STATE OF NEW YORK
OFFICE OF THE ATTORNEY GENERAL
120 BROADWAY, NEW YORK, NEW YORK 10271

ELIOT SPITZER
Attorney General

SUSANNA M. ZWERLING
Assistant Attorney General In Charge
Bureau of Telecommunications and Energy

KEITH H. GORDON
Assistant Attorney General
Vox: (212) 416-8320
Fax: (212) 416-8877
E-mail: Keith.Gordon@OAG.State.NY.US

August 5, 2005

Honorable Jaclyn Brilling, Secretary
NYS Public Service Commission
3 Empire State Plaza
Albany, NY 12223

Re: Case 05-C-0237 - Joint Petition of Verizon New York, Inc. and MCI Inc. for a Declaratory Ruling Disclaiming Jurisdiction over or in the Alternative for Approval of Agreement and Plan of Merger.

Case 05-C-0242 - Joint Petition of SBC Communications, Inc.AT&T Corporation, together with its Certificated New York Subsidiaries for Approval of Merger.

Dear Secretary Brilling:

Please accept for filing an original and five copies of the Attorney General's comments on the DPS Staff White Paper. A copy has been served electronically and by first class mail on the active parties list.

Sincerely,

Keith H. Gordon
Assistant Attorney General

**STATE OF NEW YORK**
**PUBLIC SERVICE COMMISSION**

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# COMMENTS OF ELIOT SPITZER ATTORNEY GENERAL OF THE STATE OF NEW YORK ON THE DEPARTMENT OF PUBLIC SERVICE STAFF WHITE PAPER


Mary Ellen Burns
Special Counsel
Public Advocacy Division

Jay L. Himes
Chief, Antitrust Bureau
Peter D. Bernstein
Jeremy R. Kasha
Assistant Attorneys General

Keith H. Gordon
Assistant Attorney General
Telecommunications & Energy Bureau
*Of Counsel*

120 Broadway
New York, NY 10271
Tel No.: (212) 416-6343
Fax No.: (212) 416-8877
E-mail: keith.gordon@oag.state.ny.us


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## I. INTRODUCTION

The proposed merger of Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI"), together with the pending merger of SBC Communications Inc. ("SBC") and AT&T Corporation ("AT&T"), portend a consolidation that would reshape the vital and changing telecommunications industry for a long time to come. The New York State Public Service Commission ("PSC" or "Commission") has undertaken a serious evaluation of the public interest impacts from each of these mergers.[1]

On July 6, 2005, the Department of Public Service Staff ("Staff") issued a White Paper which "presents Staff's preliminary analysis and tentative conclusions about the impact of both mergers on New York consumers."[2] The Commission then solicited comments of interested parties on the findings and recommendations in the Staff's White Paper.[3] The Attorney General submits these comments in response to the Commission's request.[4]

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[1] Verizon-MCI petitioned the PSC to approve their proposed merger February 25, 2005, with amended filings submitted March 29, 2005 and May 5, 2005. The PSC thereupon commenced Case 05-C-0237 - *Joint Petition of Verizon New York, Inc. and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction over or in the Alternative for Approval of Agreement and Plan of Merger*. After SBC-AT&T petitioned for approval of their proposed merger on February 28, 2005, the PSC commenced Case 05-C-0242 - *Joint Petition of SBC Communications, Inc. AT&T Corporation, together with its Certificated New York Subsidiaries for Approval of Merger*.

[2] Cases 05-C-0237 and 05-C-0242 - *Department of Public Service Staff White Paper*, July 6, 2005.

[3] Cases 05-C-0237 and 05-C-0242 - *Notice Soliciting Comments on Staff White Paper*, July 6, 2005.

[4] These comments supplement the New York Attorney General's Office's ("AG") preliminary comments on the Verizon-MCI merger submitted on April 29, 2005 pursuant to the Commission's April 1, 2005 *Notice Soliciting Comments*. At that early stage of inquiry, the AG urged the PSC to address two areas of concern: (1) the need for availability from Verizon of

## II. THE NEW YORK ATTORNEY GENERAL'S INTEREST

The Attorney General is charged with enforcing state and federal antitrust and consumer protection laws. The Attorney General advocates in Commission proceedings primarily on behalf of New York State, consumer and small business interests, and the public interest generally.

As the Commission knows, telecommunications is vital to New York's information-intensive economy. Competition in telecommunications is the driving force behind fair prices, high quality, innovative offerings and greater access to services in the industry. Accordingly, in reviewing whether telecommunications transactions are in the public interest, the Commission should seek to promote market conditions in which robust competition can thrive.

## III. SUMMARY OF COMMENTS

The AG concurs in Staff's analysis that the Verizon-MCI merger would greatly increase industry concentration in vital markets – ones that are already highly concentrated. The available evidence indicates that MCI, along with AT&T, have been Verizon's most aggressive retail competitors for enterprise customers, as well as crucial sources of wholesale special access services resold to other smaller scale competitors. The AG is also greatly concerned that the merger of SBC and AT&T would reduce AT&T's role as a competitor for enterprise customer services in New York and elsewhere within the Verizon footprint. Therefore, the two mergers

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stand-alone Digital Subscriber Line ("DSL") service to all customers; and (2) the need to assure non-discriminatory access to the Internet backbone that MCI controls, which will be combined with Verizon's own backbone and network. Case 05-C-0237 - *Comments of New York Attorney General Eliot Spitzer*, April 29, 2005. The DPS Staff adopted the AG's recommendation on stand-alone DSL availability, but suggested that Internet backbone access was more appropriately within the FCC's jurisdiction. White Paper, pp. 26, 18. The AG submits that both issues are relevant to the Commission's public interest analysis.

would deprive government and large business customers of alternatives to Verizon's high margin rates. Verizon would wield near monopoly power over enterprise customers and its exercise of market power could adversely impact the economic engine driving New York's economy.

The AG's concerns are exacerbated by recent regulatory actions at the national level. Local competition for mass market customers by competitive local exchange carriers ("CLECs") will likely be adversely affected as unbundled network elements platform ("UNE-P") rate discounts are phased out.[5] Other modes of competitive entry – wireless, Voice over Internet Protocol ("VoIP") and cable telephony – have not yet proven themselves capable of effectively checking the market power that Verizon would have. Furthermore, for the foreseeable future, these new modes of competition depend on the continued maintenance of Verizon's local switched telephone network to complete calls to subscribers of wireline telephony. Moreover, those VoIP providers that ride over DSL broadband connections to the Internet need the Verizon network to originate calls. Thus, it is unrealistic to consider these technologies as complete replacements for Verizon's local telephone service offerings.

New York has long been a national leader in opening telecommunications markets to competition, a condition for which the Commission deserves much credit. However, Staff's White Paper analysis starkly demonstrates that these mergers are likely to reverse this positive competitive trend in New York. Nationally, the combined effects of these two mergers could send the industry back to levels of concentration comparable to those prevailing before the breakup of AT&T.

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[5] Although the Telecommunications Act of 1996 sought to encourage competition in local markets through leasing of incumbent providers' bottleneck facilities to new entrants, recent judicial and FCC orders have sharply curtailed this mode of entry.

Given the obvious substantial anti-competitive effects of each proposed merger, and the even more serious combined effect of the two mergers, the AG is not persuaded that the modest remedies recommended in the Staff White Paper would adequately preserve competition in New York telecommunications markets, or protect the public interest. The AG believes that the conduct remedies presented by the Staff may not be effective in addressing what is essentially a structural threat to competition.

The existing market concentration levels and the increase in concentration resulting from each merger demonstrate that this is not even a close call in terms of antitrust merger analysis.[6] There is ample reason to expect these mergers to produce increased retail and wholesale prices. So the burden falls on the proponents to demonstrate persuasively that a different conclusion might be warranted. For the same reason, any potential merger conditions must also be effective in remedying the clear anti-competitive harm that the mergers would cause.

## IV. DISCUSSION

### A. The Merger Proposals Are Subject to Commission Regulation.

In answer to the Verizon-MCI petition seeking a declaration that the PSC lacks jurisdiction over their proposed merger, the AG previously argued – and the DPS Staff similarly agreed – that the Commission has jurisdiction to review these mergers.[7] The Commission has the clear authority to approve, reject or condition approval of each proposed merger.

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[6] White Paper, pp. 18-25, 27-32, 34-37, 40-44.

[7] AG's April 29 Comments, *supra*, at 5-7; White Paper, at 10-12.

## B. Each Merger Will Increase Concentration In New York's Already Concentrated Enterprise Market.

Staff accurately concluded that enterprise markets in New York "currently are highly concentrated; the proposed Verizon/MCI merger causes a significant change in the concentration of the voice and data markets for medium and large businesses, institutional and government customers."[8] Indeed, Staff's analysis of the Verizon-MCI merger concentration effect is conservative and may not identify the full harm to enterprise market competition.

Any assessment of a merger's impact on competition for New York's enterprise customers must keep foremost in mind the importance of this sector to the overall economic well being of New York's economy. New York's status as the nation's premier financial center, and as a global finance leader, depends on telecommunications to transmit data over secure private networks to conduct business nationally and globally. Many of the nation's largest businesses are either based in New York or maintain major centers of activity here which rely on special access and transport services.

### 1. MCI and AT&T are Verizon's two main retail and wholesale competitors.

The demand of major commercial customers for competitive telecommunications brought the earliest industry competition to New York City in the 1980s in the form of competitive access providers ("CAPs"). Pioneering facilities-based entry by CAPS such as Teleport, Brooks Fiber

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[8] *Id.* at 28 , 30-44, Tables 6, 7, 8 and Figure 2. Staff appropriately applies the Herfindahl-Hirschman Index as detailed in the U.S. Department of Justice Horizontal Merger Guidelines as its threshold analysis methodology. White Paper, pp. 15-17. The HHI measures market concentration by summing the square of each participant's market share, and compares the change in this sum before and after the proposed merger to determine the degree of change in concentration. *See 1992 Horizontal Merger Guidelines*, http://www.ftc.gov/bc/docs/horizmer .htm; *see also* Warren-Boulton, Frederick R., *The Contribution of the Merger Guidelines to the Analysis of Non-Horizontal Mergers*, http://www.usdoj.gov/atr/hmerger/11709.htm.

and MFS helped establish New York as the location of the earliest and broadest competitor penetration in the country. State and local government agencies have also benefitted from increased competition for enterprise customers.

MCI and AT&T acquired these CAPs and then expanded their facilities within New York's business districts, as well as elsewhere in the Verizon footprint.[9] Thus, MCI and AT&T have become Verizon's principal competitors in the enterprise market today. Not only do these merger targets pose Verizon's strongest retail challenge, but they each compete with Verizon in the wholesale market as well. MCI & AT&T purchase large volumes of special access[10] facilities from Verizon, which they need to support their own long distance business customers. The volume is so large that MCI and AT&T can take advantage of Verizon's volume discount tariffs and profitably resell surplus special access capacity to smaller CLECs who also compete in the retail enterprise market. MCI and AT&T thus supply CLECs at substantial discounts below Verizon's own rates. Verizon's acquisition of MCI would, therefore, remove one of the two most aggressive competitors for New York's enterprise customers, in both wholesale and retail markets, resulting in a significant increase in concentration in both markets.

MCI's merger with Verizon would also mean that other CLECs would lose MCI's wholesale special access offering. As enterprise customers lose alternative suppliers, Verizon would be able to increase rates without meaningful challenge.

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[9] MCI acquired Brooks Fiber and MFS, while AT&T bought Teleport.

[10] DPS Staff defines the special access market to include "engineered circuits which are used to connect large business customer buildings and large residential locations to Verizon end offices and competitor points of presence. These specially engineered high capacity circuits can be used to provide voice and/or data services." White Paper, at 38.

**2. If SBC buys AT&T, competition in Verizon territory will decrease**.

The AG questions Staff's assumption that, following SBC's acquisition of AT&T, the merged concern would continue to compete as vigorously in the enterprise customer market within Verizon's territory as AT&T does today. The Staff recognizes that "because AT&T is being acquired by another former regional Bell operating company ("RBOC"), the potential for price or rate collusion, or discrimination in the provision of access for transport or special access facilities in favor of their respective affiliates, increases (to the detriment of small carriers and business customers)." Thus, it is reasonable to assume that AT&T's role in New York markets would shrink dramatically. As discussed below, SBC has not competed out of region even when ordered to do so by the FCC. It is difficult to reconcile Staff's quotation of the April 2005 Bernstein Research Report that SBC is an aggressive competitor of Verizon for enterprise customers[11] with the Staff's own finding that "SBC has less than 10,000 lines in New York"[12] and the finding that SBC has "a negligible amount of revenues in the Verizon service territory" (White Paper at 29).

If both mergers were consummated, each vertically integrated RBOC would have strong business incentives to focus its own marketing on enterprise customers with major operations within its own footprint. Because both Verizon and SBC earn high rates of return on the special services they sell to enterprise customers, each RBOC likely would be reluctant to compete to serve an enterprise customer located largely in the other's region, as this would require the RBOC to purchase high margin special access services from its sibling RBOC. Basic business

[11] *Id.* at 30.

[12] *Id.* at 72

economics indicate that SBC would much prefer to be a net collector, rather than payer, of high margin special access rates – and so would likely avoid competing for new enterprise customers outside its territory.

**3. Competitors seeking to replace MCI and AT&T face high barriers to entry**.

Because of the high barriers to entry, New York government and large business customers would likely be left with Verizon as their only provider, except in those limited locations where the customers are physically "in close proximity to the fiber rings of remaining competitive high capacity special access providers"[13] (*e.g.*, Level 3 or Fibertech). As set forth in the comments presented by Ad Hoc Users Committee, special access rates in New York and nationally have *increased* over the five years that the FCC has allowed SBC and Verizon pricing flexibility, despite overall *downward* cost trends in the industry.[14] Verizon's demonstrated ability to raise the special access prices it charges enterprise customers today – despite competition from MCI and AT&T – means that Verizon's market power will likely grow that much stronger after the mergers. This poses serious risks to government and enterprise customers.

The Commission must assess the near-term potential for existing and newly entering providers to replace MCI and AT&T's as market competitors so as to prevent Verizon's

[13] *Ibid.*

[14] FCC WC Docket No. 05-65 - *In the Matter of SBC Communications, Inc. And AT&T Corp. Applications for Approval of Transfer of Control, Reply Comments of Ad Hoc Users Committee*, May 10, 2005, p.8; *see also* FCC WC Docket No. 05-75 - In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, *Reply Declaration of Susan Gately, Economics & Technology, Inc. On behalf of Ad Hoc Users Committee*, May 24, 2005, pp. 5-10. Ad Hoc Users Committee advocates for enterprise customers.

increased dominance. Pursuant to the Justice Department - Federal Trade Commission Horizontal Merger Guidelines, "rival sellers" must be able to "replace any localized competition lost through the merger by repositioning their product lines," thereby constraining the merging parties from increasing prices post-merger.[15] The repositioning must be timely, likely and sufficient in magnitude, character and scope to counteract a price increase.[16] In the case of these mergers, the evidence, however, does not support a conclusion that such conditions of entry by existing or new suppliers could be met.

To the contrary, new facilities-based competition capable of meeting the requirements of very large regional and national customers is not likely to replace the loss of MCI and AT&T, post-merger, over the next few years. Even those competitors who are already present face major obstacles, in addition to capital costs, in attempting to construct connections between their fiber routes and the buildings in which enterprise customers are located, including opening public rights of way to access the customer's building and obtaining permission from commercial building owners to serve tenants.[17] Tenants in some buildings cannot be readily accessed because of lack of vacant riser or basement space for locating communications equipment.

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[15] *1992 Horizontal Merger Guidelines*, §2.212, www.ftc.gov/bc/docs/horizmer.htm.

[16] *Ibid*. at §3.0. *See also* §1.322 (a firm able to enter within one year without the need to incur significant sunk costs on entry or exit may be treated as one able to constrain price).

[17] "Capacity removed from the market through mergers of CLECs into the incumbents is unlikely to be replaced any time soon because the entry barriers to deploying local fiber and other facilities are extremely high." FCC WC Docket No. 05-75, *supra*, *Petition to Deny of Cbeyond Communications, Conversent Communications, Eschelon Telecom, TDS Metrocom, Nuvox, Communications, and XO Communications*, May 9, 2005 at 18-19.

Because Verizon already has access to virtually every commercial building and tenant within its territory – acquired, for the most part, without having to pay building owners – Verizon wields enormous competitive advantage in this market. Thus, existing sellers or new entrants face not only significant sunk costs and a long timeline to expand or enter, but also the prospect of limited, if any, profitability from such a course of action. These are not conditions conducive to expansion or entry sufficient to make up for the loss of MCI and AT&T as competitive forces.

**4. Verizon is still the dominant provider in the special access market.**

In 2001, the PSC examined the New York special access market, and rejected Verizon's claims that enterprise customers had ample facilities-based competitive alternatives to Verizon's offerings.[18] In that proceeding, MCI-WorldCom presented evidence showing that:

> Verizon is the primary carrier capable of providing such facilities [needed to provide long distance service to enterprise customers]. Although some competitive access providers ("CAPs") compete with Verizon to provide, on a wholesale basis, the physical facilities needed for dedicated access, the number of customers they reach is de minimis. In Verizon's territory, for example, only a very small percentage of WorldCom's total purchase of access facilities goes to CAPs. . . . [In New York], the CAPs with which WorldCom has agreements to purchase dedicated access have the potential to offer WorldCom competitive access to only 1,483 buildings . . . a tiny fraction of the total.[19]

AT&T confirmed MCI's evidence, stating:

> Although competitive local exchange carriers (CLECs) are constructing their own facilities for use in creating high-capacity pathways, in most instances CLECs and IXCs are critically dependent upon Verizon as the sole source for the provision of

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[18] *See* Cases 00-C-2051 and 92-C-0665, Opinion 01-1, issued June 15, 2001.

[19] Cases 00-C-2051 - *Proceeding to Investigate Methods to Improve and Maintain High Quality Special Access Performance by Verizon New York, Inc.*, January 12, 2001 comments of WorldCom, Inc., pp. 3-4.

certain segments of such pathways.[20]

After evaluating the evidence presented by Verizon and the CLECs, the PSC found that:

> Verizon served 88% of the market for all Special Services, high speed data circuits, and special access outside New York City. In Greater Metro,[21] 67% of the Market was served by Verizon, and in Southern/Midtown Manhattan, 51%. . . . In the LATA 132, for example, Verizon has 8,311 miles of fiber compared to a few hundred for most competing carriers; Verizon has 7,364 buildings on a fiber network compared to less than 1,000 for most competing carriers.[22]

MCI, AT&T and other competitors also presented evidence that Verizon took advantage of its special access market dominance to favor its own retail customers with service performance far superior to that afforded to the competitors' customers. The Commission concluded:

> [W]e find, that Verizon remains the dominant provider of facilities for Special Services, that Verizon's provisioning performance for Special Services is significantly below Commission targets, and that the record suggests Verizon treats other carriers less favorably than its own end users. Because Verizon's facilities are used by carriers as they are entering the market, including the local market, on a facilities basis, Verizon's Special Services offerings are crucial for the development of facilities-based competition in the local market, and for the New York economy.[23]

The Commission went on to adopt enhanced special services performance reporting as well as incentive penalties for failure to meet required standards because "[t]he record demonstrates that Verizon provides inferior service to competitive carriers in the provisioning of special

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[20] *Id.*, January 15, 2001 *Comments of AT&T Communications of New York, Inc., TC Systems, Inc. and ACC Corp.* at p.3.

[21] Verizon separates midtown and lower Manhattan from its New York City territory and labels this the "Greater Metro" business unit.

[22] Cases 00-C-2051 and 92-C-0665, Opinion 01-1, *supra*, at 7. LATA 132 comprises New York City, Long Island, Westchester, Rockland and Putnam Counties.

[23] *Id.* at 9-10.

services."[24]

Subsequent MCI and AT&T filings in the pending FCC Special Access Proceeding[25] demonstrate no significant change. According to AT&T's October 2004 filing, the RBOCs routinely provide inferior service quality to CLECs for special access and "refuse to provide the same service quality guarantees that competing carriers routinely offer" as a means of gaining and maintaining an artificial competitive advantage.[26] AT&T also asserted that where it obtains lower quality service than the RBOCs provide to their own retail customers, the RBOCs continue to win customers even where AT&T is more efficient because special access retail customers require high quality service.[27]

According to MCI, "the resulting harm to competition and deadweight loss to the national economy are monumental."[28] In a January 23, 2003 FCC filing, MCI rejected, as "nonsense on steroids," the incumbent local exchange carriers' ("ILECs'") claims that special access competition is widespread, robust, and thriving.[29] AT&T's expert witness documented that

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[24] *Id.* at 16.

[25] *See* RM No. 10593 - *In the Matter of AT&T Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, Petition of AT&T filed October 15, 2002) http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6513297623; *see also* FCC 05-18 - *Order and Notice of Proposed Rulemaking*, released January 31, 2005 (Special Access NPRM) http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-18A1.doc.

[26] AT&T Reply, p. 10; Benway Declaration, p.8.

[27] Benway Declaration, *supra*, p. 18.

[28] WorldCom Reply Comments (filed Jan. 23, 2003), p. 2-3, http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6513404338.

[29] *Id.*, p. 2.

"[e]ven in the most competitive area in the United States, New York, no AT&T or other CLEC facilities are available at 85.9% of those locations. A similar pattern is evident in each of the other three large markets [Boston, Chicago, and Los Angeles]."[30] MCI estimated that the ILECs are monopoly providers of DS-1 or higher special access services to approximately 90 percent of the end user locations where there is demand for such services.[31] MCI further stated that competitive special access transport is available to less than 10 percent of the wire centers to which WorldCom requires such transport.[32]

There is no evidence showing that Verizon's enterprise market dominance has diminished since MCI and AT&T filed these comments with the FCC. As Staff recognizes, new intermodal competition from cable and DSL-VoIP providers has no current role in enterprise markets:

> [C]able-based telephony is of little assistance to the enterprise market at this point in time since most small and medium-sized businesses are not 'cabled-up' (*i.e.*, current cable-based services are television rather than voice-driven) and larger businesses generally have T-carrier systems for their telecommunications needs, so there is no pressing requirement in this market for broadband services either. However, it is noted that such carrier systems are provided, for the most part, by Verizon and MCI, the merger partners."[33]

If the proposed mergers are approved, Verizon's market power will only grow stronger.

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[30] *Selwyn Declaration* in support of January 23, 2003 AT&T's Comments, p. 18, ¶ 20.

[31] WorldCom Reply, p. 5, fn. 15.

[32] *Id.*, p. 5, fn. 16.

[33] White Paper at 31. Moreover, cable providers do not have ubiquitous infrastructure in central business districts and individually cover only certain regions of New York and the nation. "And while cable networks blanket suburban neighborhoods, they have a harder time winning over large corporations that need to connect a constellation of offices in far-flung metropolitan areas." Belson, Ken, *Not Just TV: Cable Competes for the Office Domain*, New York Times, August 3, 2005.

**5. Conduct remedies will not preserve competition or protect the public interest.**

The AG is not persuaded that the conduct-focused remedies proposed by Staff [34] would be adequate to address the market dominance of a merger between Verizon and MCI, along with another between SBC and AT&T. For the most part, the contemplated remedies would merely postpone the day of reckoning by conditioning Verizon's behavior for up to three years after acquiring MCI. The record, however, does not establish that within three years Verizon would lack the ability to exercise market power – or, indeed, that Verizon could not do so before then even with conditions in place. There is no persuasive showing in the White Paper that, three years after the mergers close, intermodal competitors will likely be capable of checking Verizon's dominance of the enterprise market.

Also, the White Paper proposes no remedies for the serious cumulative impact on competition likely to result from both mergers before the Commission. Given their long history of avoiding head-to-head wireline competition, even when ordered by the FCC to take on each other,[35] neither RBOC has been shown to have incentives to compete aggressively with the other for the enterprise market customers in the other's territory. SBC today faces the same entry barriers as the CLECs in providing facilities-based competition for enterprise customers in Verizon's territory, and would need to pay Verizon the same monopoly rents for special access

[34] White Paper, pp. 33, 37, 45-6.

[35] Despite the FCC's 1999 SBC-Ameritech merger condition requiring SBC to deploy switches and compete for customers in 30 out-of-territory markets – including New York City and Nassau County by 2001 – SBC currently serves only 10,000 lines in New York. That convincingly demonstrates SBC's unwillingness or inability to challenge Verizon in Verizon's territory. *See* CC Docket No. 98-141 - *In the Matter of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, For Consent to Transfer Control, etc.*, issued October 6, 1999.

services that CLECs are charged.

The Commission's determination whether these mergers would be in the public interest must balance whatever efficiency gains may be claimed to result against the enormous competitive harm that is likely to result from such a major increase in consolidation of an already highly concentrated industry. When that is done, the scale tips decidedly against the transactions.

## C. Verizon's Dominance Of The Mass Market Will Be Increased By These Mergers.

### 1. Despite competition by MCI, AT&T and other CLECs, Verizon remains the dominant mass market provider in New York.

The AG concurs with Staff's analysis that Verizon's acquisition of MCI would increase the HHI for mass markets by nine times the Department of Justice threshold in the Horizontal Merger Guidelines, in a market that was "highly concentrated even before the merger" (with Verizon's market share exceeding 50%).[36] At their peak in 2002, CLECs collectively served only 24% of customer lines in New York, compared with Verizon's 67% share.[37] Today, Verizon remains the dominant local service provider in New York, five years after CLECs entered the mass market.[38]

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[36] White Paper at 20.

[37] At the end of 2002, the PSC counted Verizon's lines at 9,247,518, A&T's at 1,105,237 and MCI at 562,943. *See* 2002 PSC Report: *Analysis of Local Exchange Service Competition in New York State*, pp. 4, 7, 9. http://www3.dps.state.ny.us/pscweb/WebFileRoom.nsf/ArticlesByCategory/E8E559BE54F990F585256E1600733A9C/$File/doc13913.pdf?OpenElement.

[38] In evaluating these mergers, the Commission should recall that, after AT&T's 1984 divestiture, the FCC found that AT&T continued to be the dominant carrier in long distance markets until its share dropped below 40% eleven years later. "In a series of orders, the Commission distinguished two kinds of carriers -- those with market power (dominant carriers) and those without market power (non-dominant carriers). The Commission gradually relaxed its regulation of non-dominant carriers because it concluded that non-dominant carriers could not charge rates or engage in practices that contravene the requirements of the Communications Act of 1934 as amended (Act), since affected customers always had the option of taking service from

Moreover, while under the UNE-P/TELRIC regime AT&T and MCI have won substantial numbers of mass market local service (or bundled local and long distance) subscribers in New York – serving 1.1 million and 500,000 access lines respectively[39] – it is unlikely that replacement competitors can maintain or increase MCI and AT&T's market shares. The future of UNE-P as a robust vehicle for competitive entry, as envisioned by the Telecommunications Act of 1996, has been cast into doubt by the D.C. Circuit's *USTA II* decision[40] and the FCC's subsequent *TRRO* order.[41] In response to these regulatory changes, MCI and AT&T ceased marketing to residential and small business customers.[42] As individual interconnection

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a dominant carrier whose rates, terms and conditions for interstate service remained subject to close scrutiny by the Commission. The Commission concluded, however, that AT&T, as a dominant carrier, should be subject to the "full panoply" of then-existing Title II regulation.." *In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier*, Order adopted October 12, 1995, 11 FCC Rcd 3271, ¶ 4.

[39] White Paper at 9.

[40] *See United States Telecom Assoc. v. FCC*, 359 F.3d 554 (D.C. Cir. 2004) (rejecting the FCC's delegation to state regulators the determination of CLEC eligibility for discounted UNEs*)*.

[41] FCC WC Docket No. 04-313; CC Docket No. 01-338 - *In the Matter of Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* Release DA 05-675, March 14, 2005.

[42] June 23, 2004 AT&T release, *AT&T To Stop Competing In The Residential Local and Long-Distance Market In Seven States*, "The reversal of local competition policy by the Administration will permit the Bell companies to raise wholesale rates as early as November. This increase in wholesale rates means that AT&T will likely be unable to economically serve customers with the competitive bundles currently available." http://www.att.com/news/2004/06/23-13121. December 15, 2005 AT&T release, *AT&T Response To The FCC's Adoption Of New Network Unbundling Rules*, "Today's order clearly eliminates the most significant, and sometimes only, competitive alternative for American residential customers. In addition, the order eliminates access to facilities where they are often needed the most by facilities-based competitors that serve America's business customers." http://www.att.com/news/2004/12/15-2. October 18, 2004 MCI release, *MCI Announces Impairment Charges*, "Due to recent regulatory decisions impacting its consumer business and an increasingly competitive industry environment,

agreements expire over the next year or so, and commercial agreements are renegotiated without the assurance of UNE rates based on the FCC's pricing methodology of total element long-run incremental cost ("TELRIC"), the UNE-P mode of entry will inexorably wither. Verizon's dominance of the market will increase accordingly

**2. Future competition in New York by AT&T would likely diminish if it is bought by SBC**.

AT&T's acquisition by SBC will likely put an end to local mass market competition in New York from the merged entity. Any effort by SBC to compete post-merger in Verizon's footprint would risk would triggering Verizon entry into SBC's own territory. As noted earlier, SBC has avoided direct competition with Verizon and other RBOCs in the past. The record does not demonstrate that they would have incentives to alter this historical behavior pattern post-merger.[43] More likely, each RBOC will re-trench within its existing footprint.

**3. Nascent intermodal competition for mass markets cannot reasonably be relied upon to offset the anti-competitive effects of the mergers.**

The AG cautions the Commission against over reliance on new intermodal competitors such as digital subscriber line ("DSL") reliant voice over Internet protocol ("VoIP") and cable telephony as potential competitive checks on Verizon's post-merger ability to exercise market

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the Company will record non-cash impairment charges of approximately $3.5 billion." www.global.mci.com/about/news/news2.xml?newsid=12131&mode=long&lang=en&width=530&root=/about/&subroot=news/news2.xml. " 'This is a sweet spot for wireline, wedged in between AT&T and MCI's exit from the consumer business, and prior to a meaningful impact from cable telephony,' wrote [Goldman Sachs analyst Frank] Governali. In the wake of an unfavorable regulatory ruling last year, AT&T, MCI and other smaller telecom companies have been pulling back from the market for residential phone service." *US Bells Seen Posting 4Q Growth, Poised For Strong '05,* Dow Jones Newswire, January 18, 2005.

[43] *See* discussion *supra*, pp. 7-8.

power. While these new technologies may hold promise for significant growth in the future, they are unlikely to gain sufficient market share within two years of the proposed mergers.[44] Cable providers, for example, currently serve only 1.5% of the national small business telephone market, as compared with 28% combined market share for Verizon-MCI and 27.9% for SBC-AT&T.[45] As Staff notes, "most small and medium businesses are not 'cabled-up'."[46] Staff similarly estimates that Vonage, the leading Internet VoIP provider, serves only 45,000 New York customers, a "1.8% market share."[47] Regarding wireless competitors, the Commission has found that of four million retail lines lost by Verizon between 1999 and 2004, 2.8 million lines shifted to UNE-P and resale CLECs while only 1.2 million lost lines can be attributed to the *combined* impacts of facilities-based carriers, wireless carriers, cable modems and DSL replacing second lines.[48]

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[44] *See 1992 Horizontal Merger Guidelines* at § 3.2 (Generally, significant impact on price will be presumed unless entry within two years is feasible.) *See also National Association of Attorneys General Horizontal Merger Guidelines* at § 5.12; *Natsource LLC. v. GFI Group, Inc.*, 332 F. Supp. 2d 626, 636 (S.D.N.Y. 2004) (inability to enter within two years suggests high entry barriers).

[45] *See* Belson, Ken, *Not Just TV: Cable Competes for the Office Domain*, New York Times, August 3, 2005 (citing data from Yankee Group).

[46] White Paper, at 31.

[47] *Id.*, at 23, fn. 55.

[48] 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 p. 21, fn. 25. Moreover, recent reports and commentary note increasing substitution of wireline service with wireless among young consumers, but this is far less prevalent among the general population. FCC data shows that after November 2003 when mobile phone number porting began, 9 times as many phone number were ported from landline to landline providers than from landline to mobile and 631 times as many number were ported from mobile to mobile providers than from mobile to landline providers. FCC *Trends in Telephone Service,* April 2005, Table 8.10.

In 2002, against the backstop of UNE-P pricing, the PSC was prepared to accept that CLEC entrants competing for mass market local customers could serve to check Verizon exercise of market power.[49] But the UNE-P backstop is soon to vanish. Similarly, the future growth of VoIP and cable entrants is too uncertain to serve as a check on Verizon's monopoly power post-merger. Under established antitrust merger review standards, such potential new entrants would not qualify as adequate replacements for MCI and AT&T.

**4. Delaying the mergers' impacts with merger conditions would not assure that intermodal competitors would check Verizon's market power exercise.**

The AG agrees with Staff's finding that, unless Verizon is required to make DSL service available to customers on a stand-alone basis, rather than bundling it with local voice offerings, DSL-based VoIP services will not stand much chance of becoming an effective substitute for wireline voice services.[50] As we noted in our April 29, 2005 preliminary comments, residential customers must be able to smoothly port their existing Verizon phone numbers to any VoIP provider they choose, while retaining DSL service at a cost that enables Vonage, Packet8 and other such emerging competitors to challenge Verizon's local voice offerings. Verizon, by virtue of its control of customer access to DSL, wields a bottleneck facility upon which VoIP competitors depend.

Another reason to discount reliance on new cable and DSL-VoIP entrants is that these technologies are not ubiquitously available in New York. Even if Verizon follows through with

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[49] The Commission adopted a new regulatory regime which, *inter alia*, allowed Verizon to increase basic residential retail rates by set amounts in each of two years while extending to CLECs favorable wholesale rates on UNE-P. Cases 00-C-1945 and 98-C-1357 - *Order Instituting Verizon Incentive Plan*, issued February 27, 2005.

[50] White Paper, p. 23.

and maintains its professed policy to allow stand-alone DSL, customers located more than three miles from the Verizon central office serving their premises cannot obtain DSL either for VoIP or for broadband Internet access generally. Also, not all customers who might wish to use cable telephony service are "passed" by cable video systems, and not every existing cable video network has been upgraded to support cable modem and VoIP telephony. Accordingly, there are daunting obstacles hindering effective entry and growth by intermodal competitors.

As another potential remedy for mass markets, the Staff suggests "freezing MCI's rates, terms and conditions for MCI customers for 12 months."[51] The AG believes that this is unlikely to be an effective merger remedy. Postponing the exit of MCI's UNE-P based offering for a year would not resolve the increased market dominance resulting from the merger, but would merely defer the impact for existing MCI customers, while providing no relief whatsoever for the rest of the public.

## D. The Commission Must Address The Verizon-MCI Merger's Potential Adverse Effects On Service Quality.

### 1. Verizon's service quality performance is of critical importance to customers, competitors and New York's economic health.

The AG agrees with Staff "that the quality of telecommunications services is a public interest concern" highly relevant to the Commission's duties in reviewing mergers.[52] Vital public health and safety priorities require that the public switched telephone network, largely operated and maintained by Verizon, be reliable. Beyond the necessity for New Yorkers to be able to call for assistance during emergencies, high quality service is essential to retaining businesses critical

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[51] *Id.* at 26.

[52] *Id.* at 46.

to the economic well being of New York and its citizens.

The Commission should not leave service quality for later consideration, as Staff recommends, but should make it part of this merger review.[53] Even as new intermodal entrants begin to compete with Verizon's wireline business, these entities, like CLECs before them, depend on the reliability of Verizon's network facilities operation. Most calls will continue to be terminated on Verizon's network, regardless of whether the call was placed by a Verizon wireline subscriber, or a caller using a competing VoIP, cable telephony or wireless providers' service. Indeed, VoIP providers such as Vonage and Packet8, which depend on DSL to access the Internet, also rely on Verizon's outside plant maintenance to carry their calls to the Internet as well as to deliver the calls to their ultimate destination. Staff noted that:

> Cable telephone providers rely in large part on Verizon special service circuits to connect to E911 access points. Also, Verizon still remains the "middle man" in most carrier-to-carrier hand offs of local traffic between networks. Staff is not aware of any major communications companies with customers in New York that do not rely upon Verizon high capacity facilities to interconnect to the Verizon network. Staff is also unaware of any major communications company in New York, beside Verizon, to which all other communications companies are connected.[54]

The Commission must ensure that the Verizon-MCI merger does not adversely affect the level of service Verizon provides to New York residents and businesses as well as to its competitors. Bearing in mind Verizon's increased market share and greater market concentration post-merger, its claims of poor earnings from its New York intrastate operations,[55] and its stated

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[53] *Ibid.*

[54] *Id.* at 23, fn. 56.

[55] *Id.*, pp. 61-64.

desire to sell off its upstate New York system due to a disappointing rate of return,[56] the Commission has more reason than ever to take direct measures to ensure the adequacy of Verizon's post-merger service quality performance.

**2. If MCI merges with Verizon, its service quality performance should also be combined with Verizon's measurement.**

The AG does not support Staff's recommendation that if the Verizon-MCI merger is approved, all MCI subsidiaries' "performance data will continue to be separately reported as it is today" including "the waiver from routine reporting of certain service quality metrics."[57] While the PSC has allowed other merging ILECs, such as Frontier of Rochester and Citizens Communications, to report their performance separately post-combination, those prior mergers involved separate networks, which often were not geographically adjacent, and thus would be operated on an independent basis.[58] No such distinction would apply for MCI, which overlaps Verizon and largely uses Verizon's facilities through UNE-P leases, which would become moot post-merger.

The basis for granting MCI a waiver from the full reporting requirements applicable to companies serving over 500,000 customer lines was that, as a UNE-P provider, MCI was unable to exercise control over maintenance of the plant it leased from Verizon and did not employ the

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[56] "The state's largest phone company has suspended talks with potential buyers, without ruling out a sale sometime in the future, according to a statement to workers that was provided by company spokesman Cliff Lee." Buffalo News: *Verizon Drops Plan to Sell Lines Upstate/ Decision Protects 1,500 Jobs in WNY* , October 1, 2004. *See also* White Paper at 48.

[57] *Id.*, at 50; *see also* p. 58.

[58] *See* Case 02-C-1426 - *Citizens Com. Co., Citizens Telecom. Co., NewOp Com. Corp. and Frontier Com. of America, Inc., Order Regarding Merger*, February 10, 2003.

technicians who performed installations and repaired customers' telephone services.[59] After MCI merges with Verizon, this rationale for waiving reporting requirements of installation and repair performance metrics would no longer exist. As a single entity, Verizon would be responsible for maintaining several million customer lines, including those nominally labeled MCI customers.

Similarly, post merger, it makes no sense to measure customer complaints about poor service from MCI's customers separately from those lodged by Verizon's customers.[60] Because the business office and field technician staff serving MCI's customers post-merger will become Verizon employees, complaints about how they serve New York customers will become Verizon's sole responsibility and thus should be counted as such.

**3. The mere presence of alternative providers is insufficient to ensure that the dominant provider will provide adequate service.**

The AG is not persuaded that the Staff's proposed remedy of relying post-merger on customer choice as a substitute for service quality performance regulation would be effective, given Verizon's continued dominance of the mass markets and the significant role of its network for most users, whether or not they are Verizon's subscribers. The mere availability of some alternative providers is not a substitute for competitors who are capable of blunting Verizon's market power. Merely telling customers who are dissatisfied with Verizon's poor service quality performance that they should switch to another carrier or technology will not ensure that New

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[59] *See* August 21, 2001 waiver request of MCI Metro Access Transmission Services, SAPA # PSC-37-01-00003-P; *see also* 16 NYCRR § 603.4(f): "A service provider may request an exemption from any or all of the reporting requirements of this section, if that provider can demonstrate that the services are provided through the resale of another service provider's tariffed services or purchase of another service provider's unbundled network elements (UNEs) over which it has no direct control."

[60] White Paper, pp. 58-9.

York customers receive adequate service.

In a prior merger review, the Commission conditioned its approval on concrete requirements giving the company incentives to improve its service quality performance.[61] Staff recognizes that, unlike other service quality measures that have shown improvement, Verizon's ability to restore service to customers who report losing dial tone within 24 hours lags far below the PSC's performance standard.[62] The AG is also concerned by this lagging service performance.

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[61] Cases 96-C-0603, 96-C-0599, 96- C-0821 - *NYNEX-Bell Atlantic Merger, Opinion Approving Proposed Merger Subject To Conditions*, Opinion 97-8, issued May 30, 1997 at 31-32. Subsequent to Bell Atlantic's acquisition of NYNEX, the company merged with GTE to form Verizon Communications, Inc.

[62] White Paper at 49. The PSC expects all telephone companies serving more than 500,000 lines to restore service within 24 hours 80% of the time. 16 NYCRR § 603.3(k). Whenever a repair bureau fails to meet PSC standard in three of five consecutive months, a service inquiry report must be filed with the PSC identifying the cause for the lagging performance and steps to be undertaken to make improvement. 16 NYCRR § 603.4(e). According to the performance Verizon reports to the PSC, repair bureaus in North and South Nassau, North and South Queens, North and South Westchester, South and East Suffolk, East Hudson and Waterfront (Buffalo) continue to perform below this threshold. Chronic under-performance by these repair bureaus is responsible for all of Verizon's service inquiry reports. *See* Cases 02-C-0543 and 00-C-1945 - *Verizon New York First Quarter 2005 Service Quality Report*, April 25, 2005, and Verizon monthly *Service Inquiry Reports*.

## V. CONCLUSION

The AG concurs in Staff's analysis that enterprise and mass markets are currently highly concentrated, and one or both mergers would increase that concentration dramatically by removing from New York Verizon's two largest competitors. Staff's analysis to date does not demonstrate that the remedies under consideration would be adequate to reverse the potential harm to competition or to protect the public interest.

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Respectfully Submitted,

ELIOT SPITZER
Attorney General of the
State of New York
By:

____________________________
Jay L. Himes
Chief, Antitrust Bureau

Mary Ellen Burns
Special Counsel
Public Advocacy Division

Jay L. Himes
Chief, Antitrust Bureau
Peter D. Bernstein
Jeremy R. Kasha
Assistant Attorneys General

Keith H. Gordon
Assistant Attorney General
Telecommunications & Energy Bureau
*Of Counsel*

120 Broadway
New York, NY 10271
Tel No.: (212) 416-6343
Fax No.: (212) 416-8877
E-mail: keith.gordon@oag.state.ny.us