Before the
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
Joint Petition of Verizon New York Inc.	)	
and MCI for a Declaratory Ruling	)	CASE NO.. 05-C-0237
Disclaiming Jurisdiction over or in the	)	
Alternative, for Approval of Agreement	)	
and Plan of Merger	)	

COMMENTS
of
CONSUMER FEDERATION OF AMERICA,
CONSUMERS UNION,
and
NEW YORK. PUBLIC INTEREST RESEARCH GROUP
CALLING FOR REVEIW AND DENIAL OF THE PLAN FOR MERGER

Mark Cooper	Gene Kimmelman	Tracy Shelton
Director of Research	Senior Director of Public Policy	Consumer Attorney
Consumer Federal of of America	Consumers Union	New York Public Interest Research Group
1424 16th Street, N.W.	1666 Connecticut Ave., N.W., Suite 310	9 Murray Street, 3rd Floor
Washington, D.C. 20036	Washington, D.C. 20009	New Yori, NY 10007
301-384-2204	202-462-6262	718/548-2751

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Pursuant to the Notice Soliciting Comments, the Consumer Federation of America (CFA),[1] Consumers Union (CU)[2] and the New York Public Interest Research Group (NYPIRG)[3] (hereafter Consumer Commenters) respectfully submit these comments dealing with the proposed merger of Verizon and MCI. The merger parties have asked the Public Service Commission ("PSC" or "Commission") to disclaim jurisdiction or approved the merger without a thorough review. Consumer Commenters vigorously oppose such action and call on the Commission to give this merger close scrutiny because it will have a devastating impact on consumers of telecommunications services in New York.

The proposed mergers of dominant Bell operating companies and their largest wireline telephone competitors (Verizon-MCI and SBC-AT&T) pending before the Commission will have profoundly anticompetitive effects across the full range of product and geographic markets touched by the merging parties. Consumer Commenters believe not only should the Commission assert jurisdiction over the Verizon-MCI merger, but if not rejected or dramatically altered, this mergers could set the marketplace back to a world more akin to deregulated monopoly than competition.

The Commission has two mergers pending simultaneously that will dramatically alter the overall competitive structure of the industry, removing the two largest non-Bell companies from the marketplace at virtually the same time. It simply cannot ignore the combined impact of the mergers, which involve the four largest firms in the industry in the state. With the largest incumbent local exchange carriers (ILECs) who are also the largest wireless carriers acquiring the largest competing local exchange companies (CLECs) who are simultaneously the largest interexchange carriers (IXCs), we are witnessing the ultimate demise of the consumers' hope for more and more choices and lower prices for local, long distance, wireless, and the new Internet-based services entering the market.

PROMOTING COMPETITION

The Verizon-MCI Merger

Verizon is the dominant local exchange carrier in its home territory by far. It is also the number one long distance carrier and wireless service provider in most of its markets. MCI is the number one or two competitive local exchange carrier in most of Verizon's service territory. It is the second largest unaffiliated long distance company and one of the largest Internet backbone providers.

While MCI had reduced its emphasis in its local residential business based on unbundled network element platform (UNE-P) after the FCC decision to eliminate this platform for competition, it still retains millions of customers throughout Verizon's service areas.

> MCI pressed it role in the enterprise VoIP market, [4] claiming an advanced VoIP service.
> MCI is uniquely positioned to enable the cable industry to rapidly enter the advanced telephony market.
> MCI has the most connected farthest-reaching IP network in the world based on number of company owned POPs.
> MCI has one of the largest local footprints outside of the ILECs.
> MCI is one of the nation's largest long distance providers.
> MCI is widely recognized in VoIP services.[5]

> While it was emphasizing business market services, it MCI had
>
> entered into a multi-year, multi-million dollar agreement with Time Warner Cable to provide consumers with next-generation voice-over-IP (VoIP) communications services utilizing MCI's global voice and data network.

> As a result of the services provided by MCI under the terms of the

> agreement, Time Warner Cable will be able to deploy its residential Internet protocol ("IP") voice service, Digital Phone, nationwide. In addition to providing local points of interconnection to terminate IP voice traffic to the public switched telephone network, MCI will also deliver enhanced 9-1-1 service, local number portability as well as manage network integration and electronic bonding of both companies' order entry systems.[6]

MCI played a key "maverick" role in the industry for decades. Not only did it break open the long distance monopoly for residential customers, but it also pioneered local competition in New York and elsewhere. Because of MCI's competitive leadership, incumbents and competitors are able to offer a uniform package across a large number of markets. MCI initiated the process with its "Neighborhood" program and other companies have followed suit. The ILECs have been forced to match the offers and the resulting consumer savings are totaling huge sums.

Because the state of competition is so important to the policy analysis, CFA developed a multifaceted approach to analyzing local competition including three characteristics – intensity, extensiveness and balance (see Exhibit 1). The intensity of competition is defined as the percentage of residential customers who have switched local carriers. Two factors are used in determining the extensiveness of competition. The first is determining the percentage of zip codes in which there are no CLECs. This indicates the lack of geographic spread of competition. On the other side, the percentage of zip codes with six or more CLECs indicates the availability of competition. The Department of Justice defines a market with 6 or more equal-sized competitors as moderately concentrated.

The third factor is balance. Balance is calculated as the ratio of residential to

EXHIBIT 1: COMPETITION IN THE LOCAL TELEPHONE MARKET

STATE	INTENSITY		EXTENSIVENESS				BALANCE	
	CLEC RES MKT SHARE		NO CLECS IN ZIP CODE		6 OR CLECS IN ZIP CODE		RES RATIO CLEC%/ILEC%	
	%	RANK	%	RANK	%	RANK	RATIO	RANK
New York	23.6	1	5.0	7	52.6	2	0.93	7
Rhode Island	21.2	2	2.8	5	0.0	34	0.97	6
Michigan	20.6	3	8.8	10	39.6	8	0.99	5
Illinois	19.2	4	32.6	27	22.8	13	1.04	2
Nebraska	16.7	5	66.9	38	0.0	38	0.93	8
Kansas	14.6	6	58.6	36	0.9	33	0.82	12
Iowa	14.3	7	36.3	30	0.0	35	1.10	1
Massachusetts	13.4	8	1.0	1	41.5	6	0.77	13
Colorado	13.3	9	26.4	20	19.2	20	0.84	9
Utah	13.1	10	32.3	26	10.9	25	0.83	10
Virginia	13.0	11	21.9	17	21.7	15	1.00	4
District of Columbia	12.6	12	11.1	12	44.4	4	0.76	14
Texas	12.4	13	17.9	15	47.3	3	0.70	23
Georgia	11.6	14	23.5	19	41.5	7	0.74	16
New Hampshire	11.4	15	3.2	6	1.4	32	0.74	17
Minnesota	11.1	16	33.7	28	8.8	26	0.59	32
Pennsylvania	10.7	17	19.5	16	28.9	11	0.61	30
Wisconsin	10.0	18	35.5	29	3.5	29	0.72	20
Arizona	8.9	19	27.5	22	28.9	12	0.71	22
New Jersey	8.6	20	1.5	3	41.7	5	0.83	11
California	8.3	21	10.1	11	37.3	9	0.72	21
Florida	7.7	22	6.7	8	60.9	1	0.58	33
Oklahoma	6.9	23	56.9	35	8.3	28	0.61	31
Arkansas	6.9	24	61.1	37	0.0	37	0.64	28
Ohio	6.9	25	30.0	25	19.3	18	0.73	18
Missouri	6.8	26	48.8	34	11.0	24	0.67	25
Washington	6.2	27	29.8	24	21.8	14	0.58	34
Oregon	5.9	28	17.4	13	2.1	30	0.67	26
Louisiana	5.7	29	26.8	21	20.9	17	0.75	15
Maryland	5.6	30	1.6	4	31.7	10	0.73	19
Mississippi	5.6	31	8.0	9	1.6	31	1.01	3
Indiana	5.4	32	39.8	32	0.0	36	0.70	24
Alabama	5.0	33	36.9	31	8.4	27	0.63	29
Connecticut	4.9	34	1.1	2	21.0	16	0.49	35
Nevada	3.7	35	22.4	18	11.2	23	0.32	37
South Carolina	3.2	36	29.0	23	17.5	21	0.45	36
Tennessee	3.1	37	42.2	33	16.3	22	0.31	38
Kentucky	2.9	38	79.1	39	0.0	39	0.67	27
North Carolina	2.2	39	17.7	14	19.2	19	0.27	39

SOURCE: Industry Analysis Division, *Local Telephone Competition: Status as of December 31, 2002* (Federal Communications Commission, June 2003) business customers for the competitors compared to the ratio for the incumbents. If the CLECs are disproportionately attracting business customers, that would be a major concern for residential competition. Although business customers were the initial targets, as UNE prices have come down, balance has improved.

New York serves as a good example of what happens when local markets are genuinely opened to competition. Consumers in the Empire State have switched companies in droves (2.7 million local and over 1.5 million long distance) since the start of true competition. Companies have engaged in "tit-for-tat" competition, matching each other's price and service offers. As a result, prices for both local and long distance service have dropped substantially (approximately 20 percent for those who shop).[7] Innovative new products, like flat rate service in markets where it had not previously been offered immediately materialized. Later, competition around large "bundles" of services developed.

Overall, New York presents a good standard by which to judge the quality of competition. The New York marketplace ranks high on all three characteristics that taken together help determine the competitive nature of the market. CFA supported the early New York model for opening competition because it was consumer-friendly and CFA hoped that it would serve as the basis for other state models.[8] This is the competition that is threatened by the merger.

Over the years since the passage of the Telecommunications Act of 1996, MCI and AT&T have pursued various approaches to delivering telecommunications products to consumers, including fixed and mobile wireless, cable, resale, UNE-P and facilities based entry. They are the largest current and potential competitors to the Bell operating companies. The foreclosure of the UNE-P approach is recent and the entire CLEC industry is developing alternative models. The elimination of the largest competitors will be a severe blow to the competitive fabric of the telecommunications industry.

The Commission must also evaluate the Verizon-MCI merger in the context of the possibility that AT&T will become a much less vigorous competitor in New York as a result of its acquisition by SBC, because of the well-documented tendency of the Bell Operating Companies to defend their home service areas as fortress regions and avoid head-to-head competition whenever possible.

The SBC-AT&T Merger

SBC is the dominant local exchange carrier in its home territory by far. It is also the number one long distance carrier and wireless service provider in most of its markets. AT&T is the number one or two competitive local exchange carrier in most of SBC 's service territory. It is the largest unaffiliated long distance company.

Applicants claim the proposed merger will not and cannot hurt mass market competition. To support this far reaching assertion, applicants cite AT&T's decision, prior to the merger, to unilaterally cease any efforts to market services actively to the mass market, and thus, absent the merger, AT&T would not be in head to head competition with SBC in the mass market.

There is no dispute that the FCC's recent Triennial Review Order, fully supported by SBC, drove AT&T, MCI and other CLECs from serving the residential mass market through the UNE-P platform, but they were migrating to other technologies.

While AT&T had declared its intention to phase out its local business based on unbundled network element platform UNE-P) after the FCC decision to eliminate this avenue to competition, it still retains millions of customers throughout SBC's service areas. It had also declared its intention to continue to compete in the market relying on voice over Internet protocol (VoIP). Because of the FCC's decision to raise UNE-P prices, AT&T had raised its prices, but it switched to VoIP, which is a lower cost technology that would have alleviated those price pressures. In other words, AT&T had set out on a strategy to remain a viable competitor, a strategy that is cut short by this merger. Verizon lists AT&T as a competitor for local residential service in its application.[9]

In fact, AT&T has hardly withdrawn itself from competing for residential mass market customers. In the face of steep increases in UNE prices, AT&T turned to the VoIP market as a more profitable method of reaching mass market customers.[10] AT&T became an aggressive player in the VoIP market, aiming to become the nation's "premier provider" of competitive VoIP calling plans.[11] AT&T set a goal of winning 1 million business and residential VoIP customers by the end of 2005, according to company officials. [12] Within a few months of the initial roll out of its VoIP offering, and shortly after the FCC's TRO decision, the company engaged in aggressive price cutting of its "CallVantage" plan.[13] AT&T continues to sell local phone service, including VoIP over its website, https://www.callvantage.att.com. Proprietary evidence introduced by consumer interveners in the California merger approval proceeding supports AT&T's strong presence in the VoIP market.[14]

Eliminating AT&T CallVantage as a competitive threat may have been a factor in

SBC's acquisition of AT&T. While AT&T, AOL and others compete in the VoIP market, SBC is struggling to introduce a consumer market VoIP offering.[15] Buying up an established VoIP competitor makes sense for SBC. Speaking at the American Enterprise Institute last month, AT&T Chairman and CEO David Dorman noted that "AT&T's residential Voice over Internet Protocol (VoIP) service, AT&T Call Vantage, would remain an important component of the combined AT&T-SBC consumer bundle."[16]

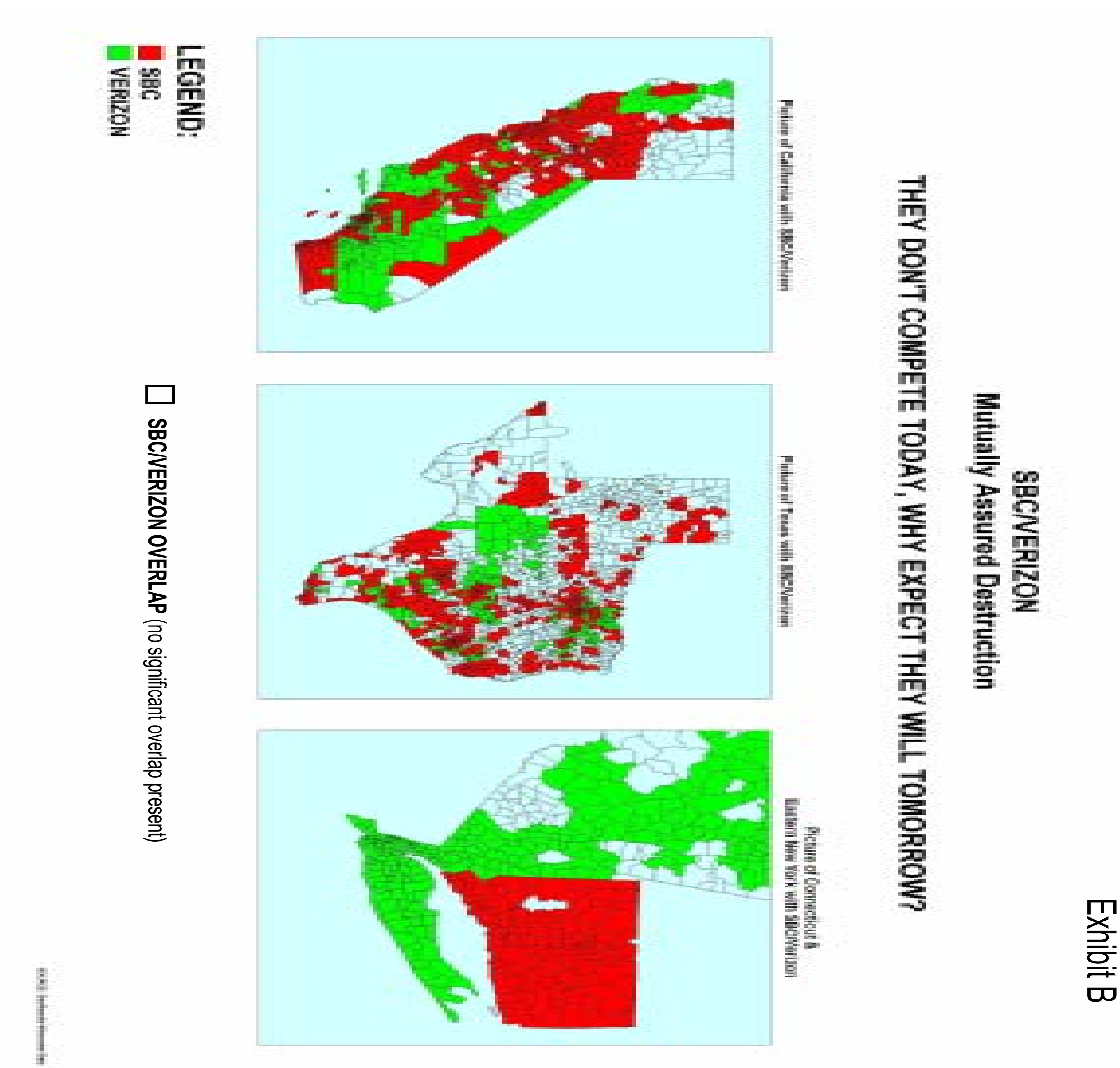
For New York, the problem of the SBC-AT&T is not the merger of competitors, since SBC has simply not tried very hard to compete out of region (see Exhibit 2). The problem is the change in incentives that will drive AT&T's behavior. Indeed, the fact that SBC has not been an aggressive out-of-region is the problem. One can only expect that AT&T will become infected with SBC's competitive timidity. The AT&T assets will be used to reinforce the in-region market power of SBC that compete out of region.

The End of Competition in Local Markets

The wave of proposed mergers in the telecommunications industry — SBC attempting to gobble up AT&T, and Verizon trying to swallow MCI — mark the ultimate demise of the era during which consumers were led to expect more and more choices and lower prices for local, long distance, wireless, and the new Internet-based services exploding on the market. The Commission cannot bury its head in the sand and ignore the fundamental impact of these simultaneous mergers on the industry.

The simultaneity of the proposed mergers is reinforced by the similarity of the arguments and flaws in the applications. In their statements and filings, the merging parties fantasize about intermodal competition and present nationwide data that purports to show

EXHIBIT 2: THE PERSISTENT PATTERN OF AVOIDING HEAD-TO-HEAD COMPETITION BY THE REGIONAL BELL OPERATING COMPANIES



Source: Petition to Deny of CBeond Communications, Conversent Communications, Echelon Telecom, Nuvox,Communications, TDS Metrocom, XO Communicaions and Xspedius Communicztiont, *In the Matter of SBC Communications Inc. and AT&T Corp. Applications for Approval and Transfer of Control*, before the Federal Communication Commission, DA 05-656, WC Docket No. 05-65, Aprile 25, 2005, Exhibit B.

that telecommunications markets are not highly competitive. This approach to market analysis is simply wrong. Telecommunications markets are still essentially local markets. In order to provide telecommunications services, one must have a last mile technology to distribute the service to the consumer and a middle mile medium to aggregate traffic and deliver it to large national and international communications and Internet networks. These last- and middle-mile facilities are the bottlenecks through which all telecommunications must flow.

These are the bottlenecks that the incumbent local exchange carriers (ILECs) like Verizon and SBC leveraged to maintain their market power over customers. These are the bottlenecks that competitive local exchange carriers (CLECs), AT&T and MCI foremost among them, were trying to break down. When the analysis moves from this macro-level to take a more granular view of real product and geographic markets, the impact of the merger becomes even uglier from the consumer point of view.

The finding that local markets were open to competition in Section 271 proceedings, which allowed the Bell operating companies to re-enter the in-region long distance business, was based upon the availability of unbundled network element platforms (UNE-P). UNE-P accounted for the vast majority of residential consumers who had switched to competitors. With the removal of UNE-P and the refusal of Bell operating companies to provide access to the local network in a manner that makes electronic aggregation of loops in central offices available, the Commission should conclude that local markets are no longer open to competition.

These two proposed mergers represent a double dose of anticompetitive chutzpah that spells disaster for consumers.

- Within their regional market, first the Bells made life so miserable for competitors that they go into bankruptcy or throw up the hands in despair. Then the Bells say they should be allowed to buy up their largest local competitors, because they really aren't very good current or potential competitors.
- When competing head-to-head with other companies outside their region, the Bells flip the argument around, with the same unfortunate result for consumers. In order to secure approval of their previous mergers, which eliminated potential out of region competitors, the Bells promised to compete out of their home regions markets, but they did not try very hard and have not done very well. So the Bells say, since we cannot be considered really good competitors now or in the future, we should be allowed to buy up the companies we were supposed to compete with.

The failure of competition becomes an excuse for the further re-consolidation and re-integration of the market, which eliminates the vestiges of competition and makes new entry into the market more difficult.

THE CURRENT STATE OF COMPETITION

The basic dynamics of a competitive marketplace is clear in theory. When companies vigorously compete against one another, they have incentives to beat the competition through lower prices and are driven to make the investments necessary to improve quality or develop new services. The market forces firms to invest and price aggressively, for fear of falling behind. Vigorous competition ensures that we all pay fair prices for the goods and services we enjoy. Unfortunately, the telecommunications marketplace is anything but competitive.

Rather than competing with one another for each customer, the telecom giants got bigger by merging with one another, resulting in less and less competition. As these large companies acquired a larger and larger footprint, it became harder and harder for new entrants to gain a toehold in the market. Today, the result is a concentrated market that is far from the economic vision of vigorous competition. And the proposed SBC-AT&T and Verizon-MCI mergers, if approved, will be the final nails in the coffin of the local competition experiment the Congress launched with the passage of the 1996 Telecom Act.

Wireline Services

Local Competing local exchange carriers or CLECs were supposed to bring competition to the marketplace after passage of the 1996 Act. But SBC and Verizon litigated, stymied, and strangled local voice competition until it has almost completely withered. As a result, the CLECs that were supposed to offer so much competition to the dominating Bells are dying in droves.[17] Born as local monopolies, the Bell companies have remained anti-competitive to the core. Once the 1996 Act was signed into law, the Bell companies immediately set out to bulk up their local monopolies into regional monopolies through mergers and acquisitions. In the end, they never competed in one another's regions as envisioned by Congress, and they never fulfilled the promises they made during their pervious mergers. This will only get worse if these mergers are approved.

Long distance. SBC and Verizon have run a brutal bait-and-switch game with long distance service. After having been allowed to re-enter the long-distance market because policymakers determined local markets were open – a finding that was overwhelmingly based on the availability of UNE-Ps – they launched a vigorous campaign to eliminate the availability of UNE-Ps. SBC and Verizon's gambit was a success and, as expected, the competition is drying up.

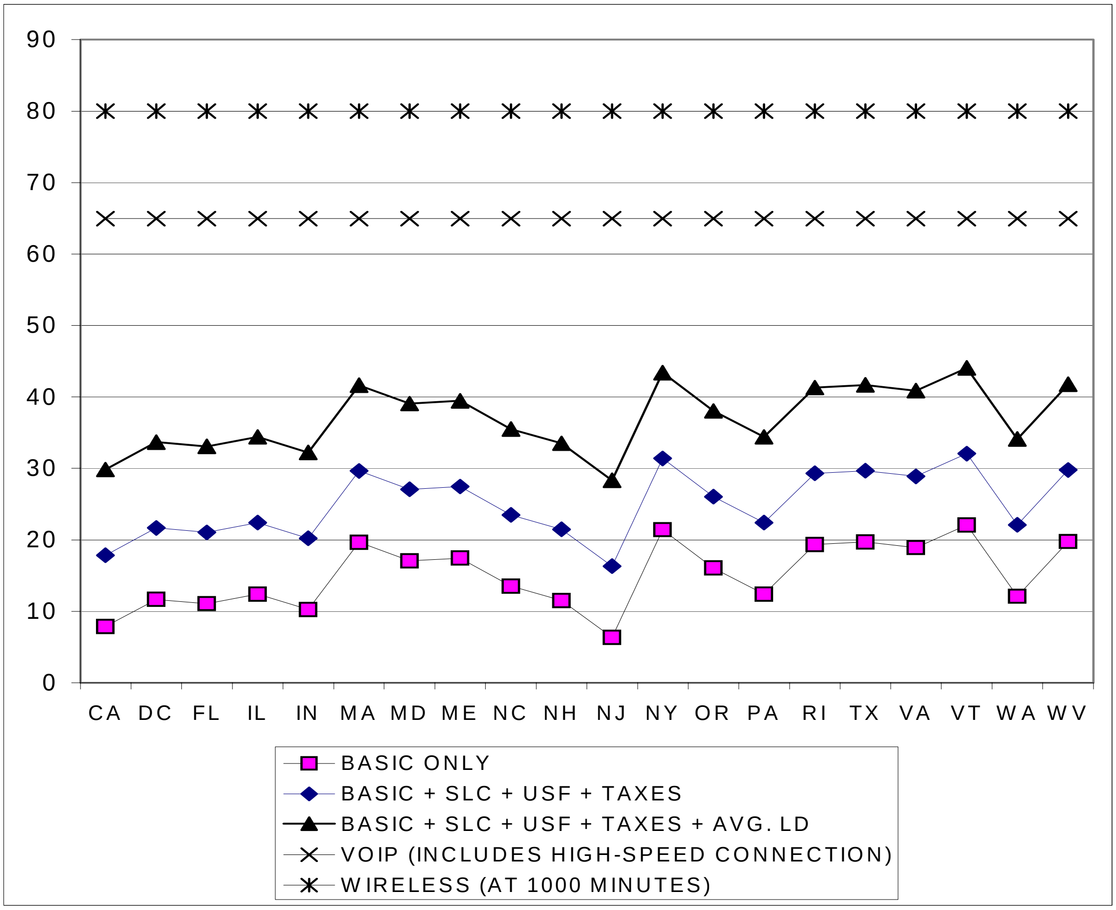
Voice over Internet Protocol/Broadband.

SBC and Verizon often point to new technologies, such as Voice over Internet Protocol (VoIP) as the source of the supposedly great level of competition, but these are actually quite limited. Given that 70 percent of households don't have broadband service and, therefore, cannot take advantage of VoIP calling,[18] VoIP is not yet an effective competitor to the traditional wired phone service. And VoIP has other problems. VoIP does not have reliable 911 service. It does not work when the power goes out. Even worse, SBC, is blocking access from VoIP providers to enhanced 911 networks.

Making matters worse, SBC and Verizon (as well as BellSouth) also use an anti-competitive bundling tactic to ensure that VoIP can never effectively compete with their basic local voice services. Neither Verizon nor SBC will sell a consumer DSL on a stand-alone basis, what is known as "naked" DSL. Both force consumers to buy their voice service in order to get a DSL line. So a consumer who wants to buy VoIP from a competitor has to pay for local service twice.

In March 2005, the *New York Times* reported on the problems of bundling DSL with local wireline phone service, citing numerous examples of DSL customers…, who rely on wireless phones for normal calling, never using the wireline phone that he pays $360 a year to keep connected. He is not alone—there are thousands more who, like him, "have to pay for a service I'm never using."[19] Tacking on local phone service to a DSL bill raises the monthly price from $20-$40 (which are often only for a limited trial period and for those willing to sign a one-year contract) to $50-80 (See Exhibit 3). This practice mirrors cable,

EXHIBIT 3: LOWEST PRICED ALTERNATIVES FOR TELEPHONE SERVICE



Sources: Billy Jack Gregg, *A Survey of Unbundled Network Element Prices in the U.S.*, February 2005; Verizon Application, *Declaration of Husser, et al.*, Exhibit 2. State prices are statewide averages. Wireless assumes 400 minutes at the average cost of $.10 per minute

which sells broadband for $40-60, so long as you purchase its television service bringing your total to $80-100 every month. Both telephone companies and cable operators force consumers to buy bundles of services – to pay twice – if they want to purchase VoIP service from a competitor.

Wireless

Two critical factors limit the ability of wireless services to effectively compete with traditional services. First, even with a big bucket of minutes, wireless costs about ten cents a minute for the typical pattern of use of local calls – five times as much, on a per-minute basis, as local flat-rate dialtone, which is the staple of local service. Wireless is also less reliable than wireline and has limited access to the 911 system. Second, Cingular and Verizon Wireless, the nation's two largest cell phone companies, are owned by two large Bells – SBC (with BellSouth) and Verizon, respectively – and, therefore, have little incentive to compete with their own wireline affiliates. Through mergers and acquisitions, as well as their brand name prominence, SBC and Verizon are each the leading wireless supplier within their respective local market.[20]

Community Broadband Internet Providers

Communities not well-served by telephone companies and cable operators should be able to deploy their own digital infrastructure. Many communities have only a single broadband provider or a cable or telephone company duopoly. In these communities, rates remain high and service remains poor. As the market becomes more concentrated, the threat of municipal entry becomes necessary to promote competitive services such as voice or video over the Internet. A new study released by CFA, CU, and other public-interest groups shows that community Internet providers, or even the threat of municipal entry, could provide the competition necessary to keep rates low and quality of service high.[21]

For example, community Internet providers are charging lower prices than Bell DSL service providers are charging: $16 in Chaksa, Minnesota, $20 in Rio Rancho, New Mexico, Moorhead, Minnesota and Lompoc, California, and an estimated $15 in Philadelphia. And if a consumer wants it, they can pay an additional $25 for unlimited local and long distance VoIP service—a significant monthly savings. In other words, today's market conditions could have evolved to a world where broadband and unlimited local and long-distance calling are available nationwide for as little as $40 a month. The SBC and Verizon, offerings cost about twice that, and mergers plus wrong-minded regulatory policies are almost certain to make this lower-cost, more competitive market disappear before it ever gets a chance to take hold and spread.

But SBC and Verizon do not merely oppose these networks. They actively fight community efforts by misleading consumers and policymakers about the network's economic operation and effects. When they fail, they move their efforts to state legislatures to block towns, cities and counties from deploying broadband networks—work the companies should be doing more of themselves.

The more competitors they gobble up and the bigger these companies get, the less incentive they have to devote resources to competing in the marketplace for consumers, and the greater the incentive they have to prevent other entities from competing with them. And even when a community provides Internet service, it doesn't mean that private investment from companies like SBC and Verizon dries up. A recent economic study shows that these municipal broadband networks don't crowd out private investment and competition,[22] while another new study analyzes a community with municipally-operated broadband, which has had significantly faster economic growth compared to matched communities.[23]

These Mergers Make the Telecommunications Market Worse

Horizontal Consolidation

The Verizon/MCI and SBC/AT&T mergers will have a deep impact in important telecommunications sectors like the local and long-distance residential and business markets. Today, pre-merger, SBC and Verizon have about an 80 percent residential market share of local telephone service in their regions,[24] and that number will increase as a result of the latest acquisitions and the decision of the Federal Communications Commission to eliminate unbundled network element platforms (UNE-P), which allowed AT&T and MCI to compete in local markets. By buying up their largest competitors and eliminating the last vestige of competition, the market shares of these two behemoths in their regions will likely exceed 90 percent in the residential sector.

Although the merging companies have failed to voluntarily provide meaningful information on product and geographic markets, state commissions have begun the process investigating the impact of the SBC/AT&T merger and the severe problems it will cause are becoming clear.[25] As the Commission well knows, merger analysis starts by evaluating industry structure with a measure of concentration know as the HHI (Hirschman, Herfindahl Index). A market with an HHI of more than 1,000 is considered concentrated and any merger that raises the HHI by more than 100 points in such a market is suspect. A market with an HHI above 1800 is considered highly concentrated and any merger that raises concentration more than 50 points is suspect. By these standards, the merger's anti-competitive impact will be extremely large.

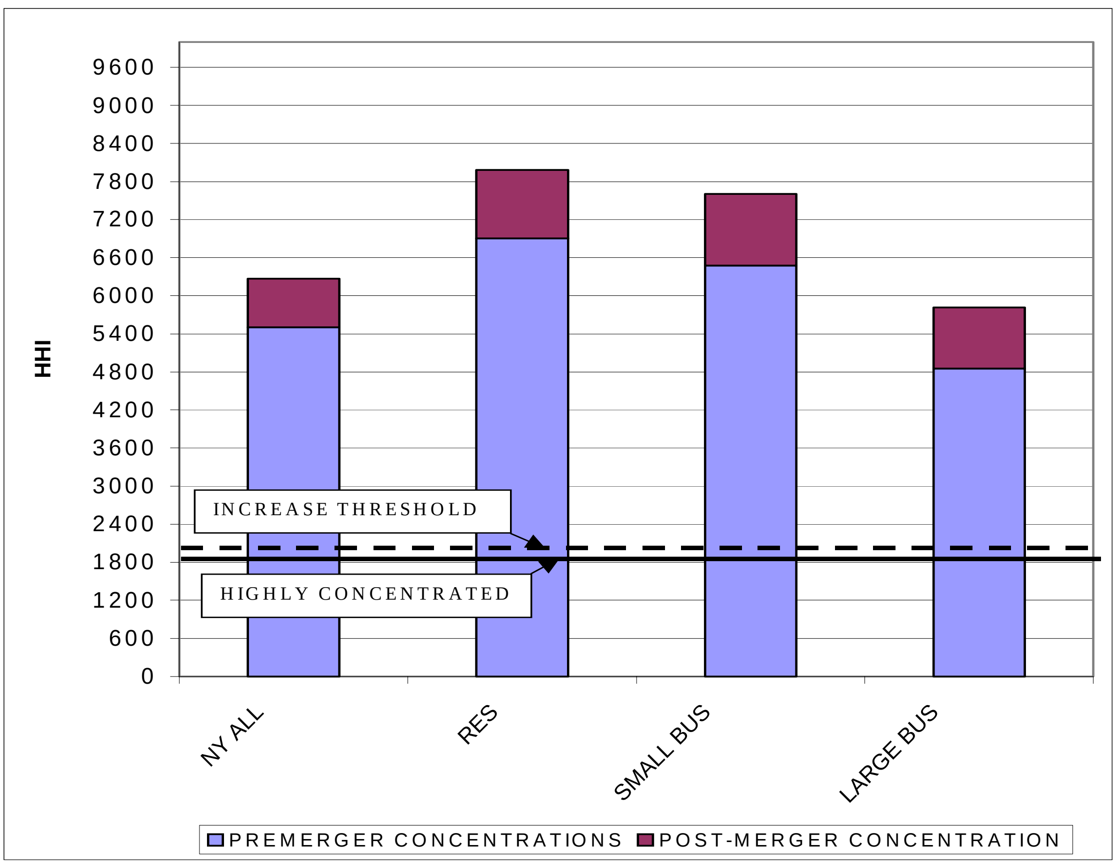
A dominant firm with a local telephone service market share of 80 percent would ensure an HHI of 6400. But in California, the concentration ratio for residential customers today, before the merger, is just over 6900 (see Exhibit 4). The SBC/AT&T merger will increase the concentration in the California residential market to 90 percent, creating an HHI of 8100. Attachment A presents the protest filed in California by Consumers Union and other consumer representatives, including members of CFA. The concerns expressed in that filing about the impact of the SBC-AT&T merger on California markets, where SBC is the dominant incumbent, apply to the Verizon-MCI merger in New York, where Verizon is the dominant incumbent.

The two corporations each already has about a 40 percent market share in the residential long-distance market within their regions, but if this merger is approved, this will increase substantially to an estimated 70 percent.[26] In fact, if these mergers go through, the telecommunications market will look a lot like the old days of “Ma Bell” before AT&T was broken up. SBC and Verizon will have about a 90 percent market share in residential local wireline,[27] 70 percent in long distance,[28] and 40-50 percent in wireless.[29] They will have the incentive and opportunity to squeeze out competitors that need access to the local or interstate “long-haul” networks.[30]

And if VoIP is a competitive threat, these mergers will add to the problems outlined above, and remove the two largest potential VoIP competitors from the market where they are needed most – in the home service territories of the two largest Bells. AT&T will no longer exist to compete against SBC’s wireline business in SBC’s service territory. The same holds for MCI, which will no longer compete against Verizon’s wireline business in Verizon’s service territory.

The big business service market appears to be only barely more competitive than residential, when measured by lines, and again these mergers would exacerbate the already-significant problems in this market segment. On average, these two companies have about a 75 percent market share for medium and large business customers.[31] These two proposed mergers, if allowed to go through, will increase the in-region market share substantially to

EXHIBIT 4:
IMPACT OF THE SBC-AT&T MERGER ON CALIFORNIA LOCAL MARKETS COMPARED TO DOJ/FTC MERGER GUIDELINES



Source: New York Public Service Commission, *Analysis of Local Exchange Service Competition in New York State*, 2002 Competitive Analysis, p. 9; "Protest of the Utility Reform Network, Utility Consumer's Action Netowrk, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum," *In the Matter of the Joint Application of SBC Communications Inc. ("SBC") and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego (U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T's Merger With a Wholly-Owned Subsidiary of SBC, Tau Merger Sub Corporation*, before the Public Utilities Commission of the State of California, Application 05-02-027, February 28, 2005, Exhibit 2 the 80 percent range, since AT&T and MCI are such large players in the market and because of the geographic pattern of competition.[32] These regional fortresses would also anchor their dominance over national corporate accounts.

Exhibit 4 contains data from New York, which is aggregated and somewhat dated, but it supports the conclusion that geographic market analysis will show that local markets to be much more highly concentrated than national data would and indicates that the merger will have a large negative impact. Across residential and business markets, the HHI for December 2002 was about 5500. A Verizon-MCI merger would increase the HHI by over 700 points.[33]

More recent data made available in California reinforces these conclusions. The HHI in the large business segment is just under 4900. A dominant firm with a market share of 70 percent would cause the HHI to be at least 4900. The merger would raise the HHI in the California large business market to over 5800.

Given this increasingly consolidated market for wired services, and especially considering the demise of competitors to the Bells – CLECs – it is critical for policymakers to consider the geographic distribution of the SBC and Verizon markets when analyzing these two mergers. MCI had its most intense competitive presence in Verizon’s service territory; the Verizon-MCI merger will eliminate Verizon’s most vigorous in-region competitor.[34] The situation with SBC-AT&T is similar. AT&T has a large presence in SBC’s service territory. If these mergers go through, policymakers will effectively be allowing SBC and Verizon to buy market power that eliminates their strongest in-region competitors.

Vertical Integration

These mergers also pose severe problems because they would allow the companies to control many of the critical inputs into the market, making it that much more difficult for competitors to obtain access to such inputs. Specifically, AT&T and MCI are large providers of Internet and interstate transport (backbone). As independent companies, their interest is in maximizing traffic. SBC and Verizon are large purchasers of Internet and interstate backbone services. As unaffiliated buyers, they make up a large portion of the market. From a competition standpoint, it is important to keep SBC and Verizon, which need the Internet and interstate backbone services as inputs, separate from AT&T and MCI, which provide this critical input. Otherwise, SBC's and Verizon's competitors will have difficulty gaining this input and are more likely to go out of business.[35]

The result of these proposed mergers – called "upstream vertical integration" in the parlance of economics – would therefore likely have a dramatic impact on the market for Internet and interstate backbone traffic. SBC and Verizon would have an incentive to abuse their control over those assets to diminish competition for their retail businesses, rather than maximize the revenue flowing over those assets.

As a vertically integrated entity, both of the resulting behemoth companies would have an incentive to maximize profits by using their leverage in the form of a price squeeze. Unfortunately, the opportunity to run a classic price squeeze will be readily available in the form of excessive access charges. The regional Bell companies have been overcharging for access, particularly special access that was prematurely deregulated by the FCC. AT&T and MCI were the leading critics of the access charge system. Should these mergers go through, those who profit from those overcharges will have swallowed those who sought lower access charges that drive down prices for consumers. These mergers should not be allowed to proceed until access charges are reformed.

This prediction is no paranoid delusion, but the logical extension of SBC and Verizon's current activities. In Court cases like *Brand X*[36], regulatory proceedings such as the wireline proceeding, and petitions to the FCC, SBC and Verizon both support the elimination of the obligation to interconnect and carry traffic on just, reasonable, and nondiscriminatory rates terms and conditions. They are buying the assets that provide critical inputs for their competitors, but at the same time they are seeking the right to discriminate against those competitors. These mergers would undoubtedly exacerbate the price-inflating, anti-competitive dangers that already exist in today's market.

If these mergers are not blocked or substantially altered by the Antitrust Division of the Department of Justice and the FCC, these regional Bells will become regional Behemoth Bells that swallowed up their original parent company (AT&T) and its main competitor (MCI), leaving consumers almost no better off than they were before the old Bell monopoly was originally demolished.

The magnitude of the two pending mergers is indisputable even at the national level (see Exhibits 5a and 5b). The number 1 (Verizon) and number 4 (MCI) companies in terms of total industry revenue are proposing to merge into a segment leader with one-third of the total industry revenue. The number 2 (SBC) and number 3 (AT&T) firms in the industry are proposing to merge to form a company that would have one-quarter of the total revenue. These two industry leaders would account for over half of all revenue. The third

EXHIBIT 5: TOTAL TELECOMMUNICATIONS REVENUE MARKET STRUCTURE

EXHIBIT 3 (a): PRE-MERGER TOTAL REVENUES REVEAL A MODERATELY CONCENTRATED MARKET WITH TWO LARGE LOCAL COMPANIES, SBC AND VERIZON AND TWO LARGE LONG DISTANCE COMPANIES, AT&T AND MCI, WHICH ARE ALSO THE LARGEST LOCAL

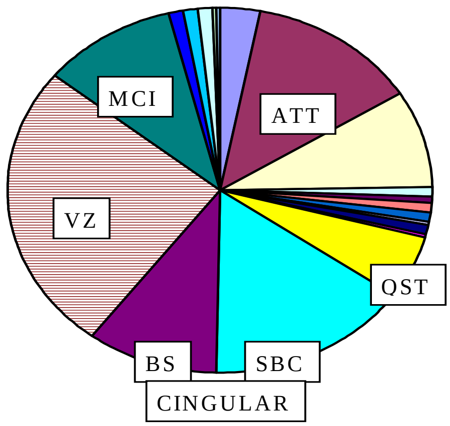


EXHIBIT 5 (b): POST MERGER (SBC-AT&T, VERIZON-MCI) TOTAL REVENUES ARE HIGHLY CONCENTRATED AND THE INDUSTRY IS DOMINATED BY TWO LARGE PLAYERS

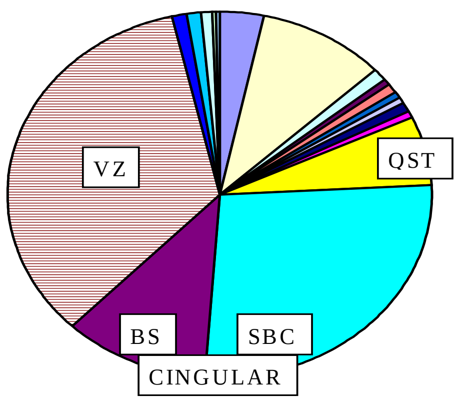
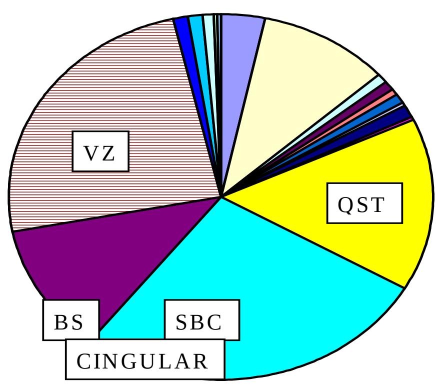


EXHIBIT 5 (c): A QWEST-MCI MERGER CAUSES A MUCH SMALLER INCREASE IN CONCENTRATION AND LEAVES A THIRD LARGE PLAYER IN THE MARKET



FEDERAL COMMUNICATIONS COMMISSION, *STATISTICS OF COMMUNICATIONS COMMON CARRIERS, 2003-2004,* TABLES 1.1 AND 1.2.

largest company (Bell South) would be less than a quarter the size of the industry leader. It also has a substantial joint venture with the number two firm.

Even measured at the level of national revenue in telecommunications, each of the mergers individually violates the merger guidelines. They take an already concentrated market and dramatically increase the market concentration. The Verizon-MCI merger increases the concentration by 500 points. The SBC-AT&T merger increases concentration by 30 percent. Taken together the mergers drive the industry well past the highly concentrated threshold.

Although Section 310 precludes a comparative analysis in merger review, implicitly and explicitly the question frequently arises as to what would happen if the mergers are not approved. Indeed, this question came up explicitly during a hearing before the House Commerce committee. In the case of MCI, there is a ready answer. It would likely be acquired by a second suitor, who has offered a higher acquisition price per share. It is appropriate to ask, therefore, what the impact of that merger would be. Exhibit 6c shows the results graphically. It is quite apparent that the competitive impact of a Qwest-MCI merger would be much less severe. The Qwest-MCI merger increases the concentration by only one-sixth as much as the Verizon-MCI merger, less than 100 points. It also produces a much more balanced industry structure, with three large firms. Measured by the routine Merger Guidelines, even if it was approved after an SBC-AT&T merger, it would not violate the threshold for closer scrutiny at the national level. There is also less competitive overlap of assets at the local level.[37]

The evidence is overwhelmingly clear. The Commission should examine this merger and just say no or impose substantial conditions to reverse the severe anticompetitive harms they will impose. Specifying such conditions must await the provision of data on a product and geographic basis so that the nature of the harm to competition and the steps necessary to repair it can be analyzed in detail.

Respectfully submitted,

Mark Cooper

By: ________________________________

Date: 4/29/05

ENDNOTES

[1] The Consumer Federation of America is the nation's largest consumer advocacy group, composed of over 280 state and local affiliates representing consumer, senior, citizen, low-income, labor, farm, public power an cooperative organizations, with more than 50 million individual members.

[2] Consumers Union is a nonprofit membership organization chartered in 1936 under the laws of the state of New York to Provide consumers with information, education and counsel about good, services, health and personal finance, and to initiate and cooperate with individual and group efforts to maintain and enhance the quality of life for consumers. Consumers Union's income is solely derived from the sale of *Consumer Report*s, its other publications and from noncommercial contributions, grants and fees. In addition to reports on Consumers Union's own product testing, *Consumer Reports* with more than 4 million paid circulation, regularly, carries articles on health, product safety, marketplace economics and legislative, judicial and regulatory actions which affect consumer welfare. Consumers Union's publications carry no advertising and receive no commercial support.

[3] NYPIRG is a not-for-profit, non-partisan research and advocacy organization established, directed and supported by New York State college and university students. NYPIRG's staff of lawyers, researchers and organizers work with college students and other citizens to help develop citizenship skills and impact public policy. Consumer protection, environmental preservation, fiscal responsibility, political reform and social justice are NYPIRG's principal areas of concern.

[4] Carolyn Duffy Marsan, "MCI Beefs up VoIP offerings", Network World ISP News Report Newsletter, March 31, 2004, available at: http//www.nwfusion.com/newsletters/isp/2004/0329isp2.html

[5] http://consumer.mci.com/cablevoice/faqs.jsp.

[6] http://consumer.mci.com/cablevoice/timeWarnerPR.jsp.

[7] Comments Of The Consumer Federation Of America, In the Matter of Application of New York Telephone Company (d/b/a/ Bell Atlantic – New York) Bell Atlantic Communications, Inc. NYNEX Long Distance Company and Bell Atlantic Global Networks, Inc., for Authorization To Provide In-Region, InterLATA Services in New York, Before the Federal Communications Commission CC Docket No. 99-295, November 8, 1999. Telecommunications Action and Research Center, *A Study of Telephone Competition in New York*, September 6, 2000; Consumer Federation of America and Consumer's Union, *Lessons From 1996 Telecommunications Act: Deregulation Before Meaningful Competition Spells Consumer Disaster*, February 2001.

[8] *In the Matter of Application by Bell Atlantic Inc., Pursuant to Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services In New York*, Federal Communications Commission, CC Docket No. 99-404 (hereafter FCC New York), 2.

[9] Verizon Application, *Declaration of Husser, et al*.

[10] Ellen Muraskin, "AT&T's VOIP Rollout Heats Up Price War," Eweek, July 8. 2004, available at: http://www.eweek.com/article2/0,1759,1620387,00.asp

[11] Ben Charny, “AT&T to Launch VoIP nationwide, CNET News.com, February 25, 2004, available at: http://news.com.com/AT38T+to+launch+VoIP+nationwide/2100-1037_3-5164973.html?tag=nl
[12] Id.
[13] Muraskin.
[14] Application 05-02-027, Before the California Public Utilities Commission, Protest of the Utility Reform Network, Utility Consumers’ Action Network, Disability Rights Advocates, Consumers Union of U.S., Inc., The Greenlining Institute, and Latino Issues Forum, April, 14, 2005, p. 35.
[15] “AOL Rolls Out Net Phone Service,” Contact.com, April 18, 2005, available at: http://www.conntact.com/article_page.lasso?id=38898
[16] “AT&T Chairman Says Communications Industry Restructuring Will Heighten Competition, Drive Renewed Interest and Stability, PR Newswire, March 24, 2005, available at: www.prnewswire.com
[17] Cooper, Mark, *Stonewalling Local Competition: The Baby Bell Strategy to Subvert the Telecommunications Act of 1996* (Consumer Federation of America, January 1998); *Competition At The Crossroads: Can Public Utility Commissions Save Local Phone Competition?* (Consumer Federation of America, October 7, 2003)
[18] Cooper, Mark, *Expanding the Digital Divide and Falling Behind in Broadband Falling Behind in Broadband,* (Consumer Federation of America and Consumers Union, October 2004), shows that penetration of the Internet into homes has stalled below 60 percent, while just over half of all Internet households have broadband.
[19] Richtel, Matt “Dangling Broadband from the Phone Stick,” *New York Times,* February 2, 2005.
[20] Letter to Michael Powell, September 16, 2004.
[21] Consumer Federation of America, Consumers Union, Media Access Project, Free Press, “Connecting the Public: The Truth About Municipal Broadband,” April 11, 2005.
[22] Ford, George, “Does Municipal Supply of Communications Crowd-Out Private Communications Investment? An Empirical Study,” Applied Economic Studies, February 2005.
[23] Ford, George and Thomas Koutkey, “Broadband and Economic Development: A Municipal Case Study from Florida,” Applied Economic Studies, April 11, 2005.
[24] Federal Communications Commission, *Local Telephone Competition: Status as of June 31, 2004*, December 2004, Tables 6, 11, show this figure at just over 80 percent of SBC and just under 80 percent for Verizon. This is prior to the impact of the UNE-P decision. Facilities-based competition accounted for only about one-fifth of total competition (Local Competition, Table 10). Most of this competition was in the medium or large business market.
[25] “Protest of the Utility Reform Network, Utility Consumer’s Action Network, Disability Rights Advocates, Consumer Union of the U.S., Inc., The Greenlining Institute, and Latino Issues Forum,” *In the Matter of the Joint Application of SBC Communications Inc. (“SBC”) and AT&T Corp. (AT&T) for Authorization to Transfer Control of AT&T Communications of California (U-5002), TCG Los Angeles, Inc. (U-5462), TCG San Diego*

(U-5389), and TCG San Francisco (U-5454), to SBC, Which Will Occur Indirectly as a Result of AT&T's Merger With a Wholly-Owned Subsidiary of SBC, Tau Merger Sub Corporation, before the Public Utilities Commission of the State of California, Application 05-02-027, February 28, 2005.

[26] See note 4 above.

[27] *Local Telephone Competition*, Tables 6, 11.

[28] Precursor, *Telecom Vital Statistics: Pillars of the Bell 2005 Competitive Respite Thesis,* January 24, 2005, put Verizon and SBC long distance market shares at close to 40 percent at year-end 2004, and predicted a gain of another 10 percent, <u>without</u> the mergers. AT&T and MCI national market shares were approximately 30 percent and 20 percent, respectively, as reported in Industry Analysis and Technology Division, *Trends in Telephone Service* (Washington, D.C.: Federal Communications Commission, May 2004), p. 9-5. Because of their respective geographic foci, the in-region market share of the long distance companies being acquired respectively is likely to be higher than the national average. Thus, a 70 percent residential market share is a cautious estimate.

[29] Consumer Federation of America and Consumers Union, Letter to Chairman Michael Powell, September 16, 2004.

[30] See Cooper, Mark, *The Public Interest in Open Communications Network* (Washington, D.C.: Consumer Federation Of America, July 2004), Chapter IV, for a discussion of past anticompetitive practices of telephone companies against CLEC and ISPs. For a discussion of the problem of vertical leverage against intermodal competitors see "Petition to Deny of Consumer Federation of America and Consumers Union," *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation,* WT Docket No. 04-70, May 3, 2004 and "Reply of Consumer Federation of America and Consumers Union," *In the Matter of Application for the Transfer of Control of Licenses and Authorizations from AT&T Wireless Services Inc., and Its Subsidiaries to Cingular Wireless Corporation,* WT Docket No. 04-70, May 20, 2004.

[31] *Local Telephone Competition*, Tables 6 and 11.

[32] Richtel, Matt "Valuing MCI in an Industry Awash in Questions," *New York Times,* February 2, 2005, C-4, puts AT&T's national market share for the "corporate telecommunications market" at 15 percent and MCI's at 12 percent.

[33] New York was the first state to open its market to competition, so that competitors had penetrated substantially by December 2002. The increase thereafter was modest. Thus, the year-end 2002 data gives a reasonable indication of the state of competition and the impact of the merger.

[34] That the geographic overlap of assets is more concentrated in specific regions and products than the national average has been noted in the press accounts of the proposed mergers. Almar Latour and Dennis K. Berman, "Qwest Presses Its Bid for MCI," *Wall Street Journal*, February 4, 2005, C-4, the *Wall Street Journal* described Verizon and MCI as follows: "A tie-up between Verizon and MCI also could face cultural challenges: The companies have been fierce competitors and have been at loggerheads in court." The map accompanying Matt Richtel, "Valuing MCI in an Industry Awash in Questions," *New York Times,* February 2, 2005, C-4, shows a concentration of MCI data centers in the Northeast.

[35] The vertical problem in the cable video and high speed Internet markets are discussed in Cooper, Mark, *Cable Mergers and Monopolies: Market Power in Digital Communications Networks* (Washington, D.C.: Economic Policy Institute, 2002), Chapters 4 and 5; see also The Public Interest in Open Communications Networks, Chapter IV; Petition to Deny and Reply, not 9 above.

[36] *National Cable & Telecommunications Association, et. al. v. Brand X*, Nos. 04-277 & 04-281.

[37] Almar Latour and Dennis K. Berman, "Qwest Presses Its Bid for MCI," *Wall Street Journal*, February 4, 2005, C-4. Yuki Noguchi and Ben White, "MCI, Qwest in Advanced Discussion," *Washington Post*, February 4, 2005, E-5. Ken Belson and Matt Richtel, "For MCI, Qwest May Not be Most Desirable," *New York Times*, February 4, 2005, C-12.