STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

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.

QWEST COMMUNICATIONS CORPORATION COMMENTS ON THE DEPARTMENT OF PUBLIC SERVICE STAFF WHITE PAPER

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Qwest Communications Corp. ("Qwest") respectfully submits its comments on the Department of Public Service Staff *White Paper*, pursuant to the Notice Soliciting Comments issued on July 6, 2005 in the above-captioned cases.

INTRODUCTION

The Staff's *White Paper* conducts a meticulous analysis of the substantial damage that these proposed mergers would wreak on competition. Qwest respectfully submits, however, that an additional important factor, mentioned but not thoroughly developed in the *White Paper*, is the high likelihood that the merged Verizon-MCI and SBC-AT&T will engage in a tacitly coordinated strategy of "mutual forbearance," further reducing competition and harming purchasers of retail and wholesale telecommunications services in New York State. Given the anticompetitive consequences correctly identified in the Staff's *White Paper* as well as the likelihood of mutual forbearance that would further reduce competition, robust remedies will be needed if these transactions are permitted to proceed, including divestitures, a "fresh look" for certain Verizon customers, and conduct remedies to ensure that merged company does not unfairly discriminate in favor of its own retail operations and against rivals in its pricing and provisioning of local connectivity services.

Qwest's comments address the following issues in the *White Paper*, in turn. First, we explain why Qwest is so deeply concerned about these mergers. Second, we address the *White Paper*'s analyses of market definitions, market power, and the competitive impacts of the mergers, and provide support for the Staff's largely accurate conclusions. Third, we discuss the vertical impact of the Verizon-MCI merger on competition – *i.e.*, the anticompetitive impact of combining Verizon's market power over the "upstream" wholesale markets for local connectivity with MCI's leading position in "downstream" retail enterprise markets. Fourth, we discuss additional competitive impacts due to the interplay between the linked mergers of Verizon-MCI and SBC-AT&T that we believe will reduce competition by an even greater extent than the staff identifies. Finally, while Qwest believes the public interest would best be served if the Commission were to reject these mergers, we discuss in detail the remedies and conditions that we believe are absolutely critical if the mergers are allowed to proceed. In particular, we describe the scope of the divestitures that should be required, a "fresh look" opportunity for certain Verizon customers, as well as the antidiscriminatory pricing remedies that should be imposed upon the merged company.

I. THESE PROPOSED TRANSACTIONS POSE CRITICAL RISKS TO THE FUTURE OF TELECOMMUNICATIONS COMPETITION IN NEW YORK.

The Staff's tentative conclusions in the *White Paper* hit the nail on the head: particularly, but not exclusively, in "the large business (enterprise) and medium size business markets, . . . the Verizon/MCI merger will produce significant consolidation and is, therefore, . . .

troubling." 1/ Qwest agrees. MCI and AT&T play an extremely important role as leading purchasers of special access, and thereby exert pressure on Verizon and other ILECs to discipline the level of rates for special access and other forms of local connectivity. In addition, as the two leading facilities-based providers of local services to retail enterprise customers and of providers of local connectivity on a wholesale basis to carrier customers (including Qwest), MCI and AT&T facilitate competition by other new entrants. By buying their leading competitors, Verizon and SBC would eliminate overnight these major forces.

Verizon, SBC, and their prospective merger partners baldly take the position that these mergers are not a problem. They contend that MCI and AT&T have permanently retreated from most mass market sectors – and they argue that, in any event, going forward, policy makers should rely primarily on intermodal competition from such sources as wireless carriers, cable operators, and VoIP providers.

There are a number of problems with the merger proponents' outlook. First and foremost, it is factually wrong. MCI and AT&T are valuable enterprises, each worth billions of dollars, that are the two leading providers of wholesale local connectivity in competition with Verizon and SBC, as well as being the leading providers of advanced data and voice retail services to large and medium-sized business customers. To be sure, both MCI and AT&T have experienced financial difficulties in recent years. But as Staff correctly concludes about MCI 2/ – and the same is true of AT&T – these companies could survive and prosper, either as

1/ *White Paper* at 6.

2/ *White Paper* at 20-21 ("However, according to equity analyst Bernstein Research, the consumer and small business sectors accounted for 44% of the MCI's revenue or $9.1 billion in 2004, and, absent this merger, Staff would expect MCI to fight to retain that revenue stream, or perhaps find another merger partner who would. . . . Staff notes that MCI's new customer additions show little sign of abating. Further, while MCI's mass market strategy would likely have transitioned from UNE-P, it could retain customers through wireline resale or use of a VoIP platform. A recent check of the MCI website found that the company continues to advertise its bundled local and long distance 'Neighborhood' package, and also its 'Neighborhood Broadband stand-alone companies or in alternative business combinations with other firms that are bringing new competition to Verizon and SBC through the possibilities of the Internet, convergence of technology and media platforms, and other recent advances. Any of those alternatives would better serve the public than allowing MCI and AT&T to be swallowed up by the two most dominant telecommunications companies, to whose overwhelming market power AT&T and MCI pose the most important competitive challenges.

Second, and more fundamentally, the viewpoint offered by the merger proponents is fundamentally pessimistic – unnecessarily so, in Qwest's view. These mergers are anything but inevitable, and are *not* driven by the competitive changes in the telecommunications marketplace. To the contrary, these mergers would thwart the competitive development of the telecommunications marketplace by eliminating the two companies that present the most serious challenges to the leading wireline carriers with the greatest market power. The Verizon merger obviously would eliminate MCI outright as a competitor. Furthermore, as we discuss in detail below, the merged SBC-AT&T would be unlikely to compete anywhere near as broadly and actively as AT&T has in the past, consistent with the long-standing practice of SBC and Verizon of limiting wireline competition in one another's regions and focusing on what SBC calls its "sweet spot" – customers located primarily in their own respective regions. No other competitive carrier in New York has the decades of experience or the billions of dollars of capital that have been invested by AT&T, MCI, and the companies they have purchased over the years (including Teleport Communications Group, MFS, Brooks Fiber, and others). And no other carrier has the billions of minutes of traffic and the enormous customer bases that justify the maintenance and expansion of the networks that those carriers have deployed to date. In

Calling' VoIP service on its website. Staff . . . ascertained that the service is currently available in New York.").

essence, these two mergers would substantially reduce or eliminate local competition in New York state and across the country.

Qwest's own experience testifies to the importance of MCI's and AT&T's role in the local access market. Qwest is authorized to provide local and interexchange services in New York, and offers a number of voice and data products and services, including:

(1) long distance voice services for business and residential customers;

(2) advanced data services – ATM/frame relay, local and long distance private line, web hosting, dedicated Internet access, and other telecommunications and information services – for medium-sized and large business customers; and

(3) a variety of VoIP packages, targeted to business customers.

Qwest has made significant investment in local and long haul network facilities in New York. In addition to using its own network, Qwest relies heavily on local connectivity from other carriers, including Verizon and MCI. Qwest purchases special access services and similar forms of local connectivity offered under other names – interoffice transport, high capacity loops, and other network services – primarily from Verizon. Qwest actively seeks alternatives through other carriers, and has obtained lower cost special access by using MCI bypass facilities in some areas. Thus, the existence of MCI as an alternative provider is important to Qwest. However, even more important is MCI's and AT&T's roles as effective "price regulators" to the special access that Qwest and other carriers purchase from Verizon. In most instances, Qwest has no alternative other than Verizon. Qwest's long haul facilities typically terminate at a POP in the various MSAs in which Qwest provides services. From there, Qwest must find a way to move customer traffic, inbound, and outbound, between the Qwest POP and the numerous customer premises it needs to reach. Only Verizon has nearly ubiquitous facilities to the customer locations in its serving territory. Absent remedial conditions, the removal of AT&T and MCI from the market will likely lead to increases in the Verizon's special access rates.

In sum, the best way to preserve and promote vibrant local competition in New York would be to prevent consummation of these proposed mergers. Short of that, robust conditions are needed to remedy the anticompetitive impacts of the transactions, as discussed below.

II. THE STAFF'S ANALYSES OF MARKET DEFINITIONS, MARKET POWER, AND COMPETITIVE IMPACTS ARE ON TARGET.

The Staff has conducted an analytically rigorous examination of the impact of the proposed transactions on the telecommunications marketplace. Qwest believes that the market definitions used in the *White Paper* are generally reasonable in this context, and the analytical approach and the conclusions it reaches are on target. As the *White Paper* concludes, the Verizon-MCI merger clearly would substantially harm competition in enterprise markets (medium-sized and large business customers), and in markets for local access services – interoffice transport and high capacity loops – which in turn will have negative impacts on competition in retail enterprise markets. Moreover, as discussed in Section IV of these comments, these anticompetitive consequences would be exacerbated by the concurrent merger of SBC with AT&T, which effectively would reduce the extent to which AT&T can be expected to continue to engage in active local competition against Verizon.

Most tellingly, neither Verizon/MCI nor SBC/AT&T provided any evidence in their submissions before the Commission regarding the appropriate market definitions or the impacts of their proposed mergers, as measured and quantified using widely accepted metrics such as Herfindahl-Hirschman Indices ("HHIs"). 3/ One would think that, if the merger applicants had any basis for showing that their proposed transactions had no significant impact

3/ *See White Paper* at 15-17; *cf.* U.S. Dept. of Justice & Federal Trade Commission, *Horizontal Merger Guidelines* § 1.5 (rev. Apr. 8, 1997) ("*Horizontal Merger Guidelines*") (explaining use of HHIs in analyzing mergers and market concentration).

on competition or market concentration, they would have every interest in providing data and antitrust analysis that would prove it. Their utter failure to provide such evidence speaks volumes.

By contrast, Staff has done a thorough job of culling and analyzing the data available and utilizing it to reach reasonable conclusions about the impact of these mergers upon competition. First, Staff's *White Paper* utilizes a widely accepted methodology for analyzing market power and competitive impacts in the merger context, including the use of the U.S. Department of Justice and Federal Trade Commission's 1997 *Horizontal Merger Guidelines* and the 2004 *Antitrust Division Policy Guide to Merger Remedies*. 4/ Qwest concurs that these documents provide generally appropriate analytical frameworks for the Commission to apply to the present transactions. In addition, the Commission must not lose sight of the fact that, in addition to the *horizontal* competition problems posed by these mergers, the mergers also raise substantial *vertical* competition problems, which we discuss at greater length below. Moreover, in addition to the pure matters of antitrust and competition policy and law addressed in the Staff's *White Paper*, the Commission has a responsibility to fulfill its statutory mandate under the New York Public Service Law to advance the "public interest, convenience, and necessity," and this may require consideration of additional factors. That said, and as noted above, Qwest generally concurs with the methodology utilized in the *White Paper*.

In particular, Qwest believes that the relevant product markets that Staff has identified are eminently reasonable for purpose of this merger analysis. In particular, with respect to local connectivity (access) services sold to carrier customers, Staff has avoided falling into the trap laid by the merger proponents of examining all these services in a single set of

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4/ *White Paper* at 15-17.

product markets. Instead, Staff correctly considered interoffice transport separately from high capacity loops. For the sake of simplicity, Qwest accepts Staff's decision to group together products with disparate capacities (*e.g.*, DS1, DS3, OCn, etc.) and other characteristics. The network facilities used to provide interoffice transport versus high capacity loops are completely different and cannot be substituted for one another, and the pricing and other characteristics of these markets are also completely different, as the FCC has recognized in both its special access proceedings and its *Triennial Review Remand Order*. 5/

Qwest agrees with Staff's view that these mergers result in extraordinary increases in concentration. Qwest further concurs with the Staff's tentative conclusion that "the acquisition of the second . . . largest wholesale provider by the largest provider of high capacity loop access services (Verizon) will significantly increase market concentration in the transport and special access markets. This may result in an unequal bargaining position for small carriers which, at some point, could result in the elimination of the favorable rates, terms and conditions currently offered by MCI to smaller carriers" 6/ – as in Qwest's experience. In each of these cases, the mergers would increase market concentration to beyond the point raising significant competition policy concerns.

5/ *See, e.g., Access Charge Reform*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd 14221, ¶¶ 100-07 (1999) ("*Pricing Flexibility Order*"), *aff'd sub nom. WorldCom v. FCC*, 238 F.3d 449 (D.C. Cir. 2001); *Triennial Review Remand Order*, ¶¶ 69-77, 149-54.

6/ *Id.* at 42, 44.

III. THE VERIZON-MCI MERGER WOULD UNDERMINE RETAIL ENTERPRISE COMPETITION BY HEIGHTENING THE MERGED COMPANY'S INCENTIVE AND ABILITY TO ENGAGE IN VERTICAL ANTICOMPETITIVE CONDUCT.

Qwest urges the Commission to take into account the likely vertical impacts of the Verizon-MCI merger, which are difficult to quantify, but very straightforward to predict. 7/ High capacity data and voice services provided on a retail basis to enterprise customers depend entirely on local connectivity – interoffice transport and high capacity loops – as "input" services. In antitrust parlance, the special access and other local connectivity offerings are "upstream" services, while the retail enterprise services are "downstream" services. Qwest does not dispute Staff's recommendation that "a direct retail based remedy is not required" in the retail enterprise market, given the close interrelationship between the retail enterprise market and the wholesale markets for interoffice transport and high capacity loops. 8/ However, by the same token, the Commission should keep in mind that the anticompetitive impacts on the retail enterprise market could be even more substantial than is indicated by the quantitative, horizontal analysis conducted by Staff. In other words, the HHIs are important, but they do not tell the entire story.

The proposed merger of Verizon and MCI would give Verizon the ability and incentive to leverage its substantial market power over local connectivity and project that market power into the retail market for advanced data and voice services to large enterprise customers. Verizon alone (without MCI) is already powerful in this market sector, but does not play as leading a role as MCI. Thus, the merger would not only eliminate MCI as a direct competitor of Verizon in the retail enterprise market; it will also substantially increase Verizon's incentives to

7/ *See* Declaration of B. Douglas Bernheim, at pp. 30-32 (April 25, 2005) (discussion of "Vertical Impacts") (attached to Qwest Comments, Case No. 05-C-0242, filed April 28, 2005); *see also* U.S. Dept. of Justice, "Non-Horizontal Merger Guidelines" (June 14, 1984), available at http://www.justice.gov/atr/public/guidelines/2614.htm ("Non-Horizontal Merger Guidelines").

8/ *White Paper* at 33. Staff's recommendation – and Qwest's support for that recommendation – are premised upon Staff's separate recommendations that remedies be imposed in the context of those upstream markets.

engage in anticompetitive conduct to harm its retail competitors and strengthen its own high end enterprise operations. The combination of Verizon's dominance over local special access services throughout New York State with MCI's leading position in the retail enterprise marketplace would give the combined company – unlike Verizon standing alone – the ability and incentive to impose price squeezes and engage in other forms of discrimination against retail competitors for enterprise customers, including Qwest. Ultimately it is business customers who would be harmed if the merger were allowed to proceed without adequately robust conditions to remedy such potentially severe anticompetitive conduct.

Following the merger, the combined Verizon/MCI could discriminate in favor of its own retail enterprise operations and against rivals in a number of ways, most of which would be relatively difficult to detect or prevent. First, the company could offer itself higher quality of access service than it provides to competitors. 9/ For example, by providing more prompt installation of new circuits or more effective maintenance and repair of existing service, the merged company could give itself discriminatory benefits that would be very difficult to monitor or detect, but that could seriously harm rival providers' ability to compete effectively. The Commission is well aware of Verizon's deficiencies in providing higher service quality to itself than to its rivals in past years; the merger would provide substantially greater incentives to engage in similar or worse behavior going forward, given MCI's leading position in the retail enterprise marketplace.

Second, Verizon could impose discriminatory "price squeezes" upon its rivals for retail enterprise services by simultaneously reducing retail rates and raising the prices of the

9/ The *White Paper* recognizes that the merger could have a negative impact on wholesale service quality, *White Paper* at 55-56, but does not adequately address the key problem – the potential for Verizon to discriminate in providing superior service quality to itself or its own affiliates (including MCI), and inferior service quality to competing carriers.

indispensable wholesale input service, special access (or other forms of local connectivity), including both interoffice transport and high capacity loops. 10/ The impact of such anticompetitive pricing strategies in the enterprise market would be clear. The acquisition of MCI, one of the largest suppliers in the retail enterprise market, would give Verizon a significantly greater incentive to exploit its market power over special access to anticompetitively assist the merged firm in the retail enterprise business. For example, Verizon effectively could impose a price squeeze by increasing all retail enterprise providers' access costs, even if Verizon were to charge all providers nominally identical special access rates. In effect the merged company's retail operations would have a major advantage, since the charges paid by the merged company would not have any material impact – out one pocket and back in the other. The "true" marginal cost of special access to MCI will be Verizon's marginal cost of supply no matter what transfer price Verizon may charge MCI for special access. By contrast, the marginal cost of special access to MCI's competitors – including Qwest – would be the supra-competitive price that Verizon actually charges those competitors. 11/

10/ *See generally FPC v. Conway*, 426 U.S. 271 (1976); *City of Batavia v. FERC*, 672 F.2d 69 (D.C. Circuit 1982); *Bethany v. FERC*, 670 F.2d 187 (D.C. Cir. 1981); *United States v. Aluminum Co. of America*, 138 F.2d 416, 436-38 (2d Cir. 1945).

11/ Verizon can charge downstream affiliate MCI the same supra-competitive price that it charges MCI's enterprise competitors and MCI can include that supra-competitive price as a line item on any competitive bids that it makes to prospective retail customers. From all outward appearances, there would be no obvious price discrimination for special access in favor of MCI. However, it would be economically rational and profit-maximizing for MCI to adjust downward its prices on the non-special access elements of the retail enterprise service package to reflect the true "marginal cost" of special access to MCI. For a complex, multi-faceted, customer-specific package, such discrimination in favor of MCI would be almost impossible to detect by outside observers. The price discrimination will enable MCI to steadily expand its market share at the expense of its "higher cost" competitors.

One might argue that Verizon is already in a position to maximize its profits on special access, so that any further price increases (or decreases in service quality) would be offset by a reduction in sales large enough to make such moves unprofitable. However, post-merger, Verizon's integration with MCI would give it additional incentives to increase special access rates. At that point, further increases in special access rates would not affect the merged company's "downstream" operations (which would continue to face the same, true marginal costs of local connectivity), but they would give the company's "downstream" retail operations a significant competitive advantage over its rivals, and would help impel enterprise consumers to select

Third, given that the merged company's retail enterprise side would be able to obtain local connectivity, in effect, at true marginal cost, it would no longer have the incentive that MCI has today to offer excess capacity on a wholesale basis to other CLECs or to rivals in the enterprise business. So Qwest, for example, would no longer be able to rely upon MCI as an alternative to buying Verizon special access.

IV. THE COMMISSION SHOULD TAKE INTO ACCOUNT THE RISK THAT COMPETITION WILL BE FURTHER REDUCED IF BOTH THE VERIZON/MCI AND SBC/AT&T MERGERS ARE ALLOWED TO PROCEED.

The proposed SBC/AT&T merger is significant to competition and consumers in New York State due to the likely coordinated impact of that merger with the proposed Verizon/MCI merger. 12/ The two nearly simultaneous RBOC/IXC mergers raise very significant risks of "mutual forbearance" – that post-merger, the two gigantic companies would compete less vigorously in one another's regions than MCI and AT&T did pre-merger. Another way to express this concept is that the two merged companies would tacitly engage in a strategy of: "I will not undercut your special access rates to competing carriers in your territory if you do not undercut my special access rates to competing carriers in my territory." 13/ Indeed, Verizon's own predecessor, GTE, characterized a similar form of tacit collusion in the long distance sector as a form of "mutually assured destruction." 14/ The likelihood that AT&T, as a

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Verizon/MCI rather than any other competitor. *See, e.g.*, Michael Riordan and Steven Salop, *Evaluating Vertical Mergers: A Post-Chicago Approach*, 63 ANTITRUST LAW JOURNAL 513 (1995).

12/ The proposed merger of SBC and AT&T, *standing alone*, might not have a significant competitive impact in New York, given SBC's minimal presence in the state to date. *White Paper* at 72-73. However, to analyze the SBC/AT&T merger standing alone would vastly understate the significance of that merger to competition in New York.

13/ Declaration of Simon Wilkie, ¶ 30, attached to Cbeyond Communications, et al., Petition to Deny, *SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65 (FCC, filed April 25, 2005) ("*Wilkie Declaration*").

14/ "Indeed, economists have long recognized that continued excess capacity can serve as a deterrent to new entry or price-cutting by signalling that retaliation will be a low-cost, rational, and credible strategy. That wholly-owned subsidiary of SBC, will compete less vigorously across a range of markets in the future than it has done in the past as an independent company creates even greater cause for concern about the anticompetitive impacts of the Verizon/MCI merger, as well as the SBC/AT&T merger.

There is ample evidence indicating that "mutual forbearance" historically has occurred and that both Verizon-MCI and SBC-AT&T have powerful incentives to continue engaging in mutual forbearance post-mergers. SBC, for one, has candidly admitted that it is most interested in competing for large enterprise customers in its "sweet spot" – *i.e.*, those business customers that have a majority of their demand in locations where SBC is the ILEC – because SBC has a cost advantage over other carriers with respect to those customers. 15/ SBC can be expected to continue this strategy post-merger, since it will continue to face the same cost

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is, each incumbent holds a 'club' over the others and over prospective new competitors – *in essence, mutually assured destruction* – that keeps both entry and a price war at bay." GTE Comments at 19, Applications of WorldCom, Inc. and MCI Communications Corp. for Transfer of Control, CC Docket No. 97-211 (FCC, filed Jan. 5, 1998) (emphasis added) (citing, *inter alia*, J. Tirole, THE THEORY OF INDUSTRIAL ORGANIZATION, Chapter 8 (MIT Press 1989)). MCI and AT&T also understood the dangers of mutual forbearance, when they themselves were in the business of opposing mega-mergers of the sort proposed here. *See* Comments of MCI WorldCom, Inc. at 30-32, *In the Matter of GTE Corporation, Transferor and Bell Atlantic Corporation, Transferee for Consent to Transfer of Control*, CC Docket No. 98-184 (FCC, filed Nov. 23, 1998) ("Indeed, approving the pending Bell Atlantic-GTE merger along with the pending SBC-Ameritech merger would be tantamount to carving most of the United States into two huge regions each controlled by a single monopolist – 'Bell West' . . . primarily in the Midwest, Southwest, and West, and 'Bell East' . . . primarily in the East. . . . two monopolists who have steadfastly resisted at every turn any progress toward local exchange competition in this country . . . ."); *see also* Comments of MCI WorldCom, Inc. at 15-17, *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor to SBC Communications Inc., Transferee*, CC Docket No. 98-141 (FCC, filed Oct. 15, 1998); Petition of AT&T Corp. to Deny Application at 34-35, *In the Matter of GTE Corp., Transferor and Bell Atlantic Corp., Transferee, for Consent to Transfer of Control*, CC Docket No. 98-184 (FCC, filed Nov. 23, 1998) ("For example, while post-merger SBC would be well poised to attack Bell Atlantic's most profitable market through its SNET territories, Bell Atlantic would likewise be well positioned to attack SBC in Los Angeles from GTE's Orange County territory. So while SBC may have incentives to enter the New York City metropolitan area, it knows that doing so would put its most lucrative market at risk to a significant competitor. Such 'mutually assured destruction' scenarios greatly facilitate maintenance of the status quo in which both Bell Atlantic and SBC benefit by maintaining their monopolies.").

15/ "SBC focuses its attention on competing to provide services to business customers in its 'sweet spot,' which refers to businesses with locations predominantly located within SBC's footprint." Declaration of James S. Kahan, Senior Executive Vice President for Corporate Development, SBC, at ¶ 27, WC Docket No. 05-65 (filed with FCC Feb. 21, 2005).

advantages for customers in its "sweet spot" and disadvantages for customers outside it, including customers in New York State. 16/

Moreover, mutual forbearance is nothing new. In part due to concerns over the potential for the reduction in competition due to mutual forbearance at the time of the Bell Atlantic-GTE and SBC-Ameritech mergers, the FCC imposed merger conditions requiring both Verizon and SBC to engage in substantial out-of-region entry. 17/ While both companies claim to have satisfied the letter of their respective merger conditions, it is indisputable that neither company has established any real market presence outside their respective home regions. For example, as the Commission is well aware, SBC – despite its base in nearby Connecticut – has virtually no retail or wholesale customer base in New York, and Verizon has almost no service in Connecticut beyond the small area where it is the ILEC. 18/ It would have been easy for SBC and Verizon to have invaded one another's territories in the past, yet both have largely forborne from doing so.

16/ While Mr. Kahan claims that this strategy would change once SBC acquires AT&T, he concedes that the principal reason the "sweet spot" strategy is beneficial for SBC today is because the company has network management and cost advantages in locations where it owns all necessary network facilities. *Id.* at ¶ 25. Even post-merger, the combined SBC/AT&T would continue to have enormous relative advantages due to ownership of network facilities within the traditional SBC region, and relative disadvantages in New York and other areas outside SBC's home region.

17/ *Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control*, 14 FCC Rcd 14712 (1999), *subsequent history omitted*; *Application of GTE Corp., Transferor, and Bell Atlantic Corp., Transferee, for Consent to Transfer Control*, 15 FCC Rcd 14032 (2000), *subsequent history omitted*.

18/ CLEC representatives have filed maps in the FCC proceedings, based on GeoResults data, comparing the extensive activities of independent CLECs in the Stamford MSA (serving a total of 1,329 buildings) with the extremely limited activities of SBC and Verizon outside their respective ILEC footprints in that MSA (only 5 SBC CLEC appearances in Verizon's ILEC territory and 3 Verizon CLEC appearances in SBC's ILEC territory). *See* Professor Simon J. Wilkie, "Further Analysis of Competitive Effects of the Proposed Mergers of SBC/AT&T and Verizon/MCI," attached to *ex parte* filing of Alliance for Competition in Telecommunications, WC Docket Nos. 05-65 and 05-75, at 14-15 (FCC, filed July 28, 2005) (available at http://gullfoss2.fcc.gov/prod/ecfs/retrieve.cgi?native_or_pdf=pdf&id_document=6518051809).

It is no answer to say, as SBC and Verizon do, that they are spending billions dollars to acquire their respective merger partners and would not do so if they did not intend to compete. 19/ To the contrary, it may be worth those billions if they enable SBC and Verizon to compete more effectively in their respective regions and foreclose other parties – most of all, one another – from entering, or from undercutting one another's prices. Either merged company would reap benefits if the lost profits from foregone bidding in the wholesale/resale markets in the other firm's territory are exceeded by the gains in their respective home markets from higher special access revenues and reduced competitive pressures on retail prices. "This analysis does not imply that SBC buys AT&T's assets and chooses not to use them," nor does it "require SBC to exit the markets in Verizon's territory." 20/ However, even though the merged SBC/AT&T can be expected to continue operating in New York and elsewhere outside the SBC region, there is a substantial likelihood that the company will compete less vigorously and less actively than AT&T did as an independent company – thereby reducing the competitive pressure faced by the merged Verizon/MCI.

If the Staff had taken into account the likelihood of mutual forbearance, then it would have found even higher levels of market concentration resulting from the mergers than those indicated by the already anticompetitively high HHIs reported in the *White Paper*. For example, consider the data on the interoffice transport market reported in the *White Paper*, 21/ but suppose that not only are Verizon and MCI merging, but also that AT&T is no longer competing actively to attract new customers in the local marketplace due to the "mutual

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19/ *See, e.g.*, SBC/AT&T Reply Comments at 11-12, Case No. 05-C-0242 (filed May 13, 2005); Verizon/MCI Reply Comments at 57, Case No. 05-C-0237 (filed May 13, 2005).

20/ *Wilkie Declaration*, ¶¶ 32, 33. *See also id.* at ¶ 34 & n.12, citing J.J. Laffont, P. Rey, and J. Tirole, *Network Competition: Overview and Nondiscriminatory Pricing*, 29 RAND JOURNAL OF ECONOMICS 1-37 (1998).

21/ *White Paper* at 34-35.

forbearance" incentives of its new parent company, SBC. Qwest is unable to recalculate the HHIs, since the underlying data on which they were based are confidential, but it is clear that the results under this set of assumptions would be significantly worse than the results reported in the *White Paper*.

In sum, it is clear that the horizontal effects of the Verizon/MCI merger are far worse when the concurrent impacts of the SBC/AT&T merger are taken into account. Accordingly, the pending SBC/AT&T merger means the threat to competition posed by the Verizon/MCI merger is even greater than it would be otherwise, and the need for remedial conditions is even more substantial than if the Verizon/MCI merger were presented standing alone. Moreover, the Commission could seriously consider imposing remedial conditions on the SBC/AT&T merger as well.

V. THE COMMISSION SHOULD EITHER REJECT THE PROPOSED MERGERS OR IMPOSE STRINGENT CONDITIONS AS REMEDIES FOR THE ANTICOMPETITIVE CONSEQUENCES OF THESE TRANSACTIONS.

Merger conditions are needed to remedy the likely reduction in competition in the markets for interoffice transport and high capacity loops, as well as the closely related, "downstream" retail enterprise markets, due to Verizon's acquisition of MCI, as well as the reduction in the vigorousness of AT&T's competitive activity. Qwest generally agrees with the overall direction suggested in the Staff *White Paper* with regard to remedial conditions – although in several respects we recommend that the Commission impose more stringent requirements on the merging parties. Qwest agrees that the remedies must be tailored closely to address the identifiable competitive harms due to the mergers. 22/ Moreover, Qwest believes that remedies must be focused on ensuring competitive benefits for consumers – and on

22/ *White Paper* at 17*;* U.S. Dept. of Justice, Antitrust Division Policy Guide to Merger Remedies.

protecting *competition*, not *competitors*. Finally, Qwest strongly encourages this Commission to utilize the fullest extent of its jurisdiction to craft remedial conditions that protect competition for the benefit of New York consumers, consistent with its broad authority under Sections 99 and 100 of the New York Public Service Law.

A. Conditions Are Needed to Remedy the Merger's Anticompetitive Impacts on Wholesale Markets for Local Connectivity and the Retail Enterprise Market

First, merger conditions must be devised that address the impacts of the Verizon-MCI merger on horizontal competition for local connectivity services (*i.e.*, special access and other services providing local interoffice transport and local high capacity loop functionality) identified in the Staff *White Paper*. In addition, these conditions must take into account the additional coordinated impact, discussed above, of the "mutual forbearance" incentives created by the parallel SBC-AT&T merger. Specifically, by eliminating MCI as an independent competitor, the merger will deprive wholesale consumers of local connectivity services of the benefits of the lower prices and competitive options that MCI offers *today* – as well as the even broader competition that MCI might have rolled out in *future years*. In addition, the elimination of MCI as an independent competitor – as well as the mutual forbearance incentives resulting from SBC's acquisition of AT&T – mean that Verizon will be subject to much less competitive pressure to reduce its rates and offer high quality services to wholesale customers. As discussed in greater detail below, the optimal solution to these horizontal anticompetitive consequences would be either to prevent the merger or to require divestitures in order to ensure a market structure that includes an alternative competitor as strong as MCI would have been. Additional remedies relating to market structure should also be adopted, such as a "fresh look" requirement (requiring the merged company to allow customers to terminate long-term contracts and change providers with no termination liability).

Importantly, the harmful impacts of these mergers on competition in New York, particularly the Verizon/MCI merger, are not limited to the horizontal impacts analyzed in the Staff's *White Paper* – in addition, as discussed above, there are also likely to be ***vertical*** anticompetitive impacts due to the combination of Verizon's increased power over markets for local special access service with MCI's leading position in the retail enterprise market. Thus, the merger will harm not only competition in the "upstream" markets for wholesale local connectivity services, but also competition in the "downstream" markets for retail enterprise consumers. 23/ Divestitures and other market structure remedies will be necessary, but not sufficient, to address these vertical anticompetitive impacts; in addition, the Commission will need to impose conduct remedies – *i.e.*, requirements governing the post-merger conduct of the combined Verizon-MCI. A number of specific conduct remedies are discussed in detail below.

1. The Commission Must Require Market Structure Remedies, Including Divestitures

First, the Commission should require, as a condition for approving the Verizon-MCI merger, divestitures targeted to remedy the elimination of MCI as an independent competitor serving wholesale customers for local connectivity. This remedy, in turn, would ensure that wholesale customers have "upstream" competitive alternatives in order to ensure a fully competitive marketplace for "downstream" service to retail enterprise customers. Such a divestiture must be sufficient to restore the local competition that will be lost due to the disappearance of MCI as a separate entity from Verizon – including not only the competition that exists today, but also the additional local competition that would have been likely to develop in

23/ The *White Paper* essentially acknowledges as much, without going into an extensive analysis. *White Paper* at 32-33.

the future. Moreover, the transaction must result in a viable marketplace competitor that can effectively replace MCI as a marketplace competitor in the Verizon region.

Specifically, the Commission should not approve the proposed merger unless the applicants agree to completely divest all MCI facilities and customers in the state that overlap with Verizon's business. This would ensure that the nationwide effects of the Verizon-MCI merger are not accompanied by severe concentration in the market for telecommunications and related services in New York State. The Commission should require divestiture of assets including, but not limited to, transport, fiber rings, collocation facilities, entrance facilities and building entrance loops. In addition, the customers must be divested along with the facilities. A sale of empty assets would not address the competitive concerns. Transferring assets without some ability to produce a reasonable revenue stream to the purchaser of those assets would not address the negative impact the merger would have on local competition. There also must be assurances that the merged entity will not immediately seek to reacquire those customers. The Commission should mandate a period during which the post-merger Verizon-MCI entity may not market to the divested customers.

The Commission can draw instructive guidance from Qwest's own experience with a similar proposed transaction in the recent past. Just eighteen months ago, Qwest's corporate parent, Qwest Communications International Inc. ("QCII"), proposed to acquire the assets of a small national CLEC, Allegiance Telecom. In many ways this was a "mini" version of Verizon's acquisition of MCI. In February 2004, the United States Department of Justice ("DOJ") was prepared to accept and file, if necessary, a consent decree providing that QCII divest substantially overlapping Allegiance facilities and customers within its region and provide the divested business with a number of ancillary services to facilitate divestiture. Specifically, Qwest would have agreed to divest, with a few specified exceptions, the following:

- all of Allegiance's switches, routers, transport facilities, and collocation facilities located in the Qwest ILEC region, and associated interconnection agreements;
- all of Allegiance's contracts with customers to provide telecommunications service to in-region locations, as well as related business and customer records and plans for marketing to potential in-region customers;
- all other in-region assets of Allegiance, including real and personal property, regulatory authorizations, intellectual property, and third-party agreements used in connection with Allegiance services provided in-region. 24/

In the *White Paper*, Staff seeks comment on whether requiring divestiture of the MCI New York interoffice transport and fiber loop networks are practical and viable remedies. 25/ Qwest's response is emphatically yes – although we also submit, as discussed below, that divestiture is a necessary, but not a sufficient, remedy to the competitive harms of this merger. Such divestitures have been required, and have been successfully implemented in the past. Both Verizon and MCI have experience with such divestitures. For example, as a condition on the Bell Atlantic-GTE merger that created Verizon, the FCC required divestiture of GTE's Internet backbone operation. The divested company, Genuity, was subsequently sold to Level 3, which continues as a major competitive force in that marketplace. Similarly, when

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24/ *See* Qwest Comments, WC Docket No. 05-65, at 45-48 (filed with FCC, April 25, 2005) (attached to Qwest Comments, Case No. 05-C-0242, filed April 28, 2005). In that case, the bulk of Allegiance's operations were outside of Qwest's ILEC region, and the transaction was strategically aimed at strengthening QCII's ability to compete on a national basis with AT&T and others. Unfortunately, QCII was outbid at the bankruptcy court auction and was not able to close its deal to acquire Allegiance. For that reason the consent decree became moot. Nevertheless, that experience is relevant to the Commission here. The consent decree followed six weeks of substantial discussions with the DOJ Antitrust Division regarding the overlap between Allegiance's and QC's in-region business. This was so despite the fact that Allegiance only served the business market in five MSAs in the QC 14-state region – five cities in which QC faced vigorous competition from AT&T, MCI and other CLECs. Post merger, the combined QCII/Allegiance still would have competed against its two biggest in-region competitors, AT&T and MCI (which, incidentally, is not the case with respect to the SBC/AT&T and Verizon/MCI mergers). Even so, the DOJ was prepared to require that QCII agree to divest substantially *all* Allegiance business operations in the QC region.

25/ *White Paper* at 37, 46.

MCI merged with WorldCom and subsequently with Intermedia, major divestitures of specific portions of those businesses were implemented successfully. Divestiture requirements are a practical, viable, and time-tested remedy to the horizontal anticompetitive effects of mergers like this one.

In addition to divestitures, "fresh look" requirements – *i.e.*, a requirement that incumbent providers allow customers to cancel term contracts with no termination liability, to enable those customers to consider migrating their service to alternative competitors – are recognized as a valuable remedy to anticompetitive harms. 26/ Such a requirement, particularly when imposed as a market structure condition in the context of a merger, can help preserve or restore competition in a marketplace that otherwise would be harmed by the merger. In this case, "fresh look" would counter the strong "lock-in" effect of certain termination liability provisions in term contracts, in order to enable customers to decide whether to take service from the divested company or alternative suppliers, and thereby preserve the competition that would have existed absent the merger.

Thus, as an important ancillary condition to requiring the divestiture of MCI's overlapping facilities and customers, the Commission also should withhold its approval unless Verizon commits to give its access customers the option of terminating their existing contracts

26/ *See, e.g.*, *Federal-State Joint Board on Universal Service*, Report and Order and Second Further Notice of Proposed Rulemaking, 17 FCC Rcd 24952, 24981, ¶ 59 (2002) (universal service context); *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, First Report and Order, 11 FCC Rcd 15499, 16045 ¶ 1095 n.2636 (interconnection agreements); *Expanded Interconnection with Local Telephone Company Facilities*, Second Memorandum Opinion and Order on Reconsideration, 8 FCC Rcd 7341, 7342-59 (1993) (vacated on other grounds); *Competition in the Interstate Exchange Marketplace*, Memorandum Opinion and Order on Reconsideration, 7 FCC Rcd 2677, 2681-82 (1992) (800 bundling with interexchange services). *See also Complaint and Request of CTC Communications, Inc. for Emergency Relief Against New York Telephone*, Order Granting Petition, Case 98-C-0426, 1998 WL 869313, at 4 (N.Y.P.S.C. Sept. 14, 1998) (not reaching the question of "fresh look" but noting that "the Commission has valid authority to disapprove existing contracts of regulated entities"); *Ordinary Tariff Filing of New York Telephone Company*, Order Approving New York Telephone Company's Local Usage Discount Plan, Case 94-C-0816, 1995 WL 270918, at 3 (N.Y.P.S.C. Mar. 31, 1995).

without incurring termination penalties for a period of 12 months after the merger closes. Some customers may choose to not exercise this right. However, the company purchasing MCI's divested facilities should have the opportunity to, in addition to serving MCI's divested customers, maximize the utilization of those facilities by attracting wholesale customers currently served by Verizon. This condition would have the added benefit of placing additional pressure on Verizon to offer special access services under competitive rates, terms and conditions.

2. The Commission Must Require Conduct Remedies

As discussed above, post-merger conduct requirements will also be needed as remedies to the vertical anticompetitive effects of the Verizon-MCI merger. In particular, the merger will create powerful opportunities and incentives for the merged company to use its market power over "upstream" wholesale local connectivity services to discriminate in favor of its own "downstream" retail enterprise operations and against competing retail providers that depend on the merged company's "upstream" services. Strong and enforceable conduct remedies are needed to reduce the likelihood of such discrimination and anticompetitive conduct to the greatest possible extent. In particular, Qwest concurs with the direction suggested by Staff with regard to remedies relating to rates, terms, conditions, and performance metrics for wholesale and retail interoffice transport and fiber loop services. 27/

As discussed above, the Verizon-MCI merger will allow Verizon to eliminate one of its largest competitors. MCI has been able to negotiate contracts for special access circuits, as well as other wholesale inputs, from a position of strength due to its high volume. MCI also has served as a price-constraining force through its role as one of Verizon's largest competitors.

27/ *Id.* at 37, 45-46, 56.

While neither MCI nor AT&T has a network scope that compares to that of Verizon, they do have local networks that provide alternatives to the use of Verizon's special access facilities. Both MCI and AT&T purchased competitive access providers (MCI purchased MFS and Brooks Fiber, and AT&T purchased TCG) that created alternatives to the ILEC. Moreover, the merged company will have incentive to raise prices (or to reduce prices less than it otherwise would have) for local connectivity services, including local interoffice transport and high capacity loops. Such rate increases would have no net impact on the merged company's retail operations, but would impose serious and discriminatory harms on competing providers of retail services to enterprise customers. Thus, merger conditions relating to the pricing of special access and other forms of local connectivity will be necessary to combat these incentives and preserve the competitive opportunities that would have remained in place absent the merger.

In particular, the Commission should withhold its approval unless Verizon commits to offer special access services (or equivalent dedicated loop and transport services) in New York at rates no higher than the lowest rate currently available from either Verizon or MCI, and agrees to keep those prices in place for a fixed period of time. This would ensure stability for special access rates in the initial post-merger period. As a further safeguard, the Commission also should withhold its approval unless the merged Verizon/MCI commits to offer special access and other services in New York at rates, terms and conditions no less favorable than those it receives when it purchases equivalent services outside the Verizon region. This would allow the leverage exerted by the merged Verizon/MCI in its out-of-region markets to serve as a proxy for the same or equivalent services in New York, where MCI no longer would exert pressure to drive lower rates. In addition, the Commission should ensure that Verizon and SBC commit not to enter into reciprocal arrangements to provide one another with more favorable access rates, whether based on "volume" or otherwise, that would facilitate two segregated telecom monopolies in the state. The Commission should also ensure that the merged company commits to make identical and strictly nondiscriminatory rates for all communications services and facilities available to all third parties as it makes available to its own affiliates and to AT&T and SBC – notwithstanding any volume, term, or growth commitments, and notwithstanding any other unrelated provisions of any agreements (*i.e.*, no "all or nothing" contract rule). This would combat incentives for anticompetitive discrimination and create a more level playing field for competitive entrants.

Finally, the Commission should impose strict and enforceable nondiscrimination safeguards, including service level obligations, in the areas of provisioning, grooming, and other performance categories relating to the installation, operation, maintenance, and repair of all forms of local connectivity offerings, including special access services.

B. Conditions Are Needed to Remedy the Merger's Anticompetitive Impacts on Retail Mass Markets

Qwest concurs with the Staff's suggestion that "a Verizon offering of unrestricted 'naked DSL' [would] stimulate intermodal competition" between conventional wireline voice service and VoIP service, by "allow[ing] DSL customers to substitute wireline voice service with VoIP service without having to purchase local telephone service from Verizon." 28/ In their Application, Verizon and MCI cite the technological changes in the telecommunications landscape as proof that the local network is irreversibly open to competition, and contend that inter-modal competition from VoIP already is established in the marketplace as a substitute for traditional circuit-switched service. But the extent to which VoIP may serve as a substitute for traditional circuit-switched service is wholly dependent on the availability of a broadband

28/ *Id*. at 26 & n.65.

connection. The Commission must ensure that VoIP providers can reach their competitive potential by ensuring that the post-merger company commits to provide a stand-alone DSL product to consumers that is free of any use restrictions. If Verizon continues to require customers to purchase its traditional wireline local voice product in order to also receive its broadband product, VoIP providers will be disadvantaged in the marketplace. VoIP providers must have the ability to make their product a true substitute for wireline voice service. This means that they also should be guaranteed connectivity to the PSTN to route VoIP calls, be able to access the E-911 database/selective routers, and have the ability to port telephone numbers within the standard intervals for non-complex porting. Without these guarantees, SBC will be in a position to minimize the effectiveness of VoIP as a competitor in mass markets.

Finally, Qwest generally concurs with the Staff's recommendations regarding the remedies and conditions needed in the area of financial accounting, and that no rate case is necessary. 29/

C. The Implementation of the Merger Conditions Must be Carefully Supervised

Conduct conditions will be ineffective unless they are backed up with strict oversight, measurement, monitoring, and enforcement to guarantee compliance. Thus, the merged company should be required to submit detailed reports to the Commission providing information regarding its compliance with all of the conditions discussed above. The Commission should make it clear that it is prepared to enforce these merger conditions strictly – and that it will back up its enforcement with credible penalties that will provide a serious deterrent.

29/ *Id.* at 68-69.

CONCLUSION

Qwest respectfully submits that, consistent with the Staff's analysis in the *White Paper*, the Commission should either reject the proposed mergers or should impose robust conditions to remedy their anticompetitive effects.

Respectfully submitted,

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