* carriers to provide transport on roughly 70 percent of those routes.[118] But an analysis of the fiber-based collocators in the wire centers that make up these 487 routes demonstrates the flaws in relying on that self-reported data set.[119] In fact, 82 percent of the 487 routes have at least one fiber-based collocator on each end of the route other than MCI; more than 55 percent of those routes have at least *three* fiber-based collocators on each end other than MCI. Moreover, there are only 72 routes (15 percent) where AT&T, SBC, or MCI are the only fiber-based collocators on each end of a route – a far cry from the 70 percent figure arrived at using Staff's incomplete data.[120] As the FCC determined, this fiber-based collocation enables carriers to transport traffic to and from that wire center, and demonstrates that competition is possible along those routes without the use of unbundled network elements.[121]

But even if the analysis were limited to routes where the *same* carrier has fiber-based collocation on both ends of the route – and therefore can use its own network to transport traffic

[117] Because Staff lumped the Tier 1 and Tier 2 wire centers together, it ignored that, on more than 200 of the routes, the FCC's rules continue to require Verizon to provide UNE DS1 transport.

[118] *See* White Paper at 36.

[119] The fiber-based collocation, moreover, understates the likely extent of alternative transport available. Many carriers that have deployed fiber networks do not collocate in Verizon's central offices.

[120] MCI is the only carrier with fiber-based collocation on both ends of only 8 routes, or just over 1.5 percent of the routes. And, the six wire centers that comprise these 8 routes have at least one fiber-based collocator other than MCI and an average of five fiber-based collocators other than MCI. Indeed, of the **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** of the 487 routes where MCI has fiber-based collocation on both ends, 74 percent of the routes have 2 or more carriers other than MCI with fiber-based collocation on both ends.

[121] *See TRRO* ¶¶ 96-98.

between the two wire centers – more than 75 percent of routes have at least one fiber-based collocator on *both* ends of the route (excluding MCI) and over 40 percent of those routes have at least three such collocators on both ends (excluding MCI).[122] As explained below, there is no valid reason for excluding AT&T and SBC from this analysis, but even if they were excluded, it would make little difference: more than 70 percent of routes still have at least one fiber-based collocator on each end; more than 50 percent still have at least three on each end; 60 percent still have at least one collocator on *both* ends; and nearly 30 percent still have at least three on both ends.

In addition, the maps included in Exhibit 2 likewise demonstrate that removing AT&T's and SBC's known fiber routes makes no virtually difference. That is, even with AT&T and SBC removed, other competitive fiber remains on *all* the routes where AT&T and SBC had deployed fiber. That is, the same competitive fiber routes still appear on the maps, and no additional MCI-deployed fiber is shown where there is no other known fiber based on the third-party data available to Petitioners. The only difference is that 7 of the 73 central offices shown on the map of New York no longer are identified as having fiber-based collocation.

But there is no merit to Staff's focus on transport deployed by AT&T and SBC. Even after those two companies have combined, that transport will remain in place as a competitive alternative to Petitioners' facilities. Speculation that SBC/AT&T would be likely to refrain from competing in New York defies common sense.[123] As an initial matter, because a key purpose

[122] For example, on the route in New York City between wire centers NYCMNY13 and NYCMNYVS, *six* carriers other than MCI have established fiber-based collocation on both ends of the route. In addition, two have established fiber-based collocation on both ends of more of the 487 routes than MCI has **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]**, and a third carrier has established fiber-based collocation on the same number of routes as MCI. Six other carriers have established fiber-based collocation on both ends of at least 55 of the 487 routes.

[123] *See* White Paper at 34.

and benefit of this transaction is the increased ability of the combined company to compete on a national and global scale, one of the primary rationales for this transaction would accordingly disappear if Verizon/MCI were to cease competing for customers in the SBC region.[124] It is simply not credible to suggest that Verizon and MCI would combine and then abandon their business in the extensive SBC region, or that SBC/AT&T would do the same in Verizon's region, as this would result in both companies losing business to competitors willing and able to provide service in both Verizon's and SBC's regions. The California Attorney General recently reached the same conclusion, finding that such collusion "would entail enormous opportunity costs" – as it would entail "ceding [national and global] customers to [the] many competitors in the enterprise market" – "would offer little chance of success," and "ignore[s] SBC's history of competing [with Verizon]."[125]

Indeed, Verizon and SBC currently compete extensively. For example, Verizon has deployed 300 miles of optical network facilities in Los Angeles to compete directly with SBC and has also extended its optical fiber into SBC's region in the Dallas MSA.[126] SBC, similarly, has obtained fiber-based collocation arrangements in central offices that contain 70 percent of Verizon's business lines in the Los Angeles MSA, as well as in central offices that contain 87 percent of Verizon's business lines in the Dallas MSA, and that contain 41 percent of Verizon's business lines in the New York MSA. Verizon also competes for enterprise customers in 28 out-

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[124] SBC and AT&T have likewise informed the FCC that they in fact plan to compete aggressively with Verizon if their merger is approved, and that "SBC is investing $16 billion to acquire AT&T precisely *because* it seeks to compete more effectively for businesses with national and international operations, including those with operations in the 30% of the country served by Verizon." Ex Parte Letter from Gary L. Phillips, SBC, and Lawrence J. Lafaro, AT&T, to Marlene H. Dortch, FCC, WC Docket Nos. 05-65 & 05-75, at 4 (May 17, 2005).

[125] Opinion of the Attorney General on Competitive Effects of Proposed Merger of SBC Communications Inc. and AT&T Corp. at 30-31, Application No. 05-02-027 (Cal. PUC filed July 22, 2005).

[126] *See*, *e.g.*, Verizon News Release, *Verizon Plugs in New National Broadband Network* (Apr. 14, 2004) (Verizon operates an IP/MPLS backbone with routers in several SBC cities, including Dallas-Fort Worth and Los Angeles).

of-franchise areas, 17 of which are in SBC's service area.[127] SBC has recently won a major contract with the American Red Cross in Washington, DC, and SBC Telecom competes with Verizon for business customers in Albany, Nassau-Suffolk, New York City, and at least 10 other areas.[128] Verizon's VoiceWing VoIP service competes with SBC by offering area codes in 11 of SBC's 13 states, including California and Texas. There is also extensive head-to-head competition between Verizon Wireless and Cingular, and a number of the major markets where Verizon has deployed its 3G wireless broadband service (EvDO) are within major metropolitan areas in SBC's territory.[129]

c. The Remedies Offered For Consideration Are Unnecessary And Should Not Be Adopted As Conditions To Approval

Because there is no basis on which to conclude that this transaction will have a material, negative effect on the availability of transport facilities in New York, there is no basis for any of the remedies that Staff proposes for consideration. As explained below, there are additional reasons why the Commission should not adopt any of Staff's suggested remedies, in particular that they pertain to *inter*state services over which the Commission lacks jurisdiction. Indeed, virtually all of the wholesale transport services that Verizon and MCI offer in New York are interstate services, with Verizon's provided under FCC tariff and MCI's provided under contract. As such, they are governed exclusively by the FCC and this Commission would violate federal

[127] *See* Bruno *et al.* Reply Decl. ¶ 15 (Attachment 5 to Joint Opposition of Verizon Communications Inc. and MCI, Inc. to Petitions To Deny and Reply to Comments, WC Docket No. 05-75 (FCC filed May 24, 2005)).

[128] See New Paradigm Resources Group, CLEC Report 2005, Ch. 6 – SBC Telecom at 7-8 (19th ed. 2005); see SBC News Release, SBC Communications Announces Five-Year, $59.7 Million Contract with the American Red Cross (Apr. 18, 2005).

[129] *See* Verizon Wireless, *Wireless Internet BroadbandAccess*, *available at* http://www.verizonwireless.com/b2c/mobileoptions/broadband/index.jsp.

law in attempting to regulate the rates, terms and conditions on which Verizon and MCI offer those services.[130]

1. Freezing MCI's Rates, Terms, and Conditions. Petitioners have already made clear that the post-transaction company intends to honor MCI's existing contracts for wholesale services. But there is no possible basis for freezing the rates, terms, and conditions "that [MCI] provided pre-merger, or which are currently tariffed or offered under SPAs, for a period of 36 months from the date of the merger."[131] And it is unnecessary: MCI already provides its wholesale services pursuant to contracts that have a usual term of a year, and it has entered – and remains willing to enter – into contracts for a longer term.

The "smaller carriers" that Staff apparently believes would benefit from this measure could procure wholesale service from the numerous other providers in those limited areas where MCI has deployed fiber networks in New York. Furthermore, contrary to the claims of some parties, MCI – as a "larger" carrier – does not obtain additional discounts on wholesale purchases of transport from Verizon, nor does MCI make a substantial business of reselling circuits that it purchases from ILECs as special access.

First, the majority of Verizon's special access discount plans in New York, including all of its DS1 discount plans, are *term* based, so that the same significant discounts are available on an order of a single DS1 or 1,000 DS1s.[132] Therefore, Verizon's special access pricing structure

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[130] *See AT&T Co. v. Central Office Tel. Inc.*, 524 U.S. 214, 227 (1998); *Boomer*, 309 F.3d at 417-24.

[131] White Paper at 37.

[132] For example, Verizon has circuit-specific plans available in New York with discounts ranging from about 5 to more than 40 percent, depending on the term selected by the customer, which can range from one to ten years. *See, e.g.*, FCC Tariff No. 11, § 7.4.10. Verizon also offers two basic types of non-circuit specific plans in New York: Facilities Management Service (where customers buy Verizon's services managing network facilities and are charged for the capacity used in DS-0 equivalents) and Commitment Discount Plans (where the discount level is based on a term of years, not volume, and the discounts available are the same as those in the circuit-specific plans). *See, e.g., id.*, § 7.2.17 (FMS), § 25.1 (CDP).

does not provide the kind of volume discounts that would give MCI any unique ability compared to other carriers.[133] In New York, for example, a number of competing carriers pay lower average rates for DS1 special access channel terminations than MCI. Even assuming that Verizon were to begin offering the kinds of volume discounts that would make such aggregation viable, MCI is by no means uniquely situated to play that role. Not only do many competing carriers already have wholesale operations, but there is no need even to operate as a carrier to enter this business – at least two companies, Global Internetworking and Last Mile Connections, have recently entered that business as carrier-agnostic wholesalers, with the former reporting that it already provides access to more than 500,000 lit buildings.

Second, the reality is that MCI resells ILEC special access to only a minimal extent today, and does not resell circuits obtained entirely from Verizon as special access. Indeed, only about one-quarter of MCI's total wholesale revenues for its Metro Private Line services (roughly equivalent to Verizon's special access) are earned from circuits where MCI uses ILEC special access at all. In the overwhelming majority of those cases, these are "Type II" circuits, where MCI uses ILEC special access for the channel termination to extend MCI's network to an off-net building. With respect to these Type II circuits, nothing about the transaction will affect the availability of the Verizon channel terminations – at the currently tariffed discount rates – to any carrier wishing to use them to complete a circuit.

2. Standardizing Rates, Terms, and Conditions for Verizon. Staff also seeks comment on whether standardizing the "rates, terms and conditions contained in commercial agreements

[133] Verizon also offers contract tariffs to its wholesale special access customers on an MSA-wide basis – and generally across multiple MSAs – in areas where it has obtained either Phase I or Phase II pricing flexibility. The total billed revenue plans available in New York, which generally have one-year terms, offer credits based on a customer's total billed revenues from traditional special access services. Services provided anywhere in Verizon's territory count towards the overall total revenue threshold. *See, e.g.*, *id.* § 32, Options 13, 20, 24, 25.

between Verizon and competitive carriers" could be "an effective tool to ensure the competitiveness of the transport market."[134] It is unclear exactly what Staff has in mind. Verizon provides wholesale access to transport through tariffs, which necessarily provide standardized terms and conditions. In addition, these tariffs provide for stable, discounted pricing through long-term commitments; indeed, virtually all purchasers of special access take advantage of such term plans. And, because the bulk of the wholesale transport that Verizon sells is pursuant to *federal* tariffs, this Commission lacks jurisdiction over such sales.

Alternatively, the Staff may be referring to commercial agreements that Verizon might enter into with competitors for transport on those routes where DS1 and DS3 transport are no longer available as UNEs. Verizon has not entered into any such agreements to date, largely because standardized terms and conditions are already available – along with significant discounts – pursuant to tariffs. Nor will the Commission have any jurisdiction over such agreements, in the event Verizon enters into one. To the extent Verizon provides DS1 or DS3 transport through a commercial agreement, it is doing so to fulfill an obligation under 47 U.S.C. § 271. And the courts and the FCC have made clear that state commissions have no authority to regulate agreements to provide elements under § 271.[135]

3. Expanding Transport-Related Retail and Wholesale Performance Measurements. Staff seeks comment on whether "the transport market-related retail and wholesale performance metric definitions [should] be expanded to help identify and monitor the market concentration

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[134] White Paper at 37.

[135] *See Qwest Corp. v. Schneider*, No. CV-04-053-H-CSO, slip op. at 14 (D. Mont. June 9, 2005); *see also MCI Telecomms. Corp. v. BellSouth Telecomms., Inc.* 298 F.3d 1269 (11th Cir. 2002) (state commission authority under § 252 is limited to implementing § 251(b) and (c)); Memorandum Opinion and Order, *Qwest Communications International Inc. Petition for Declaratory Ruling on the Scope of the Duty To File and Obtain Prior Approval of Negotiated Contractual Arrangements Under Section 252(a)(1)*, 17 FCC Rcd 19337, ¶ 8 & n.26 (2002) ("only those agreements that contain an ongoing obligation relating to section 251(b) or (c)" are "interconnection agreement[s]" covered by section 252).

effects of the merger" and whether there "[i]s . . . an enforcement or facilitation role for the Commission."[136] The short answer to both questions is "No."

First, the premise on which these proposed remedies are based – *i.e.*, that competition for wholesale transport services will be reduced – is flawed. Verizon and MCI are by no means the sole – or even two of a relatively few – suppliers for transport services. There are a myriad of network architecture and supplier choices available to end users in this market, including AT&T, which will remain a significant competitor in this market after its merger with SBC.

Second, as Staff notes, the existing performance measurements were developed specifically to monitor *service quality*. They are not designed or intended to measure market concentrations and it would be inappropriate to attempt to modify the transport retail or wholesale metric definitions for that purpose. Service quality measurements reflect the outcome of work processes that are managed by the company and largely within its ability to control (barring extraordinary events and the like). They cannot, as a practical matter, be used to gauge the extent of competition for the services included in the performance measurements, particularly given the difficulties attendant to gathering data that could be used to gauge competition.

Third, measuring "market concentration effects" is far different from measuring service quality or performance. The former involves a macro perspective of the market at issue and entails analysis of numerous economic, technical and other factors that influence micro behaviors of consumers and suppliers. There already exist means by which to measure market concentration and it is by no means clear how performance measurements could be developed to measure the "effects" of market concentration. Even if it were possible or desirable to develop such measurements, Verizon should not bear the burden of gathering and reporting additional

[136] White Paper at 37.

data, particularly when none of its competitors will have to bear a comparable burden. And unless all of Verizon's competitors were required to report data used in the performance metrics, the Commission could hardly develop complete measures of concentration.

In any event, the existing retail and wholesale transport measurements (which have been in place for many years and which have been developed collaboratively with other carriers) more than adequately address Staff's concern that the transaction will increase concentration in the market for transport services and that Verizon will therefore have an incentive to allow the quality of its transport services to decline. Any such service quality declines will be evident from Petitioners' reported performance under the current measurements. In the event such declines occur, Staff and the Commission can investigate the reasons for the decline and take steps to address it, as even Staff acknowledges in the White Paper.[137]

Finally, while it is not clear what type of "enforcement" or "facilitation" roles Staff had in mind here, it is clear there is no need for any Commission action pertaining to the quality of transport services. As noted, the existing measurements already provide adequate information concerning the levels of service being provided and the Commission already has adequate authority under the Public Service Law and its regulations to address declines in service. And the Commission has already acknowledged that it has no jurisdiction to enforce any rule or regulation in connection with interstate special access services.[138]

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[137] *See* White Paper at 52 ("the Commission . . . has a number of options at its disposal to address declines in service quality"). In fact, the interplay between competition and service quality is being addressed separately in the Intermodal Proceeding, in which other carriers are participating. It would be inappropriate to amend the existing metrics in the context of this proceeding.

[138] *See* Letter from Maureen O. Helmer, Chairman of the New York PSC, to Hon. Michael Powell, Chairman of the FCC (May 22, 2001) (advising that the NY Commission "would be willing to establish and enforce service standards on all special services, *if this were a matter your agency believed should reasonably be delegated to New York State*." (emphasis supplied)).

4. Divestiture of MCI's New York Transport Network. Staff questions whether "divestiture of the MCI New York transport network [is] practical and viable."[139] As an initial matter, it bears repeating that the evidence of actual deployment of competitive fiber networks in New York – as opposed to the limited data set Staff considered – demonstrates that this transaction will not result in any meaningful "increase in concentration" that needs to be "offset."[140] Therefore, there is no basis for considering the divestiture of MCI's transport network in New York.

In any event, divestiture is neither "practical [nor] viable." It would threaten serious disruption and interfere with the decision of enterprise customers to contract with MCI to provide the local component of their service over MCI's facilities. MCI's "New York transport network" is, in fact, constructed of fiber rings that are highly integrated with MCI's long distance, Internet, and data networks. These shared facilities, therefore, serve not only the New York customers that MCI serves entirely over its own facilities or in part using third-party facilities, but also customers outside of New York (and, indeed, outside of Verizon's territory). In addition, such divestiture would be a complex, costly, and disruptive process for MCI's New York customers served using the shared fiber transport facilities, whether those customers are served using MCI's self-deployed fiber loops or facilities obtained from other carriers. MCI's enterprise customers chose MCI because MCI offered a competitive combination of expertise, service, and price; there is no basis for the Commission to divest these sophisticated customers of their choice to remedy a non-existent problem. Divestiture would increase, not decrease, customer disruption and potentially disadvantage New York-based enterprise customers to the

[139] White Paper at 37.

[140] Id.

detriment of the New York economy. Finally, divestiture of these facilities would substantially reduce efficiencies to be obtained through this transaction.

4. Special Access And High-Capacity Loops

a. This Transaction Will Not Reduce The Extensive Competition For Enterprise Customers Purchasing Special Access Channel Terminations And High-Capacity Loops

As far back as 1999, the Commission acknowledged that the market for high-capacity services is "already competitive."[141] And Staff recognized in the White Paper that there has long been competition to serve these customers, initially from the "Competitive Access Providers (CAPs) [that] were one of the original types of facilities-based telecommunication industry competitors."[142] Competitors serve these customers using either self-deployed high-capacity loops or facilities obtained from other carriers, including special access channel terminations (*i.e.*, loops) from Verizon. As explained above, these competitors include traditional IXCs such as AT&T, Sprint, and Qwest; CLECs like XO and Level 3; cable companies such as Time Warner and Cablevision; systems integrators and managed service providers like IBM, EDS, Accenture, Northrop Grumman, and Lockheed Martin; major global telecommunications providers such as Equant, British Telecom, Deutsche Telekom, COLT, KPN Telecom, and NTT; equipment vendors like Lucent and Nortel; and, most recently, major application providers such as Microsoft.

Retail competition for these customers has advanced to such an extent that Verizon is primarily a wholesale provider for this customer segment. As much as 80 percent of Verizon's special-access revenues nationally comes from sales to other carriers, rather than from sales

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[141] Case 98-C-0690, Order Directing Tariff Revisions (Mar. 24, 1999), at 8.

[142] White Paper at 38.

directly to end-user business customers. This is true for Verizon's sales of special access overall and for its sales of DS1s and DS3s in particular – roughly 85 percent of Verizon's revenues for DS1s and DS3s comes from sales to other carriers, which then use those facilities to provide service to enterprise customers. These customers include not only large enterprises, but also small and medium-size businesses such as antique dealers, book stores, dry cleaners, florists, gas stations, and hair dressers, to name a few. Moreover, as shown above, numerous companies – in addition to MCI and AT&T – successfully compete against Verizon to serve enterprise customers, both in New York and across the country. Those carriers will continue to compete aggressively for this lucrative business following this transaction. In addition, as noted above, Verizon and MCI rarely compete head-to-head: of the more than 800 instances between October 1, 2004 and April 20, 2005 in which MCI bid on enterprise contracts, Verizon was among the competing bidders less than 4 percent of the time.[143]

This transaction will have no material effect on this extensive competition. MCI has established direct fiber connections to only **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** end-user buildings in New York, which are referred to as "on-net" or "lit" buildings.[144] In contrast, MCI serves roughly 40 times that number of buildings in New York – approximately **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** – using third-party facilities, including special access purchased from Verizon.[145] And, based on the lit-building lists provided by the limited subset of CLECs which offer to sell MCI dedicated access

[143] *See* July 1, 2005 Ex Parte Letter at 2-3 n.5.

[144] MCI has also established direct fiber connections to **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** Verizon central offices where MCI has established fiber-based collocation, as well as to **[BEGIN CONFIDENTIAL] [END CONFIDENTIAL]** carrier hotels. These facilities, which carry high volumes of traffic, are readily duplicated by other carriers, as the FCC has found. *See TRRO* ¶¶ 12, 20, 30, 141.

[145] As explained above, MCI receives no unique discounts on these special access purchases.

services in New York, these few competitors alone provide fiber to approximately 57 percent of MCI's lit end-user buildings in New York – about **[BEGIN CONFIDENTIAL]**

[END CONFIDENTIAL] such buildings. The actual number is undoubtedly higher, because MCI does not have lit building information from numerous carriers known to have such buildings in the former Bell Atlantic footprint, such as Sprint, Level 3, Broadwing (Focal), Cavalier/City Signal, Global Crossing, Qwest, and Broadview. Nor does it include the extensive fiber networks that have been constructed by utilities and other fiber wholesalers.

Moreover, approximately 85 percent of MCI's lit buildings in New York either have customer demand at the OCn or near-OCn level (which is not available as a UNE[146]) or are located in wire centers where Verizon is not obligated to provide UNE DS3 transport. In addition, nearly 75 percent of buildings in New York lit with MCI fiber are within *0.05 miles* – or *88 yards* – of known competitive fiber routes, with an average of nearly 4 such routes within 0.05 miles of those buildings. For these reasons, there is nothing unique about the bulk of the fiber that MCI has deployed to enterprise customer locations in New York, and nothing about the transaction will adversely affect the ability of the large number of other fiber providers in close proximity to MCI's fiber to "light up" buildings should MCI's wholesale prices rise.

b. Staff's Analysis Is Flawed

Staff did not conduct HHI calculations for special access and high-capacity loops.[147] Instead, Staff highlighted a variety of factors in support of its conclusion that there is an "obvious" "anti-competitive aspect" to this transaction with respect to these high-capacity

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[146] *See TRRO* ¶¶ 12, 20, 30.

[147] *See* White Paper at 42.

facilities.[148] Contrary to Staff's claims, none of the purported facts to which it points supports that conclusion.

First, Staff describes MCI as one of "Verizon's two largest wholesale market competitors" for special access services.[149] But, as shown above, MCI is a far larger *purchaser* of special access than a potential alternative *supplier* of such facilities. MCI serves approximately 40 times as many buildings using third-party facilities, including special access purchased from Verizon, than it serves using its own fiber loops. MCI's wholesale business, moreover, is tiny in comparison to Verizon's – MCI's national wholesale Metro Private Line Revenues represent just 2 percent of Verizon's total wholesale special access revenues. For these reasons, there is no merit to Staff's concern that this transaction could harm smaller carriers that purportedly rely on wholesale purchases from MCI. In any event, Petitioners have stated that the combined company intends to honor existing contracts.

Second, Staff claimed, based on its review of "maps containing MCI's New York City (NYC) loop and data facilities," that there "are large overlaps between Verizon and MCI local loop facilities, especially in the NYC area."[150] But Staff ignored that MCI's local loop facilities reach only **[BEGIN CONFIDENTIAL]** **[END CONFIDENTIAL]** end-user buildings in all of New York, and that there are *equally large* – if not larger – overlaps between Verizon's network and other carriers' local loop facilities. This is particularly true in New York City, which the attached maps show is awash in competitive fiber.

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[148] *Id.* at 45.

[149] *Id.* at 40; *see id.* at 41, 44.

[150] *Id.* at 42.

Third, Staff suggested that this transaction might "potentially increas[e]" prices.[151] But this suggestion is flawed, as an initial matter, to the extent it assumes that customers will lose the protection of existing contracts. Petitioners have made clear that they intend to honor existing contracts. Moreover, continued competition from other facilities-based competitors in virtually all of the areas where MCI has deployed local fiber in New York (as detailed above) would prevent the merged company from raising prices. In addition, Staff's concern ignores the highly limited nature of MCI's fiber loop deployment in New York, as detailed above. MCI is hardly a ubiquitous presence, and could not affect prices throughout the state. Any attempt to raise prices would give competitors an opportunity to capture additional business using existing facilities, or an incentive to extend their facilities and compete by undercutting Verizon's and MCI's price in the same manner that Competitive Access Providers have been doing in New York for years.[152]

c. The Remedies Offered For Consideration Are Unnecessary And Should Not Be Adopted As Conditions To Approval

Because there is no basis on which to conclude that this transaction will have a material, negative effect on the availability of special access and high-capacity loop facilities in New York, there is no basis for any of the remedies that Staff proposes for consideration.

1. Freezing MCI's Rates, Terms, and Conditions. As with Staff's similar proposal for transport, there is no possible basis for freezing MCI's rates, terms, and conditions for a period of three years. As explained above, Petitioners have already made clear their intent to honor MCI's existing contracts for wholesale services. In addition, MCI's fiber loops reach a small number of buildings, and competitors already do – or readily could – reach the overwhelming

[151] *Id.* at 44.

[152] Equally meritless is Staff's speculation that Verizon/MCI might engage in "price or rate collusion" with SBC/AT&T. As explained above, it is economically implausible to assume that SBC would spend billions of dollars to purchase AT&T's extensive assets in New York and then not use them to compete vigorously. In addition, Verizon and SBC are currently engaged in significant competition with each other.

majority of these locations. And to the limited extent MCI resells high-capacity facilities that it obtains from Verizon, it does not receive any unique discounts on those services that it could pass on to other carriers. Finally, these are interstate services over which the Commission has no jurisdiction.

2. Extending Expiring Verizon Interconnection Agreements. Staff questions whether Verizon should be required to extend interconnection agreements that are due to expire within 12 months of this transaction for an additional three years.[153] As an initial matter, such an extension is entirely unrelated to this transaction – any such agreements would expire and need to be renegotiated regardless of this transaction – and therefore would be an inappropriate condition. In addition, the Commission lacks the authority to mandate a change to the term of an agreement, as such negotiated provisions are "binding" on the parties.[154] In any event, it is difficult to identify any benefits from such an extension. Because Verizon's UNE obligations are established by federal law and implemented in New York through a tariff that is incorporated into virtually all interconnection agreements, extending the agreements would not alter Verizon's current or future UNE obligations. Thus, if this condition were imposed, then Verizon would be stuck with provisions negotiated long ago that are entirely unrelated to this transaction and that can be expected to be outdated in the legal and competitive context in 2007 or 2008.

3. Special Services Retail and Wholesale Performance Measurements. Staff asks whether "the special services market-related retail and wholesale carrier-to-carrier performance metric definitions [should] be expanded to identify and monitor the market concentration effects of the merger" and whether there "[i]s . . . an enforcement or facilitation role for the

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[153] *See* White Paper at 45.

[154] 47 U.S.C. § 252 (a)(1); *see Pacific Bell v. Pac West Telecomm, Inc.*, 325 F.3d 1114, 1127 (9th Cir. 2000).

Commission."[155] Staff proposed similar remedies in connection with its analysis of transport. Neither remedy should be adopted for the reasons set forth above. In short, it is inappropriate to attempt to use metrics to monitor market concentration. Adequate metrics already exist, and the expansion of these metric definitions will discourage parties from resolving matters on a business-to-business basis. And, to the extent that the special access services at issue are interstate, this Commission lacks jurisdiction over them.

4. Standardizing Rates, Terms, and Conditions for Verizon. As with Staff's proposal for transport, it is unclear whether Staff is referring to Verizon's tariffed offerings (which are already standardized) or to commercial agreements that might be entered into with respect to high-capacity loops that are no longer available as UNEs (and over which the Commission has no jurisdiction). In either event, this would be an inappropriate remedy for the same reasons as discussed above.

5. Divestiture of MCI's New York Fiber Loop Network. For many of the same reasons set forth above with respect to MCI's transport facilities, the "divestiture of MCI's New York fiber loop network" would be neither "practical [nor] viable."[156] It would be costly, complex and time-consuming. No divestiture order could prevent a customer from switching providers if the customer did not wish to have service provided facilities owned and operated by the purchaser of the divested facilities. Instead, MCI's fiber loops were deployed to take advantage of the efficiencies in an end-to-end architecture, and MCI's facilities were not designed to provide space for collocation or facilities for interconnection with the network of the new owner.

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[155] White Paper at 46.

[156] Id.

III. THE TRANSACTION WILL NOT INTERFERE WITH RETAIL OR WHOLESALE SERVICE QUALITY

A. There Is No Reasonable Basis On Which To Conclude That The Transaction Will Adversely Affect Retail Service Quality Or To Adopt Any Remedies Relating to Retail Service Quality

In assessing whether the transaction will adversely affect service quality in New York, Staff:

> Tentatively conclude[d] that today the sheer number of intermodal competitors for telecommunications services has significantly reduced the need for incorporation/application of a VNY *statewide* service quality rebate program and the requirement for a VNY *statewide* service quality rebate program as part of the merger is not required.
>
> Most customers who experience what they perceive as inferior telephone service quality or price have other options – they can change to a competing service provider in a matter of days, including VoIP, broadband or wireless carriers. Consumers exercising choice by changing carriers is not surprising. To the contrary, such actions are the natural evolution from a monopoly to a competitive market, and evidence of the Commission's goal to encourage competitive choice.[157]

Petitioners concur with these Staff findings and tentative conclusions. They are supported by the facts presented in Petitioners' May 13 Reply Comments and in these Comments, as well as the facts amassed by Staff in the *Triennial Review* proceeding. They are also consistent with the Commission's own view that it is no longer necessary or appropriate to impose service quality plans on Verizon NY when the competitive market is already imposing the discipline necessary to ensure that the company will continue to meet the service quality demands of all customers, whether residential or business.[158]

[157] *Id.* at 50 (emphasis in original).

[158] Transcript of Public Service Commission Meeting (Feb. 9, 2005) at 26, 28-29 (service quality incentive plans are no longer desired or necessary).

Petitioners disagree, however, with Staff's findings that "these competitive alternatives and opportunities . . . are *not* universally available" and that "there may be no opportunity to take advantage of some broadband voice choices due to limited build outs, and/or other limits on the 'reach of technology.'"[159] Contrary to Staff's belief, and as demonstrated above, competitive alternatives to Verizon's traditional wireline services are being offered by cable companies, wireless providers, Internet and broadband services providers, and VoIP providers throughout Verizon's service area in New York. There is no need to adopt a service quality rebate plan targeted to what Staff calls "captive customers" because there are no captive customers.[160]

Staff's analysis of the availability of competitive alternatives here is deficient in several respects. First, Staff focuses almost exclusively on the availability of broadband voice services, ignoring wireless and satellite alternatives altogether. Although Staff acknowledges cable telephony as a competitive alternative, Staff expresses a concern that "cable telephony is . . . limited to where cable companies have built out cable systems." Yet cable build-out is no limitation at all. Cable companies now pass 7,156,178 of the 7,193,381 total homes in New York, or ***99% of all homes in the state***. Of those homes passed by cable, 99% are broadband ready (and therefore, capable of receiving broadband and VoIP services), and 96% are cable

[159] White Paper at 50 (emphasis in original).

[160] In its discussion of transaction-related service quality issues, Staff notes that "the Commission believes that the quality of telecommunications services is a public interest concern and, in approving past mergers, has generally incorporated service quality protections." *Id.* at 46. Staff cites, in particular, the extensive service commitments to which NYNEX agreed when the Commission approved the Bell Atlantic/NYNEX merger. Although, as noted, Staff is not suggesting that similar commitments be made in the context of the instant transaction, it must be stressed that the levels of competition that exist in New York today far surpass the levels of competition that existed at the time of the Bell Atlantic/NYNEX merger such that it would be completely inappropriate to adopt in this proceeding service quality protections that are even remotely similar to those that were adopted in the other merger proceeding. Indeed, it is worth noting that the Commission did not request *any* service quality commitments when it approved the Bell Atlantic/GTE merger.

telephony ready.[161] Moreover, cable providers can use wireless technologies to extend services beyond the limits of their wired plant and, indeed, are already doing so. For example, Time Warner uses Wi-Fi technology to extend the reach of its cable routes.[162] Comcast, Charter and Cox have either utilized or tested wireless line extensions to serve customers previously out of reach.[163]

Second, contrary to Staff's suggestion, broadband services (and hence, "broadband voice services" as Staff calls them) are available in virtually every part of Verizon's service area in New York. As of December 2004, there were 39 high-speed broadband providers operating in New York.[164] There is at least one broadband provider in every zip code in New York and there are three such providers in 83% of the zip codes in New York.[165] And 19% of all New York zip codes have ten or more broadband providers.[166]

Staff finds other reasons to question whether these competitive alternatives pose a threat of "customer flight" that will provide Verizon with "a strong incentive . . . to address retail service quality."[167] Like its mistaken belief that broadband and VoIP services are not universally available in New York, Staff's other beliefs concerning possible limitations of these services are based on a misapprehension of the facts. For example, Staff contends that Verizon "ignores the

[161] Petitioners' Reply Comments at Table 1; U.S. Census Bureau, Statistical Abstract of the United States, 2004-2005, Table 56 and American FactFinder, New York, 2000, 2002 and 2003. Note that count of homes passed excludes RCN and that total New York households for June 2004 are estimated.

[162] *See* http://www.cabledatacomnews.com/jul05/jul05-7.html.

[163] See, e.g., Multichannel News, Cable's Quiet Growth Pump; Commercial Sales: $1 Billion a Year and Growing Fast (Aug. 23, 2004).

[164] FCC Industry Analysis and Technology Division Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of December 31, 2004* at Table 6 (July 2005).

[165] *Id.* at Table 13.

[166] *Id.*

[167] White Paper at 52.

incremental cost associated with purchasing VoIP service for customers without broadband."[168] According to Staff, "[m]any do not want to pay for broadband."[169] However, contrary to Staff's belief, the cost of broadband service is not an impediment for New York customers who wish to obtain VoIP services. That is because VoIP services are marketed and purchased largely on the basis of *marginal* costs to consumers who have already made the decision to subscribe to broadband in order to obtain high-speed internet access. The logic that the cost of broadband must be considered as a cost for VoIP service would require that rent or mortgage costs be included in the cost of basic wireline service since a customer must have a residence to receive that service.

The rapid growth of VoIP subscriptions means that traditional wireless voice providers like Verizon cannot afford to assume that the cost of broadband service generally deprives consumers of the VoIP option. As explained in Petitioners' Reply Comments, Vonage is adding some 15,000 new VoIP subscriptions per week; Comcast is adding 1,000 new subscribers per day; and Cablevision added nearly 100,000 new subscribers in first quarter 2005 alone. And these are just a few of the VoIP providers serving New York customers. Obviously, the incremental cost of adding VoIP service is not preventing customers from moving from traditional voice telephony services to the digital voice services offered by the cable companies and VoIP providers that are signing a growing number of new VoIP customers every day.

Yet even if the price of broadband and VoIP packages is more than some customers want to pay, it matters only that a significant number of customers would defect to such packages in the event that the quality of Verizon's voice services were to decline to the degree that Staff

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[168] *Id.* at 53.

[169] *Id.*

believes it could if not protected by a service quality plan. Said differently, the availability of VoIP services is itself sufficient to motivate Verizon to maintain the level of services that its customers demand; otherwise, those customers can and will switch to VoIP services and, in effect, punish Verizon for its decline in service.

Staff also suggests that the transaction will somehow reduce Verizon's incentive to overcome the existing technical limitations to its ability to offer a stand-alone DSL service on an unrestricted basis to all customers. Staff questions whether the Commission should, as a condition of approval, impose a deadline by which Verizon should make such a service available.[170] The Commission should do nothing of the sort. As discussed above, such a condition is not only unlawful but also unnecessary. Verizon is already striving to offer stand-alone DSL to all customers who want it as soon as possible since Verizon realizes that it needs to offer such a service to stay competitive with the cable companies and VoIP providers that are rapidly signing broadband and VoIP subscribers. The transaction will not change these marketplace realities, which provide all the incentive that Verizon needs to make this service available to all customers.

Since competitive alternatives – whether cable telephony, wireless, broadband and Internet communications, or VoIP – are available throughout Verizon's service area in New York, there is no reason to adopt any type of service quality gateway that would "limit Verizon's ability to increase rates in areas where neither a competitive nor a service quality gateway is passed."[171] Such "gateways" should be rejected for other reasons as well. Given the dynamic nature of the marketplace, adopting a "competitive" gateway applicable to discrete parts of

[170] *Id.* at 54.

[171] *Id* at 51.

Verizon New York's service area – and applicable to Verizon alone among all competitors – makes no sense. A threshold set today could easily be surpassed tomorrow, yet Verizon would continue to be constrained by a gateway until the competitive situation is assessed anew.

On a more practical level, Staff's own attempts to gather data in the TRO proceeding prove that measuring competition has always been difficult at best because competitors are reluctant to disclose even highly aggregated information (such as, for example, numbers of subscribers), and those that do disclose their data are not always clear and consistent in their reporting. Moreover, publicly available information (such as FCC reports) rarely captures the full extent of competition, even on a statewide basis. The difficulties typically associated with gathering high-level competition-related data would be substantially compounded (if not insurmountable) if the data must pertain to a specific area, such as a wire center, where a gateway has been established because Staff believes available competitive alternatives provide inadequate incentive to maintain good service there. Thus, setting the bar for the competitive gateway and measuring progress against "passing the bar" would be problematic, if not impossible. And any data collection or impairment issues that would impede investigation into whether the gateway has been passed would unfairly harm Verizon since its ability to move beyond the gateway would have to await resolution of those issues.

Using a gateway to constrain pricing in those areas would raise technical issues as well. For instance, if service quality gateways were established for some discrete geographic area where Staff feels broadband services are no sufficiently available, then Verizon would be required to spend an inordinate amount of time and money to rework its billing systems to reflect the different price structures that might be required in those areas should Verizon fail to pass the gateways there. Such an approach would impose an enormous burden on Verizon but not on its competitors. It would also be unduly punitive.

Gateways are also unnecessary because the transaction presents no reason for concern that service will be disrupted. The "Agreement does not call for the merger of any assets, operations, lines, plants, franchises or permits of MCI's regulated subsidiaries with the assets, operations, lines, plants, franchises or permits of any Verizon entity"[172] and therefore presents no operational issues that might affect any of Petitioners' regulated New York subsidiaries. Although, as also noted in the Joint Petition, the transaction is expected to lead to a corporate wide reduction of approximately 7,000 employees, those reductions will not result in a disruption in service quality in New York (or elsewhere). Staff states that "[b]ased on the relative percentage of employees, one might expect approximately 1,166 (17% of 7,000) job cuts in New York State,"[173] and implies that such reductions could lead to declines in service. However, there is absolutely no reason to "expect" 1,166 job reductions in New York State since reductions will not be determined based on a state's "relative percentage of employees" or on any type of rote, mathematical process such as the one Staff presumes. As Petitioners explained in their May 13 Reply Comments, reductions will be made in duplicative jobs in those areas of the company where it is able to provide shared services more efficiently. It is also anticipated that headcount reductions will be possible in the *management* of functional areas that provide opportunities for synergies – *i.e.*, enterprise markets, mass markets, international and wholesale operations, and information technology. There has been no suggestion that the transaction will result in service-affecting reductions in headcount.

[172] Joint Petition at 6.

[173] White Paper at 47.

Finally, a service quality gateway (or any other type of service quality "incentive") is not necessary because the transaction will not affect the Commission's continued oversight of Verizon's or MCI's regulated New York subsidiaries. The Commission has always monitored service quality very closely and will certainly remain vigilant after the transaction is completed. It receives monthly service quality reports that are disaggregated to discrete geographic areas determined by reference to reporting entities. These reports include service inquiry reports which detail the reasons any particular reporting entity failed to achieve threshold performance levels for any three of five consecutive months, and the plans for restoring service to the required levels. Should Verizon's service quality in any area decline after the transaction is completed, the Commission can take action to address the situation (just as it has in the past).

B. There Is No Reasonable Basis On Which To Conclude That The Transaction Will Adversely Affect Wholesale Service Quality Or To Adopt Any Remedies Relating to Wholesale Service Quality

1. The Transaction Will Not Adversely Affect Wholesale Service Quality

Staff tentatively concluded that "the merger has the potential to impact Wholesale Service quality and availability."[174] Specifically, Staff suggests that "Verizon may have less initiative to fulfill its obligations to provide good Wholesale Service quality in a post-merger environment."[175] This is incorrect.

As discussed in the Joint Petition, the Agreement does not in any way affect Verizon's obligations to provide wholesale services to its CLEC customers in New York pursuant to the applicable state tariffs and interconnection agreements. The transaction will not change the nature of this business as Verizon will continue to offer local access facilities to its carrier

[174] *Id* at 56.

[175] *Id*.

customers under tariff and contract. For its part, when MCI makes capacity on its local fiber networks available to other competitors, it generally does so pursuant to one year or longer contracts, which the post-transaction company intends to honor. Wholesale customers receiving service from Verizon and MCI will benefit from greater efficiencies in the provision of wholesale high-capacity local access services by increasing the instances in which they can meet their needs with a single vendor.

The competitive marketplace is currently imposing incentives for Verizon to provide excellent service to its wholesale customers,[176] and will continue to do so after the transaction is completed. Should Verizon's wholesale service quality decline, its wholesale customers might lose their end-user customers to other modes of telephony, such as cable telephony or VoIP. The market figures show that Verizon cannot even hope to win back these end users in anything like the numbers necessary to make up for the loss of wholesale revenues. It makes more sense for Verizon to retain its wholesale revenues by providing high quality wholesale services than to lose those revenues by losing wholesale customers whose own retail customers perceive an opportunity to obtain higher quality service from intermodal competitors.

In short, the elimination of MCI as a competitor for wholesale services will not reduce Verizon's incentive to deliver high quality service to wholesale customers. Numerous competitors are providing these services today and will continue providing those services after the transaction is completed. The transaction will not diminish Verizon's incentive to maintain the levels of service demanded by customers who can readily obtain these services from any of the several remaining providers.

[176] In March 2005 Verizon's Wholesale Market Group received the coveted Empire State Gold Award for providing excellent service to its Wholesale customers in New York.

2. The Remedies Offered For Consideration Are Unwarranted And Should Not Be Adopted As Conditions To Approval

Based upon its erroneous view of the wholesale marketplace, Staff proposes a number of remedies for Commission consideration. Because the underlying premise for these remedies – *i.e.*, that wholesale quality will be negatively affected by the merger – is wrong, the proposed remedies should be rejected out of hand. None has any merit in any event.

a. MCI's Service Quality Should Not Be Reported Separately In Carrier-to-Carrier Reporting

Staff notes that "[t]he C2C Guidelines measure performance against an established absolute standard or against parity with performance that Verizon provides to its own retail customers. Whether MCI products will continue to be reported separately or reported in Verizon's retail parity data will impact measurement against remaining CLEC performance data."[177] In light of this, Staff asks whether "MCI's service quality performance [should] be reported separately in carrier-to-carrier reporting."[178]

MCI's data should not be reported separately. After the transaction is completed, all of MCI's regulated subsidiaries will become Verizon affiliates, and to the extent MCI continues to provide services as a separate subsidiary MCI data should not be included in the monthly reports provided pursuant to the Carrier-to-Carrier Guidelines. The metrics in the Guidelines are intended to measure the wholesale services that Verizon provides to its CLEC customers, not the services that Verizon provides to any of its affiliates.

Furthermore, contrary to Staff's contention, MCI's service quality is not reported separately in the monthly C2C reports submitted to the Commission. Rather, MCI's data is part

[177] White Paper at 55 n.126.

[178] *Id.* at 56.

of the CLEC aggregate data included in the monthly reports. Once the transaction is completed MCI's data will no longer be included with the CLEC aggregate data pursuant to the Guidelines.[179]

In addition, after MCI's data are excluded from the CLEC aggregate, they should not be included, as Staff suggests, with the Verizon retail data that is used to determine parity of service to the CLECs. The level of service that Verizon provides its retail customers and that is currently captured in C2C metrics will continue to provide the Commission with sufficient information on Verizon's wholesale service quality. If, and when, the MCI operations are fully integrated with Verizon's operations, the Commission can review the efficacy of measuring the MCI operations as part of the retail compare groups. As the Commission knows, Verizon and MCI have not done any integration planning and it is therefore, impossible at this time to project how difficult it would be to capture and report MCI performance in the C2C retail compare groups.[180]

b. It Would Be Inappropriate To Require Reporting Of Service Quality Provided Under Commercial Agreements

Staff asks whether "service quality performance [should] be reported to Staff for wholesale products and services purchased by a carrier through commercial agreements."[181] First, this issue is not unique to this transaction and, in fact, is being addressed by the Carrier Working Group (the "CWG") in Case 97-C-0139. The parties' positions in that proceeding will

[179] *See* C2C Guidelines at 13. (Verizon affiliate reporting is always excluded from the CLEC aggregate for all metrics.)

[180] *See id.* at 14 (Retail Analog Compare Table).

[181] White Paper at 56.

be presented to the Commission at its October session.[182] There is no need or reason to address this industry-wide issue in the context of this bilateral transaction.

Second, any such reporting requirements would be inappropriate since, as discussed, the Commission lacks authority over commercial agreements negotiated outside the Section 252 process. It would also be contrary to the intent of the Commission, which has attempted to foster the development of business-to-business relationships among Verizon and its CLEC customers, and which has encouraged parties to move from reliance on regulation to reliance on commercial agreements.[183] Since all of the agreements are negotiated at arms-length in a commercial setting, the terms and conditions included in them are kept confidential by agreement of the parties. Requiring Verizon to report the services purchased under these agreements would unduly interfere with the process in that it would discourage parties from striking commercial deals that would ultimately have to be disclosed to others who were not parties to either the negotiations or the agreements that emerged from them. Nor could such a requirement be squared with either the Commission's goal of increasing reliance on commercial agreements. Any perceived service issues can and should be resolved through discussions between Verizon and its wholesale customers.

Finally, the service quality that Verizon provides to CLECs under the commercial agreements for the Wholesale Advantage services that replace UNE-P will be captured in the retail metrics (not the C2C metrics) along with Verizon's performance to its resale and retail customers, as it is today. In this way, the Commission (as well as Verizon's customers) will be

[182] In addition, no CLEC in the PAP Annual Review has requested that the Wholesale Advantage lines provided pursuant to commercial agreements be included in any metrics under the PAP.

[183] *See*, *e.g.*, Letter from William M. Flynn, New York PSC Chairman, to Michael K. Powell, FCC Chairman (Mar. 14, 2004).

able to detect declines in performance, make further inquiry concerning the cause of the declines and take steps to address them.

c. It Would Be Inappropriate To Expand The List Of Collaboratively Developed Wholesale Special Services And High-Cap Metrics

Staff asks if "future commercial and interconnection negotiation processes and resultant agreements [would] benefit from an expanded list of collaboratively developed wholesale special service and high cap metrics to draw from."[184] In fact, future negotiation processes will be impeded by the development of wholesale and high-cap metrics, and enforcement of adequate and nondiscriminatory service performance will not be affected by the transaction. The Commission has no authority to interfere with that process and any attempt to do so would violate federal law prohibiting the states from regulating commercial agreements negotiated outside of Section 252. It would also be contrary to the Commission's expressed intention to remain outside the commercial agreement process. The Commission should not use this transaction as its basis for injecting itself into the process since the transaction will not affect the process in any way.

Interconnection agreements ("ICAs") and commercial agreements are negotiated at arms-length between Verizon and other parties. ICAs are used for services that Verizon is obligated to provide. The ICAs themselves are publicly available documents, and CLECs who have unfettered access to the ICAs can either adopt an existing ICA or negotiate a new one. To facilitate the process, Verizon provides a template ICA as the basis for negotiation. Any attempt by the Commission to add to or supplement that template with a list of wholesale special service

[184] White Paper at 56.

and high-cap metrics would interfere with this process, which has worked well to date and which will not be disrupted by the transaction.

In contrast, commercial agreements are for services that Verizon is not obligated to provide. The terms of these agreements generally are kept confidential between the parties. If the Commission wants to foster the use of these commercial agreements, it should not attempt to develop through some collaborative process an expanded list of metrics for wholesale special services and high-cap loops. Service quality issues between Verizon and its wholesale customers who obtain services from commercial agreements are effectively managed on a business-to-business basis now and they should continue to be managed that way after the transaction is completed. A Commission-mandated template of metrics would unlawfully and unnecessarily interfere with this process.

Additionally, adequate metrics have already been developed in the Special Services Guidelines applicable to special access services and the C2C metrics applicable to unbundled high-cap loops. An expanded list of metrics is not needed since parties can refer to these measures to detect any service quality issues and to pursue them with Verizon. That MCI may have done so in the past, but will no longer do so after the transaction, is no reason to conclude that the metrics will become insufficient once the transaction is completed. Other carriers have the capacity and resources to pursue service-related issues with Verizon (as their active participation in this proceeding makes quite clear). The existing metrics need not be expanded merely because the number of providers that have relied on them is being reduced.

Staff also questions "[h]ow . . . adequate and nondiscriminatory service performance [will] be enforced" after the transaction.[185] It expresses a concern that the transaction might

[185] *Id.*

somehow disrupt continued enforcement of adequate and nondiscriminatory wholesale service performance. That concern is misplaced and provides no reason to adopt new or expanded wholesale service quality metrics. Contrary to Staff's suggestion, the transaction will in no way reduce Verizon's "incentive . . . to address deficiencies in wholesale service quality, specifically for smaller carriers, and in particular carriers now obtaining services through commercial agreements."[186] Intrastate wholesale services provided under state tariff will remain subject to Commission oversight. To the extent interstate services are regulated by the FCC, that agency (and only that agency) can enforce any service quality requirements that might exist at the federal level. This provides more than adequate incentive to maintain high quality service and to address any deficiencies that might arise in the future.

It is simply not true that "[l]osing MCI as a major wholesale competitor for the provision of T-1 circuits may have an effect on the quality of high capacity services provided to retail customers."[187] As discussed, numerous providers are competing to serve customers with the high-capacity services they demand. Even after the transaction, competition for these customers will remain intense and will itself compel Verizon to provide high quality special access service. Imposing even more special access service quality obligations on Verizon than are currently included in the Special Services Guidelines is neither necessary nor appropriate. Special access is a competitive market, and Verizon would simply be ceding that market to its competitors if it could not provide first-rate service.

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[186] *Id.* at 55.

[187] *Id.*

d. There Is No Need To Adopt a Process To Ensure The Integrity Of The Reporting System

Staff asks whether "the Commission need[s] to implement a process to ensure the integrity of the reporting systems for transport and special services."[188] This proposal should be rejected. There is absolutely no evidence that there are any problems with the current reporting systems for transport or special services and there is no reason to believe that the transaction will in any way impair the integrity of reporting. The notion that Verizon and SBC will engage in "collusion" is baseless to begin with and should not be seized upon as a reason to speculate that reporting performance metrics will be tainted after the Verizon/MCI and SBC/AT&T transactions are completed.[189] To the extent that any plausible allegations of mis-reporting are made after the transactions, the Commission has a panoply of regulatory tools at its disposal that it can use to investigate any such allegations. The Commission need not and should not take any action at this time.

IV. THE TRANSACTION DOES NOT RAISE ANY CONSUMER ISSUES THAT REQUIRE COMMISSION ACTION

A. Verizon And MCI Will Take All Necessary And Appropriate Steps To Ensure That Consumers Receive Adequate Notification Of And Information Concerning The Transaction

Staff "tentatively concludes that MCI's residential and small business customers should be properly notified regarding 1) the proposed merger and 2) any potential changes post-merger that will affect telephone service plans or rates."[190] It believes that Petitioners should discuss notification with Staff prior to issuance. Staff seeks "comments on customer notification procedures" and concludes that "no other remedies are warranted." Petitioners agree that

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[188] *Id.* at 56.

[189] *See, e.g.*, *id.* at 34.

[190] *Id.* at 58.

customers (whether residential or business customers) should be advised of the merger and any changes in service plans or rates and will provide such notice when and as appropriate.

At this early stage of the transaction, however, it is premature to advise customers of the transaction. As noted in the Joint Petition, the Agreement does not call for any changes in the rates or terms of service of any New York regulated subsidiary of either Verizon or MCI. As also noted in the Joint Petition, MCI's New York subsidiaries will remain separate from Verizon's New York subsidiary after the transaction is completed. Inasmuch as Petitioners have not begun any post-transaction planning, there are no "post-merger changes" about which to notify customers at this time. Petitioners will develop a communications plan designed to provide customers with adequate notice of any changes that will affect their relationship with the post-transaction company should any changes be made. As in the past, Petitioners will be sure to keep Staff informed of its customer notification activities and will endeavor to address any Staff concerns in that area should any such concerns arise.

B. The Transaction Presents No Financial Issues Or Risks That Require Commission Action

Staff analyzes the transaction's effect on Verizon's New York intrastate return on equity ("ROE") and on Verizon's financial position generally. It seeks comments on a number of tentative conclusions and suggested remedies that are ostensibly designed to "insulate" customers from any possible adverse financial effects from the transaction. Petitioners address these tentative conclusions and remedies in the following sections.

1. Staff Properly Concluded That A Rate Case Is Not Necessary To Consider Synergies

Staff purported to analyze the transaction's effects on Verizon's New York intrastate ROE and tentatively concluded:

> The merger begins to noticeably improve net income in 2007 but it is not until 2009 that the improvement reaches a level where it might have a material impact on Verizon's New York intrastate ROE. As indicated above, Verizon's current New York intrastate ROE is below what it would be in a traditional rate proceeding. Thus, there appears to be no basis, at this time, for the Commission to institute a rate proceeding or require Verizon to pass along the savings to customers as PULP suggests.[191]

Staff seeks comment on this tentative conclusion.

Verizon agrees that it would be inappropriate to commence a rate proceeding to analyze the synergies expected from the transaction and, in particular, to require Verizon to pass them along to customers. Putting aside whether Staff's calculation of the merger's effect on Verizon's New York intrastate ROE is accurate, it is beyond dispute that Verizon is currently *not* earning anything in New York like the kind of "authorized rate of return" that emerged from the lengthy and hotly contested rate cases of the past. It is also true that most of the synergies expected from the transaction are not expected to inure to the benefit of Verizon's operating telephone companies. And any savings that the New York operating company might achieve from the transaction are hardly likely to create an "over earning" situation now or in the future.

Indeed, the rate case concepts of "guaranteed rate of return" and "over earning" are anachronistic in these times in which Verizon is struggling to keep up with competitors that are using new technologies to provide competitively-priced services and that are steadily luring customers away from the public switched telephone network. As Staff is well aware, Verizon must remain competitive with the many cable companies, wireless providers, Internet and broadband services providers and VoIP providers operating throughout the state, all of whom are offering New York residential and business customers of all sizes a wide array of services,

[191] *Id.* at 63.

including voice and data services, using their existing platforms. Under the circumstances, Verizon needs to use any savings that it might gain as a result of the merger to invest in new services and to maintain competitive prices. Market forces will require the merged company to share the benefits of the transaction with customers, and it would be unnecessary and counterproductive for the Commission to interfere with this process and with the merged company's its efforts to remain a viable provider of competitively-priced communications services.

2. The Transaction Will Not Impair Verizon's Ability To Attract Capital And, While A Downgrade Is Not Anticipated, There Would Be No Significant Effect On Cost Of Capital If One Were To Occur

Staff seeks comment on its tentative conclusions that:

> [t]he acquisition of MCI is not expected to impair Verizon's ability to attract the capital necessary to upgrade Verizon's wireline infrastructure in New York. However, Verizon's securities could be downgraded, resulting in higher capital costs for Verizon's New York regulated operations.

These tentative conclusions are technically accurate but present no reason for concern and no basis for taking any action concerning the transaction. It should first be noted that Verizon's operating telephone companies do not go directly to the market to secure debt but borrow instead from their parent company, Verizon Communications Inc. Staff concluded that "[w]ith a market capitalization of approximately $100 billion, it is not expected that the acquisition of MCI will impair Verizon's ability to attract the capital necessary to upgrade Verizon's wireline infrastructure in New York."[192] In fact, Verizon studied whether the transaction would impair the parent company's ability to attract capital and determined that it will not. While certain debt ratings agencies have placed

[192] *Id.* at 65.

the parent company on credit watch to monitor the transaction's effects on its credit-worthiness, no transaction-related downgrade has occurred to date and none is expected. Yet even if one were to occur, Verizon's analysis indicates that the effect of such a downgrade on Verizon's cost of capital would be insignificant.

3. The Acquisition Is A Reasonable Response To Industry Dynamics

Staff seeks comment on its conclusion that '[f]rom a financial perspective, the acquisition appears to be a reasonable competitive response and strategy to growing intermodal competition."[193] Petitioners agree with that conclusion and the industry developments discussed above explain why Verizon's decision to acquire MCI makes good business and economic sense. The transaction responds to the continuing evolution of the industry as driven by customer demand and by changing technology. The industry is rapidly restructuring to deal with the reality of intermodal competition and convergence. As a recent report starkly observed, traditional landline carriers face major challenges: "The underlying business model for landline telephony has formally ceased to exist and the stock markets no longer have faith in this sector."[194] Moody's recently cut the debt ratings on certain divisions of Verizon Communications, including New York, stating that "inroads made by rivals will cause the division's operating performance to deteriorate faster than anticipated."[195] The competitive need for firms to offer products and services that respond to telecommunications convergence is

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[193] *Id.* at 69.

[194] PR Leap, Probe Group Releases First Schnee-Tumollilo Report: The End Of The Landline Business, Can Service Providers Adapt? (Apr. 21, 2004).

[195] http://www.newyorkbusiness.com/news/cms?id=10732&print=1.

further supported by Gartner Research, which found that "operators that fail to recognize this need [for unified services] will struggle to stay relevant in the market."[196]

For its part, Verizon is responding to the changing competitive landscape by accelerating its expansion into broadband and wireless services. The planned transaction with MCI will facilitate Verizon's ability to complete those plans. MCI's facilities and customer base will complement Verizon's continuing transformation into a premier wireless and broadband provider. The combination of Verizon's fiber deployment with MCI's IP backbone and IP applications will enable the development of an advanced broadband platform, one that is capable of delivering next-generation communication services to a wide range of customers. From the perspective of MCI's existing enterprise customers, the transaction adds a widespread local network and the ability to obtain wireless services and wireline services from a single source. Thus, the combined company will be able to provide one-stop shopping for consumer, small business, and enterprise customers.

The proposed transaction will enable the new firm to meet the challenges of convergence and changing industry dynamics far better than each could on its own. The post-transaction entity will be a stronger competitor that is able to meet customers' new expectations for services and pricing, and to better match the offerings of the cable companies and their suite of advanced services. In short, the post-transaction company will be better positioned to develop and to offer innovative services, providing valuable benefits to customers without harming competition.

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[196] Gartner Media Relations, *Gartner Says Three Major Shifts to Transform Fixed Telecommunications Operator Business in Europe* (Nov. 3, 2004), http://www4.gartner.com/5_about/press_releases/asset_113416_11.jsp, accessed December 6, 2004.

4. The Finance-Related Remedies Offered For Consideration Are Unnecessary Or Inappropriate And Should Not Be Adopted As Conditions To Approval

a. It Would Be Inappropriate To Insulate Customers From Transaction Costs If Doing So Would Violate GAAP

Staff suggests that "Verizon's New York utility customers should be insulated from costs that result from the merger, including the amortization expenses resulting from the write-up of intangible assets recorded as a result of the transaction, and any charges to earnings from the write-off of goodwill recorded by Verizon as a result of the acquisition."[197] In considering this suggestion, it must be noted that Verizon New York is obligated to prepare its financial statements in accordance with Generally Accepted Accounting Principles ("GAAP"). To the extent that GAAP requires cost allocations of the sort at issue here, it would be inappropriate to depart from GAAP and other requirements merely to serve Staff's narrow interest in "insulating" utility customers from costs that Staff personally believes those customers should not have to bear.

b. Consideration Of Additional Equity In Derivation Of Verizon New York's Intrastate ROE

Staff seeks comment on its conclusion that "[n]one of the additional equity resulting from the transaction under the purchase method of accounting should be considered in derivation of Verizon's New York intrastate ROE."[198] Given the way the transaction is structured, GAAP provides that any additional equity that might result from the transaction under the purchase method of accounting will not be considered in derivation of Verizon's New York intrastate ROE. There is no need for concern or action here.

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[197] White Paper at 69.

[198] *Id*.

c. There Is No Need To Take Steps To Ensure That Verizon New York's Intrastate Operations Are Not Impacted As A Result Of MCI Accounting Improprieties

Staff suggests that the "Commission should condition its approval of the transaction on requiring that Verizon take steps to ensure that Verizon's New York intrastate operations are not impacted as a result of any MCI accounting or other improprieties."[199] Verizon records each affiliate's taxes, litigation costs (including settlements and judgments), and liabilities separately. After the transaction is completed, Verizon New York and MCI will remain separate subsidiaries. Accordingly, in the unlikely event that past MCI accounting improprieties give rise to any future financial obligations, Verizon New York should not be impacted by such an occurrence.

V. THE COMMISSION HAS NO AUTHORITY TO DISAPPROVE THE PROPOSED TRANSACTION OR TO IMPOSE CONDITIONS ON IT

Quite apart from the fact that the White Paper provides no factual basis to adopt remedies (or conditions on approval), the Commission should not interfere with the proposed merger because it lacks authority to disapprove or to impose conditions on it. As explained in the Joint Petition, the Agreement and Plan of Merger Between Verizon and MCI (the "Agreement") does not involve any of the transactions covered by Public Service Law ("PSL") §§ 99(2) or 100. Thus, the Commission should refrain from adopting the remedies set forth in the White Paper because such action would constitute an unauthorized exercise of authority in contravention of the PSL.

Staff "concludes that jurisdiction to investigate and approve or deny the proposed transaction of MCI by Verizon is vested in the Commission by the statutory authority conferred

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[199] *Id*.

pursuant to [] Sections 99 and 100."[200] That conclusion is fundamentally unsound. It cannot be squared with the plain language of these provisions, or the construction placed on those provisions by seven decades of Commission and judicial decisions. The Commission's recent and abrupt "reconstruction" of these jurisdictional provisions – without any intervening change in their language – cannot support Staff's position.

A. The Plain Text Of §§ 99 And 100 Demonstrates That This Transaction Is Not Subject To Commission Jurisdiction And Fails To Support Staff's Contrary Conclusion

Section 99(2) gives the Commission authority to approve (i) the "assignment, transfer [or] lease" of a "franchise or right to or under any franchise;" (ii) "any contract or agreement made with reference to or affecting any such franchise or right;" (iii) the "transfer or lease" by a "telephone corporation" of its "works or system or any part of such works or system" or any contract "for the operation of its works or system." The Agreement involves none of the transactions contemplated by this section. As a parent company stock transaction, it does not provide for the assignment, transfer or lease of franchises to own or operate telephone lines within New York. Nor was the Agreement "made with reference to or affecting" any such franchises – indeed New York franchises are not even mentioned in the document. MCI, a Delaware holding company, is not a "telephone corporation" within the meaning of PSL § 2(17); it does not "own, operate, or manage any telephone line in New York State." Nor is MCI transferring any works or systems under the Agreement. Rather, the transaction only involves the acquisition of MCI's capital stock by a subsidiary of Verizon, another Delaware holding company.

[200] *Id.* at 12.

Staff asserts that § 99(2) grants the Commission jurisdiction to approve the proposed transaction arguing that "[c]ontrol of the MCI subsidiaries' franchises and assets will pass from MCI to Verizon, a different corporation," and "this transfer of control will affect how the MCI subsidiaries operate as telephone corporations in New York State."[201] Thus, Staff's jurisdictional theory is that the single word "affect" in § 99(2) provides the Commission with jurisdiction over holding company transactions involving the "indirect" transfer of control over a subsidiary. But Staff's effort to shoehorn the transaction into § 99(2) is unavailing. By its explicit terms that section applies only to contracts that "refer to or affect" a "*franchise* to own or operate a telephone line in the state," not to those that "affect how a subsidiary operates" after transfer of ownership of a holding company. A "franchise" is not a "subsidiary" and it is not a telephone corporation" (a term which is defined in PSL § 2(17)). While the PSL does not define "franchise," a franchise is an *asset* belonging to a "telephone corporation," or more specifically, the telephone corporation's right "to own and operate a telephone line in the state."[202] Staff is improperly reading the term "franchise" to mean a "telephone corporation" subsidiary. Yet even if "franchise" meant telephone corporation or, to use Staff's term, a "subsidiary," this transaction does not directly affect the subsidiary telephone corporations. Staff is improperly attempting to impute indirect jurisdiction into the text of the statute.

Staff makes the same error when it concludes that the transaction is subject to Commission approval under PSL § 100. By its very terms, § 100 confers jurisdiction only over transactions involving the "capital stock" of a "telephone corporation organized or existing under or by virtue of the laws of this state." MCI, whose stock is being acquired, is not a "telephone

[201] *Id.* at 10-11.

[202] Black's Law Dictionary, Revised Eighth Edition, defines "franchise" as "the right conferred by the government to engage in specific business or to exercise corporate powers."

corporation" within the meaning of PSL § 2(17); it does not own operate or manage any telephone line in the state and is not "organized or existing under" New York law. Staff contends that "transfer of control [of MCI stock to Verizon] will affect how the MCI subsidiaries operate as telephone corporations in New York State."[203] But Section 100 does not even employ the term "affect," and it makes no reference to transfers of control of stock that might "affect how [regulated] subsidiaries operate as telephone corporations in New York State." Nor does it suggest that approval is required where a transaction might have such an incidental effect. Nor does Section 100 require approval for the "indirect" transfer of control over a telephone corporation's stock.

Staff's interpretations of both §§ 99(2) and 100 are not supported by the plain language of those provisions or by long standing rules of statutory construction. It is long settled that the "[j]urisdiction of the Public Service Commission cannot be conferred by implication, but must be given by language which admits of no other reasonable construction." *City of New York v. Maltbie*, 274 N.Y 90, 98 (1937) (citing *Siler v. Louisville & Nashville R. R. Co.*, 213 U.S. 175 (1909)).[204] The Legislature has used the term ***"directly or indirectly"*** in the Public Service Law where it intended to confer pass-through or similarly broad jurisdiction over an entity and its affiliates. The absence of the term "indirectly" in §§ 99 and 100 indicates that the Legislature did not confer jurisdiction over indirect transfers of control. If the Legislature intended for the Commission to exercise jurisdiction over holding companies in this context, it could and would

[203] White Paper at 10-11.

[204] *See also New York Telephone Co. v. Public Service Comm'n of State of N.Y.*, 684 N.Y.S.2d 829 (N.Y.Sup. Ct. 1998) ("[Public Service Commission] possesses only those powers expressly delegated to it by the Legislature, or incidental to its expressed powers, together with those required by necessary implication to enable it to fulfill its statutory mandate."); *Brooklyn Union Gas Co. v. Public Service Comm'n*, 478 N.Y.S.2d 78 (N.Y. App. Div. 1984) ("Public service commission has only those powers conferred upon it by the legislature and such other powers as are incidental thereto or necessarily implied therefrom.").

have included the phrase "directly or indirectly" in the text of §§ 99 or 100, just as it did in neighboring provisions.[205] It did not, and Staff's attempt to read the term "indirect" into the statutory language of PSL § 99(2) or § 100 is not permitted under common law and statutory rules of construction.[206]

Staff's sweeping interpretation of §§ 99(2) and 100 is also inconsistent with the explicit grants of authority over holding companies in other provisions of the Public Service Laws. For example, § 110 was added in response to concern over the state's lack of regulatory authority over holding companies that owned public utilities. However, § 110 does not create jurisdiction over transactions *between two holding companies*. For example, PSL § 110(1) grants jurisdiction over the holding companies of regulated "public utility companies" only "to the extent as may be necessary to enable the commission to require the disclosure of the identity in respective interests of every owner of any substantial interest in such voting capital stocks." And PSL § 110(3) requires the filing of "management, construction, engineering, or similar contracts *between public utilities and their affiliates*." These limited grants of jurisdiction sharply conflict with the broad jurisdictional authority over holding companies that the Staff attempts to conjure out of §§ 99(2) and 100.

Staff's interpretation also conflicts with the legislative history of §§ 99(2) and 100. In the late 1920s, states had significant concerns about their authority over out-of-state companies that held controlling interests in state utilities. At the federal level, the Public Utility Holding

[205] *See, e.g.*, PSL §§ 92, 106.

[206] Staff's construction violates the longstanding principle of statutory construction "*expressio unius est exclusio alteriu.*" That principle is codified in N.Y. Stat. § 240 (McKinney 2005), which provides "where a law expressly describes a particular act, thing or person to which it shall apply, an irrefutable inference must be drawn that what is omitted or not included was intended to be omitted or excluded." When the legislature intended to refer to "indirect" ownership, it did so expressly. It did not do so in § 99 or § 100, and there is no basis for reading the term into either provision.

Company Act was enacted to give the Securities and Exchange Commission jurisdiction over transactions involving holding companies that held electric and gas utilities.[207] PUHCA did not apply to telephone utilities, however.[208] New York State responded to these and other concerns by creating the 1929 Knight Commission to investigate possible revisions of the PSL.

The Knight Commission explicitly addressed the issues surrounding holding companies in its investigation and legislative recommendations.[209] In legislative hearings, the Knight Commission directly asked two Public Service Commissioners and the Public Service Commission Chief Accountant whether the PSC had jurisdiction under then-current law to approve a merger precisely like the merger of Verizon and MCI involving holding companies that own regulated operating companies. All three explicitly stated that the Commission did ***not*** have jurisdiction over such transactions and cited multiple cases in which the Commission had expressly so held.[210] In particular, one of the testifying Commissioners noted that ***the Commission did not have control over sales of stock from one holding company to another:***

> Q: Do you believe that the provisions of Section 70 and [Section 100, which is the] corresponding section related to telephone and telegraph companies, etc. are applicable to holding companies that seek to acquire control of other holding companies?

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[207] Public Utility Holding Company Act of 1935, 15 U.S.C. §§ 79 *et seq.* (the "PUHCA").

[208] *See id.* § 79(b) (defining "[p]ublic-utility company" as "an electric utility company or a gas utility company").

[209] The Knight Commission's Report concluded that "[h]olding companies and affiliated service agencies have acquired pre-eminent importance in their bearing on the regulation of public utility companies in New York State," estimating that "98.5 per cent of all of the electric power sold in New York State during 1928 was distributed by holding company groups." Knight Commission Report, Vol. 1., at 27. Concerns focused, in particular, on the potential for holding companies to provide a means of circumventing regulatory controls on utility companies. "The domination of operating companies by holding companies may in some instances be so complete that the holding company is actually engaged in public utility operation, in which case it should be subject to regulation as a public utility corporation." *Id*. The Report indicates a particular concern regarding the financial practices of holding companies, because "[t]he interests both of consumers and of investors may be abused by the adoption of unsound financial practices by holding companies. We recognize and desire to emphasize particularly these dangers." *Id.*

[210] *See, e.g.*, *Mohawk Hudson*, Case No. 3192, reversing Initial Order for Mohawk Hudson, Case No. 2649; *Buffalo, Niagara & Eastern Power Corp.*, Case No. 2621; *Central Empire Power Company*, Case No. 5018.

A: No, because these sections apply only to ***operating utilities***.[211]

When asked about a particular transaction that came to the Commission's attention in *Central Empire Power Company*, that same Commissioner replied, "as I remember that case, these small companies were operating companies, where the stock was acquired by a holding company of all of these companies. Then this holding company sold to another holding company, and if that is the situation, ***I don't think that we had any control over the selling of the stock from one holding company to the other***."[212] Further, the Commissioner was asked:

> Q: In the case of a company, a foreign corporation operating in the State, and of course other states, how would you provide . . . for any control over such companies?
>
> A: We have control over the operating company, no matter who owns it, in the first instance, but ***that corporation, I think, could transfer its stock to some other corporation outside the State without our consent***.[213]

Significantly, the Commissioners urged the Legislature to amend the Public Service Law so that the Commission would have authority to approve or disapprove acquisitions of holding companies by holding companies. The Knight Commission issued a Report that included recommendations for amendments to the PSL. While those recommendations led to changes to the PSL that, *inter alia*, expanded Commission authority over out-of-state holding companies,[214] these amendments and expansions ***did not*** result in Commission jurisdiction over stock transactions between holding companies. Specifically, the Legislature did not amend PSL §§ 99 or 100 and did not adopt ***any*** statutory amendments that could justify the Commission's assertion

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[211] Knight Comm'n Pub. Hr'g Tr., Vol. II, at 614 (emphasis added).

[212] *Id.* at 614 (emphasis added).

[213] *Id.* at 615 (emphasis added). *See also id.* at 1552 ("Q. … Has the Commission any jurisdiction over security issues of holding companies? A. It has not. Q. Or the acquisition of property or securities from holding companies? A. It has only to the limited extent where the operating company would desire to issue securities against the property acquired from the holding corporation. Q. Has it jurisdiction over the acquisition of stockholding companies? A. It has not. Q. Or the reorganization of holding companies? A. It has not.").

[214] *See, e.g.*, PSL § 106 (added in 1933); *id.* § 110 (added in 1930).

of jurisdiction over holding company mergers. It did, however, adopt a new PSL § 110, which, as discussed, gives the Commission jurisdiction over certain contracts between holding companies and regulated entities but which does not confer jurisdiction over transactions between holding companies themselves.[215] That the Legislature expanded the Commission's authority over holding companies in some respects but refused to expand the Commission's authority to approve mergers between holding companies demonstrates the Legislature's clear intention to deny the Commission jurisdiction over mergers such as this one. It also completely defeats Staff's conclusion that §§ 99 and 100 confer jurisdiction over this transaction.

The Commission recognized the limits of its authority over holding company transactions not merely in hearings before the Knight Commission but also in its review of transactions that came before it. Thus, in *Rochester Telephone*, the Commission denied a petition by Rochester Telephone, a regulated New York telephone company, to reorganize by establishing a holding company structure for diversification purposes.[216] In its brief to the Commission in that proceeding, Staff opposed Rochester's petition, noting that the relevant Public Service Law provisions do not confer on the Commission jurisdiction over acquisitions of holding companies and stating that "if the reorganization is permitted, Rotelcom [the new holding company] could acquire a non-utility firm without any regulatory approval."[217] The Commission adopted Staff's recommendation and specifically cited its concern that it might lose regulatory oversight of the utility if it were owned by a holding company over which the Commission had no jurisdiction. When applied to the instant transaction, both Staff's and the Commission's reasoning in

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[215] *See* PSL § 110(3); *see also id.* § 106 (requiring Commission approval for any loans from a public utility to a corporation "owning or holding, directly or indirectly, any stock of said public utility").

[216] *See* Case 27015, *Rochester Tel. Corp.*, 18 NY PSC 271 (1978), at 1, 4-5.

[217] *See* Case 27015, Staff's Brief on Exceptions, at 6.

Rochester Telephone means that Verizon, a holding company, "could acquire [MCI,] a non-utility firm[,] without any regulatory approval."[218]

In its 1989 decision in *McCaw/LIN*, the Commission once again acknowledged its lack of jurisdiction over the merger of two holding companies. In concluding that it lacked jurisdiction over AT&T's acquisition of McCaw, a holding company, the Commission observed that a contrary ruling would mean that "every corporate parent of a telephone corporation would become subject to [the Commission's] authority."[219] The Commission did not attempt to assert jurisdiction over that transaction precisely because it recognized that such an attempt would extend the Commission's authority well beyond its statutory limits.

In sum, the plain language of §§ 99(2) and 100, the legislative history that underlies those sections and other sections that address holding companies, as well as the Commission's longstanding recognition of the limits §§ 99(2) and 100 imposed on its authority over holding company transactions inexorably lead to the conclusion that the Commission lacks jurisdiction to review and approve the instant transaction.

B. The Commission's Most Recent Applications Of PSL §§ 99 And 100 Arbitrarily Depart From More Than Seventy Years Of Commission Precedent Recognizing The Commission's Lack Of Authority Under Those Sections

Although Staff attempts to stretch the statutory language of §§ 99(2) and 100 to cover the structure of the Verizon/MCI transaction, Staff primarily relies on the Commission's prior

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[218] Staff claims that *Rochester Telephone* did not address the Commission's jurisdiction over the proposed transaction. According to Staff, the decision merely prohibited Rochester Telephone from reorganizing as a holding company "because of the difficulty of ensuring that customers would not be harmed by improper affiliate transactions." White Paper at 12. Staff's reasoning is specious. It ignores the fact that the very reason the Commission would have had difficulty protecting consumers from "improper affiliate transactions" if it approved a holding company structure is because, as the Commission acknowledged in the decision, it had no jurisdiction over transactions between two non-utility holding companies. *See Rochester Tel. Corp.*, at 3-4 (observing that the Commission "could [not] prevent the holding company from being acquired" by other interests).

[219] Case 89-C-116, Order Granting Petition (Oct. 25, 1989).

assertion of jurisdiction over the Bell Atlantic/NYNEX transaction as support for similar assertion of jurisdiction in this instance. The *Bell Atlantic/NYNEX* decision, however, was based on an erroneous interpretation of the PSL and provides no legal basis for asserting jurisdiction here.

The Commission's exercise of jurisdiction over holding company transactions is a baseless and arbitrary reversal of the decades-old position it articulated in *Rochester Telephone* and *McCaw*. In *AT&T/Ridge Merger Corporation*,[220] the Commission overruled *McCaw* and, without explanation, created a presumption of Commission jurisdiction: "[a]bsent proof that transfer of the stock of a holding company that indirectly has a controlling interest in a New York telephone corporation does not effectively constitute a transfer of an interest in such a telephone corporation, we will assert jurisdiction over the transaction under Section 100." The Commission's unexplained (and inexplicable) departure from *Rochester Telephone* and *McCaw* is arbitrary and capricious and cannot stand for that reason alone.[221] Certainly the Commission's expanded view of its authority over holding companies occurred without any intervening changes in the statutes governing the Commission's jurisdiction. Thus, the *AT&T* decision stands as an improper attempt to re-write the PSL in clear contravention of plain statutory language, legislative history and Commission precedent. That decision and the attempt in the *Bell Atlantic/NYNEX* decision to create jurisdiction over a parent based on jurisdiction over its

[220] Case 93-C-0777, Order Asserting Jurisdiction and Approving Transaction (Dec. 31, 1993).

[221] *See, e.g.*, *New York Tel. Co. v. PSC*, 62 N.Y.2d 57, 61-62, 476 N.Y.S.2d 60, 62 (1984); *MCI Telecommunications Corp. v. PSC*, 108 A.D.2d 289, 298, 488 N.Y.S.2d 840, 847 (3d Dep't), *appeal discontinued and withdrawn*, 66 N.Y.2d 760, 497 N.Y.S.2d 1033 (1985); *New York Tel. Co. v. PSC*, 64 A.D.2d 232, 245-46, 410 N.Y.S.2d 124, 132 (3d Dep't 1978), *leave to appeal denied*, 46 N.Y.2d 710, 414 N.Y.S.2d 1028 (1979).

regulated subsidiary and such efforts to manufacture jurisdiction have been squarely rejected by the New York state courts.[222]

Although the Commission has exercised jurisdiction over several holding company mergers since *McCaw*, it nonetheless approved those mergers and, in doing so, evidently removed any incentive for the petitioner-holding companies to challenge its jurisdictional rulings. In the case of the *Bell Atlantic/NYNEX* transaction, the Commission expressly sought the holding companies' consent to conditions that the Commission sought to impose, thereby implicitly conceding that it could not impose those conditions unless the petitioners relented in their opposition to the Commission's assertion of jurisdiction over the transaction. In nearly all such cases, the Commission has given little or no explanation supporting its jurisdictional argument, other than the blanket statement that it has previously asserted jurisdiction in similar cases. Similarly, in its White Paper, Staff dismisses Verizon's and MCI's jurisdictional challenge with no explanation other than a comparison to the equally flawed *Bell Atlantic/NYNEX* ruling.[223] Indeed, Staff fails to even acknowledge that the current position is both a contradiction of Staff's more reasoned examination of §§ 99(2) and 100 in *Rochester Telephone* and a reversal of over 70 years of Commission and state precedent. The White Paper thus reflects an arbitrary and capricious proposal to once again depart from the clear language of §§ 99(2) and 100 and to take an expansive view of jurisdiction that is fundamentally at odds with well-reasoned and longstanding precedent and legislative history.

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[222] *See N.Y. Tel. Co. v. Pub. Serv. Comm'n of N.Y.*, 258 A.D.2d 234, 236-37 (3d Dep't 1999) (rejecting § 99 jurisdiction over sale of interest in research organization created by telephone local carriers), *reversed on other grounds*, *N.Y. Tel. Co. v. Pub. Serv. Comm'n of N.Y.*, 95 N.Y.2d 40 (2000); *Matter of Brooklyn Union Gas Co. v. Pub. Serv. Comm'n of N.Y.*, 34 A.D.2d 71, 73 (3d Dep't 1970) (rejecting pass-through jurisdiction over a New Jersey affiliate of a New York utility company).

[223] *See* White Paper at 10-11.

Petitioners do not challenge the Commission's jurisdiction over Verizon's and MCI's regulated New York subsidiaries. Indeed, it is precisely because the Commission maintains regulatory oversight of those subsidiaries' rates terms and conditions of service that it need not assert jurisdiction over the parent companies. However, Staff would have the Commission obliterate the legal and factual distinctions between a parent entity and a subsidiary, just as Staff would have the Commission ignore the distinction between "directly" owned and "indirectly" owned. The assertion of jurisdiction over this transaction is, quite simply, contrary to law. The Commission recognized this for decades before abruptly reversing course in *AT&T*. Petitioners respectfully submit that the decades-old position that preceded *AT&T*, grounded in the plain language of the PSL and supported by legislative history is the correct one and should once again be embraced by the Commission.

C. Any Attempt To Impose Conditions On The Commission's Approval Of The Merger Would Violate The Federal Constitution

Even if the Public Service Law could be construed to authorize the Commission to review and approve the transaction, any attempt to attach conditions to such an approval would be inconsistent with the dormant Commerce Clause of United States Constitution. Simply stated, a state cannot impose burdensome conditions on this transaction which serve only to benefit the narrow interests of a single state to the detriment of the Petitioners' right to engage in interstate commerce. Yet that is precisely what Staff urges be done, here, as even Staff admits.[224]

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[224] "Staff recognizes that the mergers impact not only New York state telecommunications markets, but national markets as well, and that certain market concerns/considerations may be more appropriately addressed at the federal level (by the FCC or the Department of Justice). However, this paper analyzes the impacts of the mergers on New York State telecommunications markets specifically, and the tentative conclusions and remedies that are put forth in this document are aimed at impacts on New York's consumers." White Paper at 5.

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

The Supreme Court's dormant Commerce Clause jurisprudence establishes a number of constraints on the power of states to impose direct or indirect burdens on interstate commerce. For example, '"[w]hen a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor in-state economic interests over out-of-state interests, [the Court] ha[s] generally struck down the statute without further inquiry. When, however, a statute has only indirect effects on interstate commerce and regulates evenhandedly, [the Court] ha[s] examined whether the state's interest is legitimate and whether the burden on interstate commerce clearly exceeds the local benefits.'" *Healy v. The Beer Institute,* 491 U.S. at 337 n.14 (quoting *Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. 573, 579 (1986)). Moreover, the Supreme Court's "recent Commerce Clause cases also have invalidated statutes that may adversely affect interstate commerce by subjecting activities to inconsistent regulations." *CTS Corp. v. Dynamics Corp. of Am.,* 481 U.S. at 88; *see Healy,* 491 U.S. at 336-37 ("the Commerce Clause protects against inconsistent legislation arising from the projection of one state regulatory regime into the jurisdiction of another state"). And it is well settled that "the 'Commerce Clause . . . precludes the application of a state statute to commerce that takes place wholly outside of the State's borders, whether or not the commerce has effects within the State.'" *Healy*, 491 U.S. at 336 (quoting *Edgar v. MITE Corp*., 457 U.S. 624, 642-43 (1982) (plurality opinion)); *see Brown-Forman Distillers Corp. v. New York State Liquor Auth.*, 476 U.S. at 584.

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

The State of New York no doubt has a legitimate interest in ensuring that its citizens have access to reasonably priced, competitive, high quality telecommunications services. That legitimate interest, however, cannot support the heavy burden that Staff's proposed "remedies" would impose on the proposed merger. The record in this proceeding fails to substantiate Staff's conclusory assertions that the merger will lead to higher rates or poorer quality for *any* services than would otherwise be the case if Verizon had decided not to acquire MCI. In the absence of such a showing, any claim that the proposed remedies are justified by legitimate local concerns created by the merger is implausible, and must be dismissed as a subterfuge. *See Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334, 343 n.5 (1992) (*Pike* test authorizes state regulation only where, *inter alia*, valid '"legislative objectives are *credibly* advanced'") (emphasis added). *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979) ("when considering the purpose of a challenged statute, this Court is not bound by '[the] name, description or characterization given it by the legislature or the courts of the State,' but will determine for itself the practical impact of the law").

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

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

VI. CONCLUSION

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

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

Respectfully submitted

Of Counsel:

SCOTT H. ANGSTREICH
Kellogg, Huber, Hansen, Todd
Evans & Figel, P.L.L.C.
Sumner Square
1615 M Street, N.W. Suite 400
Washington, D.C 20036
202-326-7900

SANDRA DiIORIO THORN
ROBERT P. SLEVIN
1095 Avenue of the Americas
New York, New York 10036
212-395-6390

Counsel for Verizon Communications Inc.

LAURA GALLO
200 Park Avenue
New York, New York 10166
212-519-4436

Counsel for MCI, Inc.

Dated: August 5, 2005

EXHIBIT 1

[REDACTED]

REDACTED

NEW YORK PUBLIC SERVICE COMMISSION

COMMENTS OF

GUSTAVO E. BAMBERGER,

DENNIS W. CARLTON

and

ALLAN L. SHAMPINE

August 5, 2005

I. INTRODUCTION AND OVERVIEW.

A. Qualifications.

Gustavo E. Bamberger

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

Dennis W. Carlton

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

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

Allan L. Shampine

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

B. Summary of Conclusions.

5. We have previously submitted declarations in this matter before the FCC dated March 9, 2005 and May 24, 2005. In those declarations we concluded based on our initial analysis that the proposed transaction between Verizon and MCI would benefit consumers by enhancing the ability of the combined firm to develop innovative services and enabling the merged firm to operate at substantially lower costs than those that MCI and Verizon would face separately. We also concluded that the transaction was unlikely to create significant competitive problems.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

B. The staff relies excessively on HHI calculations

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

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

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

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

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

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

A. Merger analysis should be forward looking.

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

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

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

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

.[18] [END PROPRIETARY]

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

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

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

obtain broadband VoIP services such as Vonage.[21]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

25. MCI.
26. MCI.

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

Table 1

Prices of MCI and Verizon Bundled Packages

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

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

Sources: MCI and Verizon.

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

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

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

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

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

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

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

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

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

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

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

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

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

35. See Declaration of Bamberger, Carlton & Shampine, FCC 05-75, March 9, 2005, ¶¶ 18-30.

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

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

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

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

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

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36. White Paper, p. 32. Staff refers to the provision of retail services to large business customers as "enterprise services." We follow their terminology.

37. The Staff identifies AT&T, MCI, Verizon, Sprint, XO and Level 3 as the only providers of enterprise services in Verizon's territory.

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

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

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

1. Traditional IXCs.

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

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

39. See company web sites.

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

2. Operators of new fiber networks.

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

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

3. CLECs.

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

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

4. Systems integrators.

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

5. International carriers.

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

6. Equipment manufacturers / VARs.

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

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

integrator channel partners and vendors to gain access to SMBs."[44] Leading firms in this category include Cisco and Avaya.

47. Verizon data confirm the existence in Verizon's region of many competitors not identified by the Staff. Through interviews with selected enterprise customers, Verizon has found that it has lost business to a wide variety of other companies that the Staff has not considered, including Abovenet, Broadwing, Cavalier, Equant, Fibertech, Global Crossing, McLoud, Qwest, Siemens and Time Warner.[45]

B. HHIs overstate the risk of harm to competition in the provision of enterprise services resulting from the proposed transaction.

48. The use of market share and HHIs is a first step in analyzing the potential competitive impact of a merger. However, there are a variety of industry characteristics that indicate that analysis based on market shares and HHIs is likely to overstate the risk that the proposed transaction will result in higher prices for enterprise services. These factors include:

1. Customer heterogeneity.

49. Enterprise customers are highly heterogeneous with respect to size, geography, and services demanded as well as service quality requirements. Customers also differ with respect to their desired supplier mix, with some choosing a single provider for all services, others using different providers for different services, and others using multiple suppliers for the same service for redundancy purposes. These circumstances make it more difficult for firms to monitor each others' behavior and succeed in elevating price as a result of a merger.

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44. Yankee Group, "Level 3 Reaches SMBs Through a Systems Integrator Channel Partner," September 2004, p. 1.
45. Verizon.

50. As noted above, customers differ with respect to purchasing practices, with some customers using formal bidding procedures while others negotiate informally. Problems in observing prices resulting from negotiated deals and/or non-public bids make it difficult to monitor rivals' prices and thus to succeed in elevating price as a result of a merger.

2. Large, infrequent contracts.

51. Sales to business customers often involve lumpy, multi-year contracts which can provide strong incentives to bid aggressively in order to obtain a large amount of business for many years. In such circumstances, a merger is less likely to lead to increased prices.

3. Highly sophisticated buyers.

52. As frequently recognized by the FCC, large enterprise customers are often highly sophisticated, and often have IT staffs with considerable telecommunications expertise.[46] In addition, there are a wide variety of consultants that advise business customers and may assist in both the design of requests for proposals (RFPs) and evaluation of bids for telecommunications services. These services are also provided to a wide range of businesses through VARs and others that offer a variety of technological "solutions" to buyers.

4. Complex procurement practices.

53. Enterprise customers often use procurement practices that make it unlikely that the proposed transaction will harm competition. As discussed above, enterprise customers often invite bids from suppliers. These bidding opportunities are idiosyncratic

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46. See, for example, FCC, Bell Atlantic-GTE Order, FCC 00-221, January 16, 2000, ¶ 121.

and even the form of the outcome may not be known. For example, a contract award could be "winner take all," or result in a split outcome, with portions of the contract awarded to multiple bidders. Overlapping awards for primary and secondary or backup service may be made. The range of these outcomes is not necessarily specified in advance. Such circumstances complicate the ability of firms to monitor each other's activities and thus limit the risk that the proposed transaction will result in higher prices as a result of the merger. It is widely recognized that "market share" is a poor indicator of a firm's potential market power in such bidding situations.[47]

5. The importance of non-price elements of competition.

54. Additionally, the importance of non-price elements of competition further reduces the likelihood that the proposed transaction will facilitate the exercise of market power. Buyers often have specialized needs and bidders do not necessarily offer the same technological solutions. In addition, any type of coordination is further complicated by the fact that different buyers place different relative weights on price and quality characteristics of bids.

55. In sum, the Staff's analysis of the impact of the proposed transaction on competition in the provision of business services ignores a wide variety of firms that serve business customers in New York. Its analysis also fails to account for a wide variety of factors that complicate the ability of firms to raise price as a result of a merger.

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47. If all firms in a bid competition are equally likely to win, it is the number of firms that best measures the extent of competition, not bidders' market shares. The Horizontal Merger Guidelines of the U.S. Department of Justice and Federal Trade Commission recognize that market shares may not be relevant in such situations, and note that "[w]here all firms have, on a forward-looking basis, an equal likelihood of securing sales, the Agency will assign firms equal shares." See Section 1.41.

We conclude that the transaction is unlikely to create significant competitive problems for business customers.

V. THE PROPOSED TRANSACTION IS UNLIKELY TO RESULT IN HARM TO COMPETITION IN THE PROVISION OF SPECIAL ACCESS AND TRANSPORT SERVICES.[48]

A. Staff's analysis of transport routes is flawed both methodologically and conceptually.

56. The Staff analyzed concentration on transport routes using confidential data on CLEC-reported data on the routes they serve linking Verizon wire centers in New York. The data were provided to the New York Department of Public Service in its Triennial Review Order (TRO) and Triennial Review on Remand Order (TRRO) proceedings in 2004. The Staff analyzed the effect of the merger on concentration based on alternative sets of routes: (i) routes between all wire centers in New York; (ii) routes served by two or more competitive providers in metropolitan New York (LATA 132); and (iii) routes where there is no impairment based on the standards set forth in the TRRO (the TRRO triggers).

57. We understand that Staff calculated HHIs by calculating the number of potential intraLATA routes between Verizon offices in categories defined above (assuming that Verizon provides direct transport between each pair), then using CLEC-reported data on wire center-to-wire center routes served by reporting CLECs. Shares

48. In our previous declarations, we have defined special access as being composed of three parts: (i) "channel termination" facilities, which reflect services provided over facilities between a customer's premises and the LEC end office; (ii) interoffice facilities between the LEC end office and the LEC serving wire center; and (iii) a second "channel termination" between the LEC serving wire center and the competitive carrier's point of interconnection with the LEC. Staff discusses interoffice facilities, or "transport," separately from the "channel termination" facilities, which they refer to as "special access," or "high capacity loops." We follow Staff's convention in this section.

were calculated based on each carrier's share of the number of route-specific connections. That is, if there are three wire centers, there are three possible routes: A/B, B/C, A/C. Verizon is assumed to serve all combinations. If there is only one CLEC, which serves only one route, then the CLEC's share would be 25 percent. We understand that all firm/route combinations receive equal weights in these calculations.

58. Staff's calculations will underreport CLEC "shares." Staff apparently used data for only a subset of all CLECs and those data are more than a year old. A total of 17 CLECs reported routes served in the 2004 proceeding and we understand that there are at least that many CLECs that did not report in that proceeding. Furthermore, we understand Staff assumes that Verizon had direct transport between all wire centers but did not make the same assumption for CLECs. For example, if a CLEC reported that it had transport between points A and B, and between B and C, but not between A and C, Staff assumes that the CLEC does not serve route A/C. This assumption will likely cause CLEC "shares" to be underreported. In many cases, CLECs (other than MCI) appear to have fiber collocations on both ends of the routes Staff includes in this analysis, although transport links between these routes may not have been reported. Presumably, CLECs either provide transport between these fiber collocations or could readily do so.

59. More generally, Staff presents no economic basis for calculating market shares in this way. Staff's calculations aggregate routes with potentially distinct competitive conditions. Staff presents no evidence that "shares" calculated in this manner have any relationship to price or other competitive conditions.

60. The Staff's "overlap" analysis is similar in principle to the HHI analysis. The analysis is based on 487 intraLATA routes on which, according the Staff, Verizon is not obligated to offer UNE transport under the TRRO triggers. Staff then analyzes the

extent to which MCI, Verizon, AT&T and SBC have overlapping transport facilities on these routes. Staff uses the same data and assumptions for its "overlap" analysis as it does for its HHI analysis, and therefore also underreports CLECs' presence in the "overlap."

61. Staff's analysis of transport routes also does not account for the possibility of entry. In particular, Staff's "overlap" analysis discusses transport routes which the FCC found to be "unimpaired" in the TRRO proceeding.[49] However, the FCC's findings of a lack of impairment are "designed to capture both actual and potential competition, based on indicia of significant revenue opportunities at wire centers."[50] That is, the FCC found that the potential of entry on these routes was sufficient to justify a finding of a lack of impairment with respect to transport facilities.[51]

B. Available evidence indicates that the proposed transaction will not adversely affect competition in the provision of special access services.

62. Although the Staff was "not able to measure the overlap analysis of high capacity loops in the same manner as Staff performed its transport overlap analysis,"[52] the Staff nonetheless tentatively concludes that the proposed transaction will raise concentration and harm competition in the provision of special access services.[53]

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49. White Paper, Table 8.
50. FCC, Triennial Review Order on Remand, FCC 04-290, February 4, 2005, ¶ 88.
51. FCC, Triennial Review Order on Remand, FCC 04-290, February 4, 2005, ¶ 66. For example, competing carriers are impaired without access to DS-3 transports on all routes for which at least one end-point of the route is a wire center containing fewer than 24,000 business lines and fewer than three fiber-based collocators. If both end-point wire centers contain 24,000 or more business lines and three or more fiber-based collocators, then competing carriers are not considered impaired with respect to such interoffice transport.
52. White Paper, p. 42.
53. We remind the reader that we use special access here in the manner that the Staff has defined it, which is a narrower definition than we use in our prior declarations to the FCC.

63. Available data, however, are inconsistent with the Staff's conclusion that the proposed transaction will harm special access competition. In order to investigate this issue, we have obtained data from MCI that identify the location of its fiber-lit buildings in New York. We have also attempted to obtain data on CLEC service offerings, but we have had great difficulty in doing so. MCI has provided data on the location of fiber-lit buildings served by certain CLECs (henceforth "MCI-reported CLECs") that provide this information to MCI with the goal of selling access services to MCI. We understand that the AT&T data may not be accurate, so we exclude them from our analysis. Our results significantly understate the number of CLEC-lit buildings because they do not include AT&T, Level 3, Sprint, Qwest and other carriers. Attachment D [PROPRIETARY] contains maps for New York, New York City, and Manhattan that identify buildings lit by MCI and MCI-reported CLECs (excluding AT&T).

64. Verizon has also provided data on which serving wire centers are considered "impaired" by the FCC with respect to high capacity (DS-3) loops. The FCC's rules determine whether CLECs are "impaired" in providing special access services (and thus where ILECs are obligated to provide high capacity loops on an unbundled basis).[54] In the FCC's view, a CLEC is not "impaired" if it faces no barriers to providing service in an area at current prices without relying on the ILEC's facilities.[55] The FCC obligates ILECs to offer high capacity circuits (at TELRIC rates) only in areas

54. Impairment is defined on a wire-center specific basis based on the number of CLECs with fiber-based collocations and the number of business lines served by the wire center. Separate triggers are used to define impairment with respect to DS-1 and DS-3 circuits. The data available do not include the capacities used by MCI or the CLECs in each building. For our analysis, we look at impairment based on DS-3 loops.
55. See FCC, Triennial Review Order on Remand, FCC 04-290, February 4, 2005, ¶ 10.

that fail to meet FCC-specified triggers based on the number of business lines in the wire center and the number of fiber-based collocations in the area.

65. Given the FCC's view that the presence of fiber-based collocation equipment in an ILEC central office service area is significant in evaluating competitive conditions, this additional information on the presence of local fiber in the central office service area also is likely to be of value in assessing the likelihood that the merger results in the risk of harm to competition. If MCI and other CLECs operate local fiber facilities in an area served by a given ILEC central office, then it is likely that those firms also could serve buildings in that area economically if prices rose from current levels.[56]

66. Table 2 shows that, as of December 2004, MCI serves only a few hundred buildings of the total number of commercial buildings in New York State. Furthermore, of those MCI-lit buildings, many are: (i) already served by the few CLECs for which we have been able to obtain data; and/or (ii) have multiple competitive suppliers available, as defined by the FCC's no impairment criteria. That is, only a small share of MCI-lit buildings are in areas in which CLECs are "impaired" according to the FCC's measures. More specifically:

- Of the [BEGIN PROPRIETARY] [END PROPRIETARY] fiber-lit buildings served by MCI and MCI-reported CLECs (not including AT&T) in New York State, [BEGIN PROPRIETARY] [END PROPRIETARY]

56. The ability of another CLEC to serve a particular building depends on the distance and other geographic factors that affect the cost of a building interconnection. The costs faced by a new CLEC deploying service to a building can depend in part on the physical proximity of its fiber to a building. The new CLEC's costs of entry may also be lower than those that had been faced by an existing CLEC serving the building if the new CLEC can utilize building-specific conduit or other facilities established by other CLECs.

are served by MCI. Of those, [BEGIN PROPRIETARY] [END PROPRIETARY] are also served by other MCI-reported CLECs.

- An additional [BEGIN PROPRIETARY] [END PROPRIETARY] are in areas that the FCC has found to be subject to multiple competitive supply under the no impairment test.
- Thus, this leaves only [BEGIN PROPRIETARY] [END PROPRIETARY] buildings in New York State served by MCI alone and not subject to multiple competitive supply under the no impairment test (or less than three percent of buildings served by MCI and MCI-reported CLECs). The comparable figure for New York City is only [BEGIN PROPRIETARY] . [END PROPRIETARY]

Assuming that Verizon also provides fiber to each of these buildings, these would be the only buildings for which there would be a decline from two to one in the number of current fiber-based local carriers as a result of the proposed transaction.[57] Moreover, as we have discussed, the numbers reported above are likely to overstate MCI's importance because we lack data on fiber-lit buildings from a variety of CLECs, including AT&T, Level 3, Sprint and Qwest.

57. As we discuss next, most MCI-lit buildings are close to fiber networks owned by other CLECs that may be able to serve these buildings profitably.

[BEGIN PROPRIETARY]

Table 2

[END PROPRIETARY]

C. Most MCI lit buildings are close to other competitive fiber routes.

67. Staff has noted that it lacks the data to fully analyze competitive alternatives for special access. Nonetheless, Staff has expressed the concern that "unless customers are located in close proximity to the fiber rings of remaining competitive high capacity special access providers in the market (e.g., Fibertech, Level 3), it may be difficult to get access to high capacity loops at competitive terms…"[58]

58. White Paper, p. 44.

68. Altman, Vilandrie & Company on behalf of Verizon has analyzed the distance from MCI-lit buildings to competitive fiber using data on fiber routes from GeoTel.[59] Their results are summarized in Tables 3 and 4. They find that roughly 73 percent of all buildings served by MCI fiber in New York are located within 1/20 of a mile from existing competitive fiber routes, and that there are, on average, 3.8 competitive fiber routes within 1/20 of a mile of MCI-lit buildings in New York.

69. The data thus show that the majority of MCI-lit buildings in New York are, in fact, "located in close proximity to the fiber rings of remaining competitive special access providers."

Table 3

Average Number of Non-MCI CLECs Within Given Radius of MCI-Lit Buildings

	Miles			
City	**1/20**	**1/10**	**1/4**	**1/2**
New York State	3.8	5.3	6.7	7.6
New York - Newark - Edison	4.6	6.4	8	8.9

Table 4

Percent of MCI-LIt Buildings With At Least One Non-MCI CLEC Within Given Radius

	Miles			
City	**1/20**	**1/10**	**1/4**	**1/2**
New York State	73%	84%	88%	92%
New York - Newark - Edison	79%	86%	89%	92%

59. GeoTel maintains data on the routes of various CLEC fiber networks. The GeoTel data do not report all CLEC networks in certain areas and do not identify all CLECs that offer service using fiber acquired or leased from network providers. Thus, the analysis is likely conservative.

VI. CONCLUSION.

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

Attachment A

GUSTAVO E. BAMBERGER **July 2005**
Economist

Business Address: Lexecon Inc.
332 South Michigan Avenue
Suite 1300
Chicago, IL 60604 (312) 322-0276

Home Address: 5134 S. Woodlawn Ave
Chicago, IL 60615 (773) 955-5836

EDUCATION

Ph.D., UNIVERSITY OF CHICAGO, 1987, GRADUATE SCHOOL OF BUSINESS

M.B.A., UNIVERSITY OF CHICAGO, 1984, GRADUATE SCHOOL OF BUSINESS

B.A., SOUTHWESTERN AT MEMPHIS, 1981

EMPLOYMENT

LEXECON INC., Chicago, Illinois (3/87-Present): Senior Vice President

UNIVERSITY OF CHICAGO, (1984, 1986): Lecturer

GOVERNORS STATE UNIVERSITY, (1986): Community Professor

UNIVERSITY OF CHICAGO, (1982-1986): Teaching Assistant

UNIVERSITY OF CHICAGO, (1982-1986): Research Assistant

ACADEMIC HONORS AND FELLOWSHIPS

University of Chicago Fellowship, 1981-1984

H.B. Earhart Fellowship, 1985-1986

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Statement and Letter of Gustavo Bamberger In the matter of: A La Carte and Themed Tier Programming and Pricing Options for Programming Distribution on Cable Television and Direct Broadcast Satellite Systems: Before the Federal Communications Commission, MB Docket No. 04-207, July 15, 2004 (Statement); and November 4, 2004 (Letter with Michael G. Baumann, John M. Gale, Thomas W. Hazlett, Michael L. Katz, Kent W. Mikkelsen and Bruce M. Owen).

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Declaration and Deposition of Gustavo Bamberger in Re: Issuer Plaintiff Initial Public Offering Antitrust Litigation and Public Offering Fee Antitrust Litigation: In the U.S. District Court for the Southern District of New York, 00 Civ. 7804 (LMM) (DFE) and 98 Civ. 7890 (LMM), September 16, 2004 (Declaration); and January 27, 2005 (Deposition).

Expert Report and Deposition of Gustavo Bamberger in Re: Congoleum Corporation v. Ace American Insurance Company, et al.: In the Superior Court of New Jersey, Law Division: Middlesex County, Docket No. MID-L-8908-01, December 17, 2004 (Expert Report); and Deposition (March 18, 2005).

Declaration of Gustavo Bamberger in Re: Gas Plus, a California Corporation; and Gas Plus San Marcos, Inc., a California Corporation vs. Exxon Mobil Corporation, a Corporation; Mark McEnomy, an individual; Anthony Moss, an individual; and Does 1-50, inclusive: In the Superior Court of the State of California in and for the County of San Diego, North County Division, Case No. GIN 032455, February 14, 2005.

Declaration of Gustavo E. Bamberger in Re: Robert Ross and Randal Wachsmuth, on behalf of themselves and all others similarly situated vs. American Express Company, American Express Travel Related Services, Inc., and American Express Centurion Bank: In the U.S. District Court for the Southern District of New York, 04 CV 05723, February 18, 2005.

Expert Report of Gustavo E. Bamberger and Dennis W. Carlton, Testimony of Gustavo E. Bamberger and Rebuttal Report of Gustavo E. Bamberger in Re: In the Matter of EchoStar Satellite, L.L.C v. Fox Television Holdings, Inc., Fox/UTV Holdings, Inc. and News Corporation Limited: American Arbitration Association, Case No. 71 472 E 00690 04, March 2, 2005 (Expert Report); March 12, 2005 (Testimony); and April 5, 2005 (Rebuttal Report).

Declaration and Reply Declaration of Gustavo E. Bamberger, Dennis W. Carlton and Alan L. Shampine in Re: Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control: Before the Federal Communications Commission, WC Docket No. 05-75, March 11, 2005 (Declaration); and May 24, 2005 (Reply Declaration).

Statement of Gustavo Bamberger and Lynette Neumann in Re: Applications of Adelphia Communications Corporation, Comcast Corporation, and Time Warner Cable Inc., For Authority to Assign and/or Transfer Control of Various Licenses: Before the Federal Communications Commission, MB Docket No. 05-192, July 21, 2005.

Attachment B

DENNIS WILLIAM CARLTON July 2005
Senior Managing Director

Business Address: Lexecon Inc. (312) 322-0215
332 South Michigan Avenue
Chicago, Illinois 60604

Email Address: dcarlton@lexecon.com

Home Address: 21 Lakewood Drive (847) 835-8855
Glencoe, Illinois 60022

EDUCATION

Ph.D., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts: Economics, 1975.

M.S., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts: Operations Research, 1974.

A.B., HARVARD UNIVERSITY (Summa cum laude): Applied Math and Economics, 1972.

EMPLOYMENT

LEXECON INC., Chicago, Illinois (1977 - present): President, 1997 – 2001, Senior Managing Director, 2003 - present.

UNIVERSITY OF CHICAGO, Graduate School of Business (1984 - present): Professor of Economics.

UNIVERSITY OF CHICAGO, Law School (1980 - 1984): Professor of Economics.

UNIVERSITY OF CHICAGO, Department of Economics: Assistant Professor (1976 - 1979): Associate Professor (1979 - 1980).

MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts, Department of Economics (1975 - 1976): Instructor in Economics.

OTHER PROFESSIONAL EXPERIENCE

HARVARD UNIVERSITY, Public Policy Summer Course in Economics (1977): Professor.

BELL TELEPHONE LABORATORIES (Summers 1976, 1977).

JOINT CENTER FOR URBAN STUDIES OF M.I.T. AND HARVARD UNIVERSITY, Cambridge, Massachusetts (1974 - 1975).

CHARLES RIVER ASSOCIATES, Cambridge, Massachusetts (Summers 1971, 1972): Research Assistant.

FIELDS OF SPECIALIZATION

Theoretical and Applied Microeconomics Industrial Organization

ACADEMIC HONORS AND FELLOWSHIPS

M.I.T., National Scholar Award, 1968
Edwards Whitacker Award, 1969
Detur Book Prize, 1969
John Harvard Award, 1970
Phi Beta Kappa, 1971
National Science Foundation Fellowship, 1972 - 1975
Recipient of Post-doctoral Grant from the Lincoln Foundation, 1975
National Science Foundation Grant, 1977 - 1985
Recipient of the 1977 P.W.S. Andrews Memorial Prize Essay, best essay in the field of Industrial Organization by a scholar under the age of thirty
Ph.D. Thesis chosen to appear in the Garland Series of Outstanding Dissertations in Economics
Alexander Brody Distinguished Lecture, Yeshiva University, 2000
Keynote Address to the International Competition Network, Mexico, 2004
Milton Handler Lecture, New York, 2004
Distinguished Visitor, University of Melbourne, April 2005

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

Co-editor, Journal of Law and Economics, 1980 - present
Associate Editor, Regional Science and Urban Economics, 1987 - 1997
Associate Editor, The International Journal of Industrial Organization, 1991 - 1995
Member, American Economics Association, Econometrics Society
National Bureau of Economic Research, Research Associate
Member, Advisory Committee to the Bureau of the Census, 1987 - 1990
Editorial Board, Intellectual Property Fraud Reporter, 1990 - 1995
Consultant on Merger Guidelines to the U.S. Department of Justice, 1991 - 1992
Accreditation Committee, Graduate School of Business, Stanford University, 1995
Visiting Committee, MIT, Department of Economics, 1995 - present
Resident Scholar, Board of Governors of the Federal Reserve System, Summer, 1995
Member, Advisory Board, Economics Research Network, 1996 - present
Member, Steering Committee, Social Science Research Council, Program in Applied Economics, 1997 - 1999
Participant in meetings with Committee of the Federal Reserve on Payment Systems, June 5, 1997
Participant in roundtable discussions on "The Role of Classical Market Power in Joint Venture Analysis," before the Federal Trade Commission, November 19, 1997 and March 17, 1998.
Member, Advisory Board of Antitrust and Regulation Abstracts, Social Science Research Network, 1998 - present
Participant in the Round Table on the Economics of Mergers Between Large ILECS before the Federal Communications Commission, February 5, 1999
Advisory Board, Massachusetts Institute of Technology, Department of Economics, 1999 - present
Chairman, FTC Round Table on Empirical Industrial Organization (September 11, 2001)
Professor, George Mason Institute for Judges, October 2001
Consultant on Merger Guidelines to the FTC, 2003
Presidential Appointment to the Antitrust Modernization Commission, March 17, 2004 - present
Editorial Board, Competition Policy International (CPI), 2004 – present
Advisory Board, Journal of Competition Law and Economics 2005- present

BOOKS

"Market Behavior Under Uncertainty," Ph.D. Thesis, Massachusetts Institute of Technology (September 1975); Garland Publishing (1984).

Modern Industrial Organization, Scott, Foresman & Co., co-authored with Jeffrey Perloff, first edition (1990), second edition (1994), translated into Chinese, French, Hungarian and Italian; Addison Wesley Longman, third edition (2000), fourth edition (2005).

RESEARCH PAPERS

"The Equilibrium Analysis of Alternative Housing Allowance Payments," (with Joseph Ferreira) Chapter 6 of Analysis of a Direct Housing Allowance Program, The Joint Center for Urban Studies of M.I.T. and Harvard University, (July 1975).

"Theories of Vertical Integration," presented at Fourth Annual Telecommunications Conference. Appears in a volume of Proceedings of the Fourth Annual Telecommunications Conference, Office of Telecommunications Policy, (April 1976).

"Uncertainty, Production Lags, and Pricing," American Economic Review, (February 1977).

"Selecting Subsidy Strategies for Housing Allowance Programs," (with Joseph Ferreira) Journal of Urban Economics, (July 1977).

"Peak Load Pricing With Stochastic Demand," American Economic Review, (December 1977). (Reprinted in Economic Regulation edited by P.L. Joskow, Edward Elgar Publishing Limited, 1998.)

"The Distribution of Permanent Income," Income Distribution and Economic Inequality, edited by Zvi Griliches, et al. (Halsted Press, 1978).

"Market Behavior with Demand Uncertainty and Price Inflexibility," American Economic Review, (September 1978).

"Why New Firms Locate Where They Do: An Econometric Model," in Studies in Regional Economics, edited by W. Wheaton, (Urban Institute, 1980).

"Vertical Integration--An Overview," in Congressional Record Hearings on the Communications Act of 1978. Bill H.R. 13105, (August 3, 1978).

"Vertical Integration in Competitive Markets Under Uncertainty," Journal of Industrial Economics, (March 1979). Awarded the P.W.S. Memorial Prize for the best essay in the field of Industrial Organization by a scholar under the age of thirty.

"Valuing Market Benefits and Costs in Related Output and Input Markets," American Economic Review, (September 1979).

"Contracts, Price Rigidity and Market Equilibrium," Journal of Political Economy, (October 1979).

"Benefits and Costs of Airline Mergers: A Case Study," (with W. Landes and R. Posner) Bell Journal of Economics, (Spring 1980). (Reprinted in "Air Transport" in Classics In Transport Analysis series, edited by Kenneth Button and Peter Nijkamp, 2001.)

"The Limitations of Pigouvian Taxes as a Long Run Remedy for Externalities," (with G. Loury) Quarterly Journal of Economics, (November 1980).

"The Law and Economics of Rights in Valuable Information: A Comment," Journal of Legal Studies, (December 1980).

"Price Discrimination: Vertical Integration and Divestiture in Natural Resources Markets," (with J. Perloff) Resources and Energy, (March 1981).

"The Spatial Effects of a Tax on Housing and Land," Regional Science and Urban Economics, (November 1981).

"Comments on Weicher," Journal of Law and Economics, (December 1981).

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"Planning and Market Structure," in The Economics of Information and Uncertainty, edited by J.J. McCall, University of Chicago Press, (1982).

"The Disruptive Effect of Inflation on the Organization of Markets," in Robert Hall, ed. The Economics of Inflation, University of Chicago Press, (1982).

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"Futures Trading, Market Interrelationships, and Industry Structure," American Journal of Agricultural Economics, (May 1983).

"The Location and Employment Choices of New Firms: An Econometric Model with Discrete and Continuous Endogenous Variables," The Review of Economics and Statistics, (August 1983).

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"Energy and Location," Energy Costs, Urban Development, and Housing, Brookings Institution, (1984).

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"Market Power and Mergers in Durable Good Industries," (with R. Gertner), Journal of Law and Economics, (October 1989).

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"The Economics of Cooperation and Competition in Electronic Services Network Industries," in Economics of Electronic Service Networks, Wildman Steven ed., Praeger Press, (1992).

"Merger Policy and Market Definition Under the EC Merger Regulation," (with W. D. Bishop). Conference on Antitrust in a Global Economy, Fordham Corporate Law Institute, (1994).

"The Antitrust Economics of Credit Card Networks," (with A. Frankel) Antitrust Law Journal, (Winter 1995).

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"Price Rigidity," Business Cycles and Depressions, David Glasner ed., Garland Publishing, Inc., (1997).

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"Why Barriers to Entry are Barriers to Understanding", American Economic Review, (May 2004).

"Using Economics to Improve Antitrust Policy", Milton Handler Lecture, Columbia Business Law Review, (June 2004).

"The Proper Role for Antitrust in an International Setting", (Keynote address: Second Annual Conference of the International Competition Network (ICN), Merida City, Mexico (June 25, 2003), appears as Appendix to "Using Economics to Improve Antitrust Policy", Columbia Business Law Review (June 2004).

"The Competitive Effects of Fannie Mae," (with D. Gross and R. Stillman) in Housing Matters: Issues in American Housing Policy, Fannie Mae (January 2002, reprinted 2004).

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“Predation and the Entry and Exit of Low-Fare Carriers”, (with G. Bamberger), in Advances in Airline Economics: Competition Policy and Antitrust, Darin Lee, ed., 2005 (forthcoming).

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"Modeling the Housing Allowance Program," M.A. Thesis, Massachusetts Institute of Technology (September 1974).

"The Cost of Eliminating a Futures Market and The Effect of Inflation on Market Interrelationships," (1984).

"The Empirical Importance of Delivery Lags as an Explanation of Demand," (1984).

"Statistical Supplement to The Antitrust Economics of Credit Card Networks: Reply to Evans and Schmalensee Comment, 63 Antitrust Law Journal 903 (1995)," (with Alan Frankel), (May 1997).

"Competition, Monopoly, and Aftermarkets," (with M. Waldman), Working Paper No. 8086, National Bureau of Economic Research, (January 2001, revised March 2002).

“Product Variety and Demand Uncertainty”, (with James D. Dana Jr.), (2004). NBER Working Paper 10594.

“Tying, Upgrades, And Switching Costs In Durable-Goods Markets”, (with Michael Waldman), (2005), NBER Working Paper 11407.

“Theories of Tying and Implications For Antitrust”, (with Michael Waldman), (July 2005).

EXPERT TESTIMONIAL EXPERIENCE

Testimony of Dennis W. Carlton in Re: "Vertical Integration--An Overview." Congressional Record Hearings on the Communications Act of 1978: Proceedings before the House on Bill H.R. 13105, August 3, 1978.

Testimony of Dennis W. Carlton, William M. Landes and Richard A. Posner in Re: Competitive Effects of the Proposed North Central-Southern Airline Merger: Proceedings before the Civil Aeronautics Board, Docket No. 33136, Exhibit NC/SO-T-7, October 13, 1978 and October 9, 1979.

Testimony of Dennis W. Carlton in Re: McNeilab, Inc.: Proceedings before the United States Department of Justice, Drug Enforcement Administration, Docket No. 78-13, March 13, 1980 and May 1980 (Oral).

Testimony of Dennis W. Carlton in Re: Acco Industries, Inc. v. Kresl Power Equipment, Inc.: In the U.S. Court of Appeals For the Seventh Circuit, Docket No. 80-2024, March 29, 1980.

Deposition, Testimony, and Rebuttal Testimony of Dennis W. Carlton in Re: Ethyl Corporation: Proceedings before the Federal Trade Commission, Docket No. 9128, November 10 & 11, 1980 (Deposition), November 13 & 14, 1980 (Testimony), February 20, 1981 (Rebuttal).

Deposition of Dennis W. Carlton in Re: Independence Tube Corporation v. Copperweld Corporation, Regal Tube Company, The Yoder Company v. David F. Grohne (counter-defendant): In the U.S. District Court for the Northern District of Illinois, Eastern Division, No. 76 C 4201, January 24, 1981.

Affidavit of Dennis W. Carlton in Re: Ellis Banking Corporation, Ellis First National Bank of Bradenton, and Ellis First Security Bank v. Barnett Banks of Florida, Inc., Barnett Bank of Manatee County, and Westside National Bank of Manatee County: In the U.S. District Court for the Middle District of Florida, Tampa Division, No. 81-693-Civ-T-H, July 28, 1981.

Deposition and Economic Report of Dennis W. Carlton in Re: Schneider Industrial Sales and Service Company, William Schneider and Mary Emily Schneider v. Acco Industries, Inc.: In the U.S. District Court for the District of New Jersey, April 19, 1982.

Deposition and Testimony of Dennis W. Carlton in Re: City of Batavia, et al. v. Commonwealth Edison Company: Proceedings before the U.S. District Court, Northern District of Illinois, Eastern Division, No. 76 C 4388, May 17, 18 & 25, 1982 (Deposition), July 22, 1982 (Testimony).

Deposition of Dennis W. Carlton in Re: M. K. Metals Inc., et al. v. National Steel Corporation: In the U.S. District Court for the Northern District of Illinois, Eastern Division, No. 79 C 1661, September 15, 1983.

Declaration and Deposition of Dennis W. Carlton in Re: Carter Hawley Hale Stores, Inc. v. The Limited, Inc., et al.: In the U.S. District Court, Central District California, No. CV 84 22000 AWT (JRX), April 21, 1984 (Declaration), April 23, 1984 (Deposition).

Verified Statements and Testimony of Dennis W. Carlton in Re: Denver & Rio Grande Western Railroad v. Santa Fe Southern Pacific Corporation et al: Proceedings before the Interstate Commerce Commission, Docket No. 30400, August 28, 1984, November 14, 1984, and May 22, 1985, (Statements), and January 30, 1985 and June 19, 1985, (Testimony).

Affidavit of Dennis W. Carlton and William M. Landes in Re: United States of America v. Western Electric Company, Inc. and American Telephone and Telegraph Company: In the United States District Court for the District of Columbia, December 19, 1984.

Statement of Carlton in Re: To the National Telecommunications Information Administration (NTIA) Request for Comments in Connection with the Comprehensive Study of the Structure and Regulation of the U.S. Telecommunications Industry, March 29, 1985 (with DeMuth, Landes, and Rosenfield).

Deposition and Affidavit of Dennis W. Carlton in Re: L&W Industries, Inc. v. American Standard, Inc.: In the U.S. District Court, Eastern District of Wisconsin, Civil Action No. 81-C-1409, May 14, 1985 (Deposition), August 30, 1985 (Affidavit).

Testimony of Dennis W. Carlton in Re: E. I. Du Pont De Nemours and Company's Thebaine Import Application: Proceedings before the U.S. Department of Justice, Drug Enforcement Administration, Docket No. 84-51, May 31, 1985.

Testimony of Dennis W. Carlton, William M. Landes and Sam Peltzman in Re: Joint Application of Pan American World Airways, Inc. and United Airlines, Inc., Pacific Division Transfer Case: Proceedings before the U.S. Department of Transportation, Docket No. 43065, August 7, 1985.

Deposition of Dennis W. Carlton in Re: General Motors "THM 200" Transmission Litigation: Proceedings before the U.S. District Court, Northern District of Illinois, Eastern Division, No. 79 C 1249, 80 C 2151 and 85 C 4805, July 2, 1986.

Affidavit of Dennis W. Carlton in Re: Norwest Bank Fire Case: Proceedings before the U.S. District Court, Fourth Judicial District, State of Minnesota, Court File No. 83-08122, August 28, 1986.

Affidavit of Dennis W. Carlton in Re: Policy and Rules Concerning Rates for Dominant Carriers: Before the Federal Communications Commission, Washington, D.C., Docket No. 87-313, October 16, 1987.

Deposition of Dennis W. Carlton in Re: Research Institute for Medicine and Chemistry, Inc. v. Wisconsin Alumni Research Foundation: In the U.S. District Court, Western District of Wisconsin, Case No. 85-C-1060-D, October 20 & 21, 1986.

Affidavit and Deposition of Dennis W. Carlton in Re: United States Football League, et al. v. National Football League, et al.: In the U.S. District Court, Southern District of New York, 84 Civ. 7484 (PKL), November 24, 1986 (Affidavit), February 26, 1986 and December 4, 1986 (Deposition).

Verified Statements of Dennis W. Carlton in Re: Coal Trading Corporation, et al. v. The Baltimore and Ohio Railroad Co., et al.: Before the Interstate Commerce Commission, ICC Docket No. 38301S, December 16, 1986 and September 8, 1987.

Testimony of Dennis W. Carlton in Re: The Application of Pacific Bell, a Corporation, for Authority to Increase Certain Intrastate Rates and Charges Applicable to Telephone Services Furnished within the State of California, California Public Utilities Commission, Application No. 85-01-034, December 19, 1986 and January 22 & 28, 1987.

Deposition of Dennis W. Carlton in Re: John H. Torphy v. Touche Ross & Co., et al: In the Circuit Court Dane County, State of Wisconsin, Case No. 82-CV-4033, August 25, 1987.

Deposition of Dennis W. Carlton in Re: Martin Exploration Management Company, et al. v. Panhandle Eastern Corporation, et al.: In the U.S. District Court for the District of Colorado, Civil Action No. 86-Z-804, May 5, 6 & 18, 1988.

Deposition of Dennis W. Carlton in Re: The Dow Chemical Company v. Halliburton Company and The Dow Chemical Company v. Mississippi Power & Light Company: In the U.S. District Court for the Northern District of Mississippi Greenville Division, No. GC-78-31-GD-D and No. GC-78-32-GD-D, June 16, 1988.

Statements and Testimony of Dennis W. Carlton in Re: Trailer Train Company et al., Approval of Pooling of Car Service With Respect to Flat Cars: Before the Interstate Commerce Commission, Finance Docket No. 27590. (Sub-No. 1), July 7 & 14, 1988 (Statements), July 25 & 26, 1988 (Testimony).

Testimony of Dennis W. Carlton in Re: Pontarelli Limousine, Inc. v. City of Chicago, Finance Docket No. 83-C-6716, September 25 & 26, 1989.

Deposition of Dennis W. Carlton in Re: Great Northern Nekoosa Corporation v. Georgia-Pacific Corporation: Before the United States District Court District of Connecticut, Civ. Action No. B-89-607-WWE, December 28, 1989, January 15, 1990.

Testimony of Dennis W. Carlton in Re: The Matter of the Physicians and Surgeons Medical Malpractice Insurance Rates of St. Paul Fire & Marine Insurance Company: Before the State of Minnesota Office of Administrative Hearings for the Commissioner of Commerce, O.A.H. Docket No. 0-1004-3412-2, January 1990.

Deposition of Dennis W. Carlton in Re: Dale A. Ervin, et al. v. Amoco Oil Company, et al.: In the District Court, City and County of Denver, State of Colorado, No. 88-CV-11994, September 5, 1990.

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Deposition, Testimony, and Rebuttal Testimony of Dennis W. Carlton in Re: In the Matter of Marathon Oil Company and Phillips Petroleum Company: Before the Department of Revenue, State of Alaska, Case No. 89314, April 23 & 24, 1991 (Deposition), March 28, 1991, June 19, 1991 (Testimony), July 22, 1991 (Rebuttal Testimony), October 3 & 4, 1991 (Oral).

Deposition of Dennis W. Carlton in Re: Martin Exploration Management Company, et al. v. Panhandle Eastern Pipeline Corporation, et al.: In the U.S. District Court for the District of Colorado, Civil Action No. 91-N-110, February 5, 1992.

Deposition, Affidavit and Testimony of Dennis W. Carlton in Re: United States of America v. Brown University, et al.: In the U.S. District Court For the Eastern District of Pennsylvania, Civil Action No. 91-CV-3274, February 18 & 19, 1992 (Deposition), April 28, 1992 (Affidavit), July 8 & 9, 1992 (Testimony).

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Expert Report, Deposition and Affidavit of Dennis W. Carlton in Re: Celanese Ltd., et al. v. JO Tankers AS, et al, April 8, 2005 (Expert Report); and May 6, 2005 (Deposition); June 10, 2005 (Affidavit).

Affidavit of Dennis W. Carlton in Re: In the matter of Beatrice C. Romero vs. Philip Morris Price Fixing Allegations: In the United States First District Court State of New Mexico County of Rio Arriba, April 15, 2005.

Expert Report, Written Direct Examination, Deposition and Trial Testimony of Dennis W. Carlton in Re: United States of America v. Philip Morris USA Inc. (f//k/a Philip Morris Incorporated), et al., In the United States Court for the District of Columbia, Civil Action No. 99-CV- 2496 (GK), April 29, 2005 (Expert Report); May 23, 2005 (Written Direct Examination); May 23, 2005 (Deposition), June 2, 2005 (Trial Testimony).

Declaration of Dennis W. Carlton in Re: Covad Communications, et.al. v. Bell Atlantic, et. al., Civil Action No.:1:99-CV-01046, June 10, 2005 (Declaration).

Attachment C

ALLAN SHAMPINE **May 2005**

Business Address: Lexecon
332 South Michigan Avenue
Suite 1300 (312) 322-0294
Chicago, Illinois 60604-4306 Email: ashampine@lexecon.com

Home Address: 5441 Arcadia Street
Skokie, IL 60077 (847) 663-1433

EDUCATION

Ph.D. UNIVERSITY OF CHICAGO: Economics, 1996
(Full scholarship from the University)

M.A. UNIVERSITY OF CHICAGO: Economics, 1993
(Full scholarship from the University)

B.S. SOUTHERN METHODIST UNIVERSITY: Economics and Systems Analysis, Mathematics Minor, 1991
(Summa Cum Laude, Honors, Departmental Distinction)

PROFESSIONAL EXPERIENCE

LEXECON, Chicago, Illinois: Vice President (2003-Present)

LEXECON, Chicago, Illinois: Economist (1996 - 2003)

UNIVERSITY OF CHICAGO: Teaching Assistant (1994 – 1996)

DEGOLYER SPECIAL COLLECTIONS LIBRARY (May - July 1991)

BARNES & NOBLE (May - July 1989)

UNIVERSITY OF TEXAS, Research Assistant to Dr. Brian Berry (May - July 1987)

OTHER PROFESSIONAL EXPERIENCE

Member of the *American Economics Association*

Associate member of the *American Bar Association*

Referee for the *American Journal of Agricultural Economics* and *Journal of Business*.

Reviewer for *Agricultural and Resource Economics Review*.

Coordinated the *Conference on Valuing Non-Market Goods*, University of Chicago (July 21-22, 1995)

Assisted in coordinating the *Conference on Research in Health Economics*, University of Chicago (October 21-22, 1994)

Assisted in organizing the *Economic Policy and Public Finance Workshop*, University of Chicago (1993 - 1996)

Presented papers on information externalities and technology diffusion at the *Economics and Public Policy Workshop* (3) and *Price Theory Workshop* (1), University of Chicago (1995, 1996)

Presented *The Impact of Technology on the Modern Labor Market* at the 68th Annual Meeting of the Southwestern Social Science Association (March 29, 1990)

Independent research projects with Drs. Slottje and Hayes, Southern Methodist University (1987 - 1991)

ACADEMIC HONORS

Graduated Summa Cum Laude, Honors, Department Distinction
Phi Beta Kappa
Alpha Lambda Delta (Treasurer, honorary society recognizing academic achievement)
Phi Eta Sigma (honorary society recognizing academic achievement)
Omicron Delta Epsilon (international honor society in economics)
Kappa Mu Epsilon (honor society in mathematics)
Award for Excellence (given to the outstanding senior in the Economics Department as decided by the vote of the faculty)
Presidential Scholarship (full scholarship, Southern Methodist University)
National Merit Scholar (honorary)
Full Scholarship (University of Chicago)
Hyer Society (honorary society of Southern Methodist University)
Honor Roll (1987-1991)

FIELDS OF SPECIALIZATION

Telecommunications
Technology Diffusion
Urban Economics
Agricultural Economics
Environmental Economics

PUBLICATIONS

BOOKS

Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies, (Editor) Nova Science Press (2003).

ARTICLES

Handicapping Countries in the Race to Digital Switching, Progress in Economics, edited by Frank Columbus (forthcoming).

"The Evolution of Telecommunications Switching in the Central Office," in Down to the Wire: Studies in the Diffusion and Regulation of Telecommunications Technologies, Nova Science Press (2003).

The Welfare Implications of Advertising and Extension Under Uncertainty (with George Tolley) Technological Forecasting & Social Change, 70 (2003).

Determinants of the Diffusion of U.S. Digital Telecommunications, Journal of Evolutionary Economics, 11 (2001).

Compensating for Information Externalities in Technology Diffusion Models, 80 American Journal of Agricultural Economics, 2 (1998).

Contributed to two catalogs at DeGolyer Special Collections Library (1991).

The Impact of Technology on the Modern Labor Market, 11 Southwestern Journal of Economic Abstracts, 1 (1990).

RESEARCH PAPERS

An Evaluation of Technology Diffusion Models and Their Implications, Ph.D. Dissertation, University of Chicago (1996).

A New Direction in Mixed Income Housing, submitted to Chicago Housing Authority (1993).

UNPUBLISHED PAPERS

A Survey of the Economics of Information, Focusing on Water (1992).

Petroleum Price Shocks and Rationality, B.S. Honors Paper (1991).

EXPERT TESTIMONY

Reply Declaration to the Federal Communications Commission, In the Matter of Verizon Communications Inc. and MCI, Inc., Application for Approval of Transfer of Control (WC Docket No. 05-75), May 24, 2005 (with Gustavo Bamberger and Dennis Carlton).

Declaration to the Federal Communications Commission, In the Matter of Verizon Communications Inc. and MCI, Inc., Application for Approval of Transfer of Control (WC Docket No. 05-75), March 9, 2005 (with Gustavo Bamberger and Dennis Carlton).

Reply Declaration to the Federal Communications Commission, In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements (WC Docket No. 02-112) and 2000 Biennial Regulatory Review of Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules (CC Docket 00-175), July 28, 2003, (with Dennis Carlton and Hal Sider).

Declaration to the Federal Communications Commission, In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements (WC Docket No. 02-112) and 2000 Biennial Regulatory Review of Separate Affiliate Requirements of Section 64.1903 of the Commission's Rules (CC Docket 00-175), June 30, 2003, (with Dennis Carlton and Hal Sider).

Reply Declaration Re: 2000 Biennial Regulatory Review Spectrum Aggregation Limits for Commercial Mobile Radio Services, Before the Federal Communications Commission, Washington DC, WT Docket No. 01-14, May 14, 2001, Reply Declaration (with Robert Gertner).

Declaration Re: 2000 Biennial Regulatory Review Spectrum Aggregation Limits for Commercial Mobile Radio Services, Before the Federal Communications Commission, Washington DC, Docket No. 01-14, April 13, 2001, Declaration (with Robert Gertner).

Report to Directorate General IV of the European Commission: "Remedies in the United States," in *Remedies in the United States,* in *Remedies in EU Competition Law: The Policy and Practice of the European Commission, A Report for Directorate General IV of the European Commission*, July 1998, Report (with James Langenfeld).

Attachment D [PROPRIETARY]

EXHIBIT 2

Replace this page with

Exhibit 2 - Wirecenter Maps

Provided in separate e-mails