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BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In Re: Request for approval of merger of MCI Communications Corporation (Holder of AAV/ALEC Certificate 2986 in the name MCI Metro Access Transmission Services, Inc.; and IXC Certificate 61, PATS Certificate 3080, and AAV/ALEC Certificate 3996 in the name of MCI Telecommunications Corp.) with TC Investments Corp., a Wholly-Owned Subsidiary of WorldCom, Inc.	)	Docket No. 971604-TP

JOINT ANSWER OF WORLDCOM, INC. AND MCI COMMUNICATIONS CORPORATION TO GTE PETITION ON PROPOSED AGENCY ACTION AND REQUEST FOR SECTION 120.57 HEARING AND CWA PETITION TO INTERVENE AND PROTEST OF PROPOSED AGENCY ACTION

WorldCom, Inc. ("WorldCom") and MCI Communications Corporation ("MCI"), by their undersigned counsel, hereby answer the Petition on Proposed Agency Action and Request for Section 120.57 Hearing of GTE Corporation and GTE Communications Corporation (collectively "GTE"), and the Petition to Intervene and Protest of Proposed Agency Action of the Communications Workers of America ("CWA"), filed on February 12, 1998, in the above-referenced proceeding.

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Introduction and Summary

1. Under Florida law the type of economic and competitive claims that GTE and CWA raise are not a basis for challenging an application for transfer of control pursuant to section 364.33. Section 364.33 is not a merger review statute. It authorizes the Commission to determine who

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LAW OFFICES
MESSER, CAPARELLO & SELF
A PROFESSIONAL ASSOCIATION

215 SOUTH MONROE STREET, SUITE 701
POST OFFICE BOX 1876
TALLAHASSEE, FLORIDA 32302-1876
TELEPHONE (904) 222 0720
TELECOPIERS (904) 224 4359, (904) 425 1942

March 3, 1998

BY HAND DELIVERY
Ms. Blanca Bayo, Director
Division of Records and Reporting
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

Re: Docket No. 971604-TP

Dear Ms. Bayo:

Enclosed for filing on behalf of WorldCom, Inc. and MCI are an original and fifteen copies of the following documents in the above-referenced docket:

1. Joint Motion of WorldCom, Inc. and MCI Communications Corporation to Dismiss GTE Petition on Proposed Agency Action and Request for Section 120.57 Hearing and CWA Petition to Intervene and Protest of Proposed Agency Action; and

2. Joint Answer of WorldCom, Inc. and MCI Communications Corporation to GTE Petition on Proposed Agency Action and Request for Section 120.57 Hearing and CWA Petition to Intervene and Protest of Proposed Agency Action.

Please acknowledge receipt of these documents by stamping the extra copy of this letter "filed" and returning the same to me.

Thank you for your assistance with this filing.

Sincerely,

Floyd R. Self

Enclosures
cc: Mr. Brian Sulmonetti

joint motion
DOCUMENT NUMBER-DATE
02831 MAR-3 98
FPSC-RECORDS/REPORTING

joint answer
DOCUMENT NUMBER-DATE
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FPSC-RECORDS/REPORTING

should be allowed to own and operate telecommunications facilities in the State of Florida. To the extent that a "public interest" determination is involved, the only issue is whether the public interest is served by the acquiring company's ownership and operation of telecommunications facilities in the State -- not whether a merger that company engaged in is or is not in the public interest. If MCI WorldCom, after the merger, were to file an original application for authority to operate telecommunications facilities in Florida, there would be no basis for rejecting the application under section 364.335. The fact that the company is seeking to acquire authority to own and operate telecommunications facilities through acquisition of stock ownership does not confer merger review authority on the Commission that it would not otherwise have.

2.A. In any event, even if the Commission does have merger review authority, the merger of WorldCom and MCI will further the public interest and benefit consumers in Florida, by creating a company that will be in a better position than either MCI or WorldCom separately to offer significant, facilities-based competition to the local telephone exchange monopolies. In view of the tremendous size of the local exchange markets (some $108 billion gross revenues nationwide, and some $ 6 billion in Florida) and the current lack of local exchange competition on any significant scale, the potential benefit to consumers of reducing monopoly profit margins is enormous.

Nor is there any danger of diminishing competition in the local exchange market. Local exchange markets at present are overwhelmingly dominated by monopoly telephone companies, who have some 99% of the market. The merger of two companies whose market total share (together with several other competitors) is no more than 1% raises no competitive concern. There is no danger of a combined company with such a small market share colluding with the incumbent; instead it will have every incentive to compete vigorously on both price and quality of service, in

order to capture a significant market share. Following the merger it will be better able to provide such competition, and increased competition will benefit Florida consumers.

Indeed, it would seem that GTE's principal concern in this case is not that the merger will decrease local competition, but that it will *increase* local competition by enhancing the chance that GTE's monopoly position in the areas of Florida that it serves might, for the first time, face a serious competitive challenge.

2.B. GTE portrays the present long-distance market as noncompetitive and collusive, and argues that it is likely to become more so with the merger. GTE's portrayal is contrary to the facts. For example, the present long-distance market is characterized by a huge number of customers changing carriers in response to price discounts from competitors. Customer "churning" at this level demonstrates competition, not collusion. GTE's argument also ignores the rapid rate of entry by carriers other than the top four; indeed, the "other" category of long-distance carriers had over 10% of the market in 1996 and has had an annual growth rate exceeding 40 percent in recent years. With new entry occurring at such a rapid rate, the existing carriers -- no matter what their market share -- cannot engage in monopoly pricing.

GTE's principal argument is that the merger will diminish competition in the long-distance market. GTE contends that only WorldCom offers long-distance capacity at significant discounts for wholesale customers, and that it will terminate this service upon acquiring MCI in order to avoid undercutting MCI's retail business. But history shows that MCI and AT&T have been significant wholesalers as well as significant retailers -- which would not have happened if GTE's theory were right. The fact is that facilities-based carriers with ample network capacity currently generate vibrant competition at the wholesale level, and new entrants are adding capacity at a rapid and

accelerating rate. MCI WorldCom will continue to provide wholesale capacity after the merger as long as the wholesale business continues to be profitable; and if it does not do so, others will.

At times, a page of history is worth a volume of logic. In 1990, MCI, the number two interexchange carrier, acquired Telecom*USA, a facilities-based carrier that was then the fourth-largest interexchange carrier, and overall concentration of the long distance market nonetheless continued its steady decline in 1990 and thereafter.[1] The merger of WorldCom and MCI -- which is likewise between the number two and number four carriers -- will not harm competition any more than the MCI-Telecom*USA merger did. The interexchange market is vibrantly competitive for all consumers, including residential and wholesale purchasers, and the merger will not change this fact. Indeed, the merged company will take advantage of the significant efficiencies and savings described above to compete even more effectively in all portions of the long distance market.

2.C. There is no basis for CWA's contention that the merger will harm residential or small business customers. In fact, MCI's widely recognized brand name, and its strong base of millions of residential long-distance customers, will present an opportunity for the combined company to offer these customers "one-stop shopping," including local exchange, long distance, Internet and other services. If the combined company does not do so, it will waste this opportunity and lose customers to other competitors who will offer "one-stop shopping." The whole point of this merger is to gain customers, not lose them. In addition, the combined company will have a powerful financial incentive to fully load its local networks, including carrying traffic of residential customers

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[1] The decline in concentration in the long-distance industry since 1990 is described in the Affidavit of Robert E. Hall at ¶ 66. Prof. Hall's Affidavit is Attachment B to the Joint Reply of WorldCom and MCI, filed in the FCC merger proceeding described in the text and attached hereto. *See* p. 6 and n.2 *infra*.

in off-peak hours.

3. The merger will not undermine universal service. Under the Telecommunications Act of 1996, universal service must be supported through explicit subsidies, funded by contributions from all telecommunications carriers on an equitable basis. The fact that the merger will result in reduced access charges and will place competitive pressure on business rates, which previously have been a source of implicit subsidy for universal service support, is not a basis for blocking a procompetitive merger.

4. The merger will create jobs. In contending to the contrary, CWA makes erroneous calculations and ignores the fact that employment growth must inevitably occur if the merger is successful and the combined company significantly increases its sales and market share. Basically, CWA's complaint is that the combined company will be able to expand more efficiently than the separate companies could. But that means more growth, and more growth means more jobs.

5. CWA makes claims regarding the effect of the merger on competition in the Internet. The claims are identical to those currently being reviewed by the FCC and the Department of Justice. In view of the interstate and nationwide nature of the Internet, it is doubtful whether this Commission should address those claims as well. In any event, claims that the combined company will dominate the Internet have no foundation.

6. GTE may not incorporate claims made by other parties opposing the merger in proceedings before the FCC. Those commenters have chosen not to intervene here and have not expressed any Florida-specific concerns.

7. A hearing is neither required nor appropriate. The issues at stake in this proceeding are not issues of "fact." Rather, they concern economic, predictive and policy inferences to be drawn

from the facts. For this type of controversy, the written presentations the Commission is currently considering are sufficient. An evidentiary hearing would involve nothing more than a "battle of experts" and would not assist the Commission in resolving the economic and policy issues in dispute.

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The arguments made by GTE and CWA in this proceeding are a repetition of arguments they are making in the merger approval proceeding presently pending before the Federal Communications Commission ("FCC"). *Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211. GTE and CWA have suggested *no* aspect of the telecommunications market in Florida that differentiates it from other States and justifies a separate examination of public interest issues. In this Joint Answer, we cover some of the issues also discussed in our Reply before the FCC, and refer at several points to our FCC Reply for a more detailed discussion. We attach a copy of the Joint Reply of WorldCom, Inc., and MCI Communications Corporation to Petitions to Deny and Comments, filed with the FCC January 26, 1998 in its merger proceeding ("Joint FCC Reply").[2]

We also attach an Affidavit of Drs. Dennis W. Carlton and Hal S. Sider ("Carlton/Sider Aff't"), responding to the Affidavit of Robert G. Harris submitted by GTE ("Harris Aff't").

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[2] Attachment G to the Joint FCC Reply is Amendment No. 3 to Form S-4 (Registration Statement under Securities Act of 1933), filed with the SEC by WorldCom January 22, 1998. It was submitted to the FCC as a separate bound document. In the attached copies of the Joint FCC Reply we have included only the cover page and the five pages of the Form S-4 we have cited in this Answer.

I. The claims of competitive injury made by CWA and GTE are beyond the scope of the Commission's authority.

GTE and CWA are treating this case as if it were a merger review case, rather than a proceeding under section 364.33 to obtain approval of the acquisition of ownership or control of a telecommunications facility. But section 364.33 does not grant the Commission authority to review mergers. The language of section 364.33 is very specific. It provides, in pertinent part, that "[a] person may not acquire ownership or control [of any telecommunications facility], in whatever manner, including the acquisition . . . [of] controlling stock ownership, without prior approval." This language does not grant the Commission the authority to approve or disapprove mergers. It is focused exclusively on acquisition of stock *as a form of acquiring ownership or control of telecommunications facilities*. In that context, any "public interest" determination that the Commission makes is focused on whether it is in the public interest for the acquiring company to own and operate telecommunications facilities within the State of Florida. That is a very different issue from whether a merger is in the public interest.

The Commission's authority is limited to that granted by the Legislature. United Telephone Co. of Florida v. Public Service Comm'n, 496 So.2d 116, 118 (Fla. 1986). As such, the Commission cannot act on matters in which it lacks enumerated authority. Nothing in section 364.33 gives the Commission the authority to review corporate mergers. If the Commission were reviewing a transfer of certificates under section 364.335, or the original issuance of certificates, it would not ask whether the proposed certificate holder were the product of an anticompetitive merger; it would simply ask whether it was in the public interest for that company to own and operate telecommunications in the State of Florida. Nothing in section 364.33 gives the Commission any

greater authority simply because it is reviewing an acquisition of ownership and control of telecommunications facilities by means of an acquisition of stock ownership.

In Order No. PSC-97-1370-FOF-TP this Commission granted GTE's Motion to Dismiss MCI's complaint for anticompetitive practices related to excessive intrastate switched access charges. In that Order, the Commission found that its authority under Section 364.13 to act in regard to switched access charges could not be enlarged by reliance on other statutes. In this case, there is nothing in section 364.33 authorizing the Commission to review the anticompetitive effect of mergers. Even if reference is made to the Commission's authority under section 364.335 to approve certificates, under that statute the Commission considers only whether it is in the "public interest" for the applicant to own and operate telecommunications facilities in the State of Florida -- not whether an applicant should or should not have engaged in a merger.

II. The merger will benefit Florida consumers in both the local exchange and long-distance markets.

In any event, even if section 364.33 is regarded as a merger review statute, approval should granted because the merger will benefit the public interest and Florida consumers.

A. Local exchange markets.

To date, competitive local exchange carriers ("CLECs") have had relatively little success in penetrating local markets. Nationwide, CLECs have a market share of less than 2%.[3] There is no reason to believe that this figure is any different in Florida.

MCI and WorldCom believe that the combined company will be in a better position than the

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[3] In 1996, the CAP/CLEC share of nationwide local service revenues was less than 1%. *Trends in Telephone Service*, Industry Analysis Division, Common Carrier Bureau, FCC, Feb. 1998, Table 9.1, 1998 WL 44862.

two companies separately to accelerate the development of local competition and bring the competitive benefits of lower prices, improved service, and increased innovation to Florida consumers. MCI already has a widely-recognized brand name and recognized marketing expertise, together with a broad base of both business and residential customers for its long distance service. Its combination with WorldCom will extend the reach of its local service by adding WorldCom's local exchange network. A more extensive local exchange network, in combination with MCI's recognized brand name, will give the combined company a unique opportunity to provide a significant facilities-based challenge to the current local exchange monopolies.

The combined company will also have a greater ability than the separate companies to provide "one stop shopping" by offering a package of local, long-distance, international and Internet services, as well as state-of-the art telecommunications services which WorldCom and MCI have developed (such as new broadband and advanced data services).

In addition, the combined company expects to achieve significant cost savings and efficiencies. For example, the combined company will achieve a reduction in both leased line costs and access costs by routing both originating and terminating long distance calls to its customers over its own local networks. It will also be able to expand in the local market at a lower cost than either company could achieve on a stand-alone basis. Other savings are explained in WorldCom's Registration Statement filed with the SEC.[4] These cost savings should make the combined company able to build and operate additional local network facilities faster and further than the two companies could do separately. These reductions in the cost of providing local service will permit the combined

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[4] Attachment G to Joint FCC Reply, at pp. 40-44.

company to reach more areas and more customers for the same total investment and make it more economically feasible for the combined company to offer local service to customers who might not be able to provide the revenues needed to support a higher cost structure.

The fact that the combined company will be providing facilities-based competition is particularly important. The 1996 Act "contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale."[5] Of these entry strategies, resale is not a viable strategy today because resellers cannot differentiate their products, OSS is deficient,[6] and the level of wholesale discounts is generally inadequate. Reliance on unbundled elements of the incumbent's network has been stalled by the Eighth Circuit's decision that incumbents need not combine elements for new entrants, by non-cost based recurring and non-recurring charges, and by unsatisfactory and technically infeasible OSS.[7] That leaves pure facilities-based entry, which has been widely recognized as the preferred method of providing significant long-term local exchange competition. But local exchange facility

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[5] *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, 11 FCC Rcd. 15499, ¶ 12 (rel. Aug. 8, 1996), rev'd in part, *Iowa Utilities Board v. F.C.C.*, 120 F.3d 753 (8th Cir. 1997), *cert. granted, 66 U.S.L.W. 3484* (Jan. 26, 1998).

[6] This Commission has specifically found that BellSouth's OSS systems are inadequate. Florida Public Service Commission, Consideration of BellSouth Telecommunications, Inc.'s entry into interLATA services pursuant to Section 271 of the Federal Telecommunications Act of 1996, Dkt. 960786-TL (Nov. 19, 1997) at §§ VI.B.3.j, VI.M.4.

[7] *Iowa Utilities Board v. F.C.C., supra; Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, Inter LATA Services in Michigan*, CC Dkt. 97-137 (rel. August 19, 1997), ¶ ¶ 128-221; *Application of BellSouth Corporation et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in South Carolina*, CC Dkt. 97-208 (rel. Dec. 24, 1997), ¶ ¶ 101-169.

construction takes time and is expensive. Only competitors with the financial strength to build and operate their own networks can pursue this mode of entry. Following the merger, MCI WorldCom intends to place its primary reliance on facilities-based entry. This strategy will become more feasible than it has been for either company operating on its own.

Nationwide, the potential benefits to consumers from a more competitive local exchange market are huge. The MCI WorldCom submission to the FCC pointed out that consumers spent about $108 billion in 1996 on local exchange services, and that the gross margin earned by local exchange providers was more than 45 percent.[8] Under these circumstances, "even a modest acceleration of entry into the provision of local service with a modest effect on price can generate very large consumer benefits."[9] In Florida alone, where BellSouth and GTE continue to be a well-entrenched monopolists, gross local exchange revenues and exchange access revenues in 1996 were some $ 6 billion.[10] Clearly, even a modest reduction in the monopoly profit margin promises a significant benefit to Florida consumers.

GTE argues that the merger might harm local competition, because it would reduce by one the number of local competitors. *GTE Petition* at 20, 36. That contention makes no economic sense (it is notably absent from the affidavit of GTE's economist, Dr. Robert Harris). Local exchange markets are overwhelmingly dominated by the incumbent local exchange carriers, which in most markets have a 99% market share. In this regard, there is no reason to believe that Florida is any

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[8] *See* Atch. B to Joint FCC Reply, ¶¶ 17, 18.

[9] *Id.*

[10] *Universal Service Support by State and Telephone Revenue by State*, FCC, January, 1998, Tables 21 and 23.

different from the rest of the country. Under the Department of Justice Merger Guidelines, a merger of two competitors sharing a tiny portion of the market raises no competitive concern. For example, where one competitor has 99% of the market, a merger between two competitors who each have 0.5% of the market raises no anti-trust concern.[11]

Mergers raise a competitive concern when they enhance the likelihood of coordinated pricing. But where the combined company will have no more than a tiny market share, the only rational business strategy is to attack the incumbent's customer base. Indeed, the merger would be pointless if MCI WorldCom were satisfied with the minuscule share of the local exchange market it will have when the merger is consummated. To attack the incumbents' market share, MCI WorldCom, like all the other CLECs, must compete to provide better value. There is simply no realistic scenario in which the merger would increase the likelihood of coordinated pricing or other collusion with the incumbents.

B. Long-distance markets.

The merger will produce procompetitive synergies and efficiencies resulting in better services at lower prices in the interexchange as well as local markets. The expanded and accelerated local reach of the merged company will benefit its long distance customers, by enabling MCI WorldCom to provide integrated packages of innovative services including local, long distance, data,

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[11] Under the so-called "HHI index," used by the Department of Justice, a merger in a concentrated market raises antitrust concern only if it raises the HHI by 50 points. Where one competitor has 99% of the market, as is the case in most local markets in Florida, a merger of the remaining competitors would raise the HHI by less than one point. *See* Joint FCC Reply at 13-14, discussing the applicability of the HHI index to situations where one competitor has over 90% of the market and pointing out that, under the Department of Justice Merger Guidelines, a merger of two competitors sharing a portion of the remainder of the market does not come anywhere close to a level raising antitrust concern.

wireless, and international telecommunications services. Moreover, integration of the long distance operations will permit MCI WorldCom to achieve savings in designing and operating its long distance network and in procuring the equipment and facilities needed to run it. Lower costs, including lower costs of capital, increase the combined company's ability to make the investments needed for further innovation and continued growth. In addition, because MCI's and WorldCom's retail businesses are largely complementary, with MCI stronger in direct residential and larger business sales and WorldCom stronger with small and mid-sized business customers, the merger of these two companies will blend and reinforce their respective strengths.

GTE argues that the merger will diminish long-distance competition. The fundamental premise of GTE's argument is that the long-distance market is not competitive. *GTE Petition* at 33-34. That argument is at war with reality. For example, there is a huge amount of customer-switching that takes place in this market, as a result of competition among long-distance carriers. Nationwide, AT&T alone processes in excess of 30 million PIC changes annually (an average of more than 600,000 requests per week).[12] Given AT&T's present market share, that works out to over 50 million PIC changes nationwide. Assuming customers in Florida change carriers as often as customers elsewhere, one can assume there are over 3 million PIC changes annually in Florida alone.[13] As Dr. Marius Schwartz, Professor of Economics at Georgetown University and the Department of Justice's expert in the BellSouth South Carolina case, put it: "if there is no

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[12] *Policy and Rules Concerning the Interstate, Interexchange Marketplace*, 12 FCC Rcd. 15014, ¶ 40 (1997).

[13] Florida represents about 6% of the nation's total presubscribed lines. *Universal Service Support by State and Telephone Revenue by State*, FCC, January, 1998, Table 1.

competition, why do so many customers switch back and forth between carriers each year?"[14]

The competitiveness of this industry is confirmed by Robert E. Hall, Professor of Economics at Stanford University, who has concluded, "the long distance industry is substantially competitive," resulting in "benefits to the consumer in the form of substantial reductions in the price of long-distance service as well as numerous technical improvements and the development of new services."[15] Real average revenue per minute for long distance carriers has declined substantially since the divestiture of AT&T, and it continues to fall.[16] More importantly, real long distance prices have fallen even when access charges are netted out.[17]

GTE argues that if the merger takes place, "two firms -- AT&T and the combined MCI/WorldCom -- would control at least 74% of the national long distance market." *GTE Petition* at 34. But using GTE's own figures (which place WorldCom's share of the market in 1997 at 7%[18]), the combined market share of AT&T and MCI without the merger would be 67%. Clearly, GTE's market-share figures do not explain customer-switching, falling prices, and other signs of vigorous competition in this growing industry.

GTE's analysis of market concentration focuses insufficient attention on the "other" carriers

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[14] Affidavit of Marius Schwartz on behalf of the U.S. Department of Justice, Exhibit 1 to Evaluation of the United States Department of Justice, *Application of BellSouth Corporation, BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in South Carolina*, FCC Docket CC 97-208, at ¶ 94.

[15] *See* Declaration of Robert E. Hall ¶¶ 32, 33 ("Hall Decl.") (Atch. C to Joint FCC Reply).

[16] *See* Hall Decl. ¶38.

[17] *See* Hall Decl. ¶¶40-43.

[18] *See* Harris Aff't Exh. 25.

category. According to the most recent figures from the FCC, this category accounted for over 12.1% of presubscribed lines in 1996. *See* J. Zolnierek & K. Rangos, *Long Distance Market Shares-Third Quarter 1997*, Table 2.2 (FCC Common Carrier Bureau, Industry Analysis Division, Jan. 1998). This category comprises over 600 competitors, at least 20 of whom have annual revenues over $100 million, and several of whom have revenues exceeding $1 billion, including LCI, Excel, Frontier, and GTE. *See id.* at 4 and Table 3.1. Smaller companies, too, can and do compete cost-effectively against larger carriers.

This "other" category is the fastest growing segment of the industry with annual growth rates *exceeding 40 percent* (*see id.* at Table 2.3) -- and this growth does not include the several carriers that began building huge new national networks within the last few years and are now beginning to carry revenue-generating traffic.[19] These statistics are not surprising to anyone familiar with the industry. As explained in more detail in our Joint FCC Reply (at 34-39), all long-distance carriers have access to long-distance capacity at competitive prices, dozens of long distance carriers own facilities and can expand their facilities-based networks at relatively low and decreasing cost, and new competitors can become important market participants virtually overnight.

As the Department of Justice's Merger Guidelines indicate, "[i]n markets where entry is easy . . . , the merger raises no antitrust concern and ordinarily requires no further analysis."[20] In the last twelve months alone, a number of carriers -- including Qwest, IXC, Williams Co. and Level 3 Communications -- have started to construct national fiber networks or announced plans to expand

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[19] *See* Joint FCC Reply at 35-37 and Atch. B ¶¶ 36-46.

[20] Merger Guidelines ¶ 3.0.

significantly.[21] Each plans to build a national fiber network close to the size of MCI's current network.[22] The competitive significance of these new networks is magnified by the number of firms that will own and operate significant capacity on them. Qwest has sold significant capacity on its network to Frontier and GTE, and IXC has sold capacity to five other firms in addition to WorldCom and MCI.[23] Qwest has announced that by September 14, 1998, it will provide services in Jacksonville, Daytona Beach, Melbourne, West Palm Beach, Fort Lauderdale and Miami.[24] Qwest's service in Orlando and Tampa is scheduled to begin in November, 1998.[25] In addition, Interstate FiberNet currently provides service in Miami, Fort Lauderdale, West Palm Beach, Fort Myers, Jacksonville, Sarasota, Tampa, Orlando, Ocala, Gainesville, and Tallahasee,[26] and between now and September, 1998 will be deploying service in Daytona, Homestead, Hollywood, Vero Beach, Melbourne, Cocoa Beach, Port Charlotte, and St. Augustine.[27] These facts confirm the Wall Street Journal's recent report that "[t]he telecom industry is being shaken to its circuit switches by network upstarts that are building new systems promising far faster transmission and lower operating costs

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21 A description of these networks is set forth in the Joint FCC Reply at 35-36 and Atch. B ¶ ¶ 36-45. *See also* Carlton/ Sider Aff't at ¶ ¶ 6 and 7.

22 *See* Hall Decl. ¶ 12, Attachment C to Joint FCC Reply. Qwest has stated that its network, to be completed by early 1999, will consist of "over 700,000 miles of the world's purest fiber optics [and] will offer more carrying capacity that any other long-distance provider." http://www.qwest.net/networkupdate.html

23 Joint FCC Reply, Atch. B ¶ 41.

24 Carlton/Sider Aff't ¶ 15.

25 *Id.*

26 Carlton/Sider Aff't ¶ 16.

27 *Id.*

than the vast systems now being run by AT&T Corp., the Bell companies and others."[28]

These new facilities-based competitors take advantage of the decreasing cost per unit of constructing new fiber networks or expanding existing ones. Rapid improvements in electronics, including developments in multiplexing and laser technology, enable new and existing competitors to increase exponentially the amount of traffic that a single strand of fiber can carry, allowing rapid expansions of a carrier's network capacity without acquiring an additional mile of fiber. In addition, arrangements like that used by Qwest, in which a number of carriers share the costs of laying large quantities of fiber, have significantly reduced the costs to individual carriers of laying cable to create national networks. The rapid growth of interexchange usage for voice and data services spurred by dramatic declines in price has created an enormous market more than sufficient to support multiple carriers, including multiple facilities-based carriers. In sum, there is no shortage of facilities-based contenders -- and no shortage of capital for those contenders to draw on -- competing for market share in the burgeoning telecommunications industry.

GTE argues that the new entrants' networks are not competitively significant, because no single network achieves the national coverage of the top four. Harris Aff't at 8-10. However, this claim is refuted by the experience of Excel, perhaps the nation's largest reseller, which relies extensively on "second tier" providers of wholesale service. Carlton/Sider Aff't ¶ 12. This experience shows that "resellers can be sophisticated buyers that can assemble the necessary geographic coverage by relying on smaller networks." *Id.*[29] In addition, GTE has mischaracterized

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[28] *Wall Street Journal*, Jan. 20, 1998, p. A3.

[29] For a further description of Excel's successful experience in relying on several wholesale providers, *see* "Excel CEO Relives Frontier Daze: A Look at the Carriers' Carrier

the scope and coverage of new networks and the speed with which they can expand. *Id.* ¶ 13.

GTE argues that MCI WorldCom, after the merger, will stop supplying competitors service at a wholesale discount, in order to avoid undermining sales under the MCI brand name. *GTE Petition* at 5, 10-13, 28-33. GTE suggests that it is crucially dependent on its wholesale contract with WorldCom, and that the merger will force it into more costly arrangements with either Sprint or AT&T. *Id.* at 31 and attached Covey Aff't at ¶ ¶ 3-6.

GTE has created a false impression of its reliance on its contract with WorldCom for wholesale long-distance services. GTE itself admits that its contract with WorldCom is "multi-year," thus protecting it from immediate cancellation. Covey Aff't ¶ 3.[30] Moreover, GTE has already announced that it will be in a position *in 1998* to obtain long-distance service from other sources (not including the supposedly higher-priced AT&T or Sprint). On May 6, 1997, GTE announced a series of transactions (*not involving WorldCom, MCI, Sprint or AT&T*) which will "position GTE to have the fastest, most reliable and most secure national network available, enabling end-to-end managed network solutions that we believe will be unmatched in the industry."[31] GTE explained that this network, which it is purchasing from Qwest Communications, would be "fully operational next year" and that "[a]t that point, we will be in a position to reach virtually the entire

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Game," tele.com (February, 1998, at p. 116. The article is accessible on line at http://www/teledotcom.com/0298/opinion/tdc0298ondemand.html.

[30] The terms of the contract are confidential. If the Commission wishes to request a copy of the contract to ascertain the full extent of the "multi-year" protection GTE enjoys under it, we would be happy to submit a copy pursuant to a confidential request under section 364.183 and Rule 25-22.006.

[31] A copy of the GTE announcement, which was obtained from the Internet at GTE's web site, is attached. http://www.gte.com/g/news/050697.html

U.S. population." *Id.*

There is, in short, simply no basis for GTE's claim that it is in danger of losing its WorldCom contract and being forced to obtain service at a higher price from AT&T or Sprint.

Nor is there any factual basis for the claim that GTE will be harmed because only WorldCom is willing to offer advanced services that GTE wants to buy. In the first place, GTE announced that the network it is acquiring, which will be "fully operational" in 1998, will be an "advanced data network" that will enable GTE to "[d]evelop innovative and value-added communications services to meet customer needs" and "[r]apidly deploy 'next generation' value-added services and Internet Protocol offerings." *Id.*

It is worth repeating that this network does *not* depend on WorldCom or MCI. Instead, GTE has announced its "purchase of a national, state-of-the-art fiber-optic network from Qwest Communications." *Id.* (emphasis in original). The Harris Affidavit, attached to GTE's pleading, states that the Qwest network does not reach Florida. Harris Aff't p. 9 and Exh. 15. But in fact, Qwest has announced that its network will provide service to all the following cities in Florida by the end of 1998: Jacksonville, Daytona Beach, Melbourne, West Palm Beach, Fort Lauderdale, Miami, Orlando and Tampa.[32]

Another flaw with GTE's claim is its own admission that it has not attempted to purchase advanced services from WorldCom. Ms. Covey admits that "GTE LD has not yet chosen to purchase such [advanced] service from WorldCom." Covey Aff't ¶ 5. Perhaps that is because GTE is acquiring this capability through its transaction with Qwest. In any event, GTE's claim of injury

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[32] See Carlton/Sider Aff't at ¶ 15.

rests on the assertion that sometime in the future it might want to acquire from WorldCom advanced services which it has not yet ordered from WorldCom, but has already arranged to obtain elsewhere.

Moreover, GTE's argument assumes that wholesale and retail services are separate markets. They are not. Long distance transmission capacity is fungible (a DS-3 is a DS-3 whether a wholesale or retail customer buys it) and switches perform the same function whether the service is marketed by the owner of the switch or by a reseller. Switch-based and switchless resellers simply buy dedicated and switched services in the volumes that qualify them for the same discounts that large retail customers obtain for basically the same services. The long-standing FCC prohibition against unreasonable restrictions on the resale of interexchange services complements market pressure to make interexchange services available to resellers on nondiscriminatory terms and conditions.[33]

In short, resellers have ready access to retail services, including those retail services with large volume driven discounts, and facilities-based carriers that market to retail customers can easily market to resellers. The upshot is that if MCI WorldCom were to stop giving discounts for wholesale customers, carriers that do not currently market to resellers would jump at that opportunity, and they can easily increase wholesale sales because the same capacity that is used for retail services can be used for wholesale services and that capacity can be expanded at relatively low

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[33] *See In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Domestic Public Switched Network Services*, 83 F.C.C.2d 167 (1980), *aff'd sub nom., National Association of Regulatory Utility Commissioners v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984); *see also In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities*, 60 F.C.C.2d 261 (1976), *motion for reconsideration granted in part and denied in part*, 62 F.C.C.2d 588 (1977), *aff'd, AT&T v. FCC*, 572 F.2d 17 (2d Cir. 1978).

cost.

Also, the resellers themselves can build or purchase their own facilities if adequate discounts for wholesale customers are not available. A typical path for new interexchange carriers -- successfully followed by MCI and WorldCom among others when the market was dominated by AT&T and much more concentrated than it is today -- was to go into business primarily as a reseller and then, over time, to add their own facilities.[34] In fact, most carriers that buy services for resale own at least some of their own switching and transmission facilities, including significant regional networks, and the cost to these carriers to expand the capacity of their transmission networks through enhanced electronics may be lower than the cost of constructing new networks from scratch, although the per-unit costs of laying fiber are also decreasing as carriers join together to share these costs.[35] Facilities-based carriers thus could not refuse to give adequate discounts for wholesale customers, because many of their reseller customers would simply accelerate construction of their own facilities. Then, having built these facilities, the former wholesale *customer* would be likely to become a wholesale *competitor*, since carriers that choose to build their own facilities often include sufficient capacity to supply not only their own needs but also those of other carriers. The fact that many carriers are currently choosing to build or purchase rather than lease in a competitive wholesale market demonstrates that the option of building and purchasing new facilities constrains wholesale prices.

Given these market conditions, tacit collusion to withdraw discounts for wholesale

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[34] Carlton/Sider Aff't ¶ 21.

[35] Carlton/Sider Aff't ¶ ¶ 6, 7; Joint FCC Reply Atch. B ¶ ¶ 39, 40, 41, 44.

customers is out of the question, and GTE's purported concern about such collusion is misguided. Even putting aside the inducement to new entry that increased prices resulting from tacit collusion would create, tacit collusion could not occur as a practical matter because wholesale services are sold under carrier-to-carrier contracts that are not publicly filed and that are often customized. Moreover, purchasers of wholesale services are sophisticated consumers experienced in playing competing providers against each other.[36]

There is no basis for GTE's argument that a facilities-based interexchange carrier with capacity to support a successful retail business would not use that capacity to support a successful wholesale business. In fact, MCI *and AT&T* sell on a substantial scale to *both* wholesale *and* retail customers.[37] AT&T's history of significant participation in the wholesale market is particularly significant: if GTE's argument were correct, AT&T would not have made *any* wholesale sales.[38]

If interexchange carriers with retail customers were to refuse to sell to resellers (assuming they could do so legally), the resellers could follow the familiar path of constructing their own facilities, or they can obtain capacity on favorable terms from wholesale-oriented competitors like Qwest, Williams and IXC. GTE itself is a good example of an interexchange carrier that began by reselling intercity services and is now rapidly becoming a substantial facilities-based provider. [39] Facilities-based interexchange carriers therefore face a simple choice: (1) get no revenue from a

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[36] *See* Hall Decl. ¶¶ 20-24 (Atch. C to Joint FCC Reply).

[37] Carlton/Sider Aff't ¶¶ 18-21.

[38] The Harris Affidavit, attached to GTE's comments, significantly understates the extent of AT&T's participation in the wholesale market. Carlton/Sider Afft ¶¶ 18-21.

[39] *See* GTE's announcement of its purchase of network capacity from Qwest.

competitor because the competitor obtains capacity from other facilities-based interexchange carriers or constructs its own; or (2) get some revenue by selling available capacity to the competitor on nondiscriminatory terms. It is not surprising that many facilities-based interexchange carriers, including MCI and AT&T as well as WorldCom, choose the second option -- which incidentally also complies with their FCC-mandated resale obligations. And of course, if MCI and WorldCom each individually has an incentive to compete for wholesale as well as retail customers, so too will the merged company.

C. Residential and small business customers.

CWA argues that the merger will result in a cut back of MCI's plans to serve residential and small business customers. But nothing in the merger provides an economic reason to cut back on investments in residential and small business service; if such investments made economic sense before the merger, they will after. Indeed, the merger enhances the economic attractiveness of residential and small business service. One of the principal reasons for this merger is that the combined company will have an enhanced ability to offer consumers a total package of services: local, long distance, wireless, international and Internet. MCI already has a strong base nationwide of millions of residential customers for its long-distance service. Many residential customers prefer buying all their telecommunications services from a single company and receiving a single bill. The more customers the combined company has for its local services, the more potential customers it has for its other services. If the combined company does not offer full service packages, including local service, other companies will. At bottom, the whole point of this merger is to gain and retain customers, not lose them -- to grow faster, not slower.

Moreover, in order to recover its embedded investments, the combined company will have

a powerful financial incentive to fully load its local networks, including by carrying traffic of residential customers in off-peak hours. As MCI's President has explained, "you build capacity to handle the needs of your business customers during the work week in the daytime, and you have to start recruiting residential customers who use the network mostly at night and on weekends. That's the only way you can get efficient use of your capacity."[40]

The President and CEO of WorldCom and the Chairman of MCI, in a recent joint letter to the Chairman of the FCC, have reaffirmed that "MCIWorldCom intends to be the leading local service competitor for both residential and business customers of all sizes across the country."[41] The letter explains the business logic: "MCI WorldCom will have an established base of residential and business customers, the marketing and product-development expertise to reach those customers, and the local facilities that will be used most efficiently by carrying residential night and weekend traffic along with business traffic."[42]

CWA asserts that WorldCom's SEC filings show that the combined company plans to "abandon MCI's previous plan to build out its network in order to serve residential and small business customers." *CWA Petition* at 5. But the figures CWA cites represent cost efficiencies in carrying out present plans to *expand* local service. WorldCom explained to the SEC that its estimated savings in local services will occur because "[a]s a result of WorldCom's extensive local

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[40] J. Van, "MCI Deal May Cut Consumer Phone Bills $37 Billion," *Chicago Tribune*, Nov. 11, 1997.

[41] A copy of the letter, dated January 26, 1998, from Bernard J. Ebbers and Bert C. Roberts, Jr. to FCC Chairman William Kennard, is attached.

[42] *Id.*

network and operations, the combined company *will be able to execute MCI's plans to expand in the local market at a lower cost* than MCI would be able to on a stand-alone basis."[43]

CWA quotes remarks attributed to a WorldCom executive, John Sidgmore, in a *Washington Post* article of October 3, 1997. *CWA Petition* at 4-5. But what CWA does not say is that the next day, the *Washington Post*'s Assistant Managing Editor took the unusual step of publicly admitting that the "wording [of the Oct. 3 article] was stronger than Sidgmore's remarks warranted;"[44] WorldCom also widely disseminated a press release disclaiming any intent to abandon residential customers.[45]

Residential and small business customers will benefit if the local exchange market in Florida -- now overwhelmingly dominated by BellSouth and GTE -- becomes significantly competitive. This merger will advance that goal and thus benefit the public interest and all Florida consumers.

III. The merger will not undermine universal service.

CWA argues that the merger will undermine the availability of quality service at affordable rates in rural, high cost and inner city areas. *CWA Petition* at 9-12. CWA argues that the combined company will (1) divert local exchange service to businesses from the public switched network, draining resources now available to the incumbents for their universal service obligations; and (2)

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[43] *See* Form S-4, Atch. G to Joint FCC Reply, at 42-43 (emphasis added).

[44] M. Mills, "WorldCom Clarifies MCI Plans," *Washington Post*, Oct. 4, 1997.

[45] "WorldCom Will Not Abandon MCI's Residential Long Distance Customers; Combined Company to Offer Competitive Choices For Both Local and Long Distance Service," Press Release, Oct. 3, 1997.

bypass the access charge regime that compensates LECs for use of their local exchange facilities.

CWA's argument rests entirely on the faulty foundation that universal service support will remain implicit in local business rates and access charges. Under Section 254 of the Telecommunications Act of 1996, these implicit subsidies are to be eliminated and replaced with explicit subsidies. As explicit funding mechanisms become fully implemented, local business rates and access charges are to be reduced to cost, thereby eliminating the implicit subsidy for universal service. The implicit subsidies that CWA fears will be lost as a result of the merger will be replaced by explicit subsidies. As the second-largest provider of interstate telecommunications services in the country, MCI WorldCom expects to pay a substantial contribution to support universal service.

CWA's argument also misses the point that local competition will drive down the price of local service for all consumers and thereby make telephone service more affordable and more universally available. To the extent that service to some customers should still be subsidized to keep rates affordable, these subsidies should be provided through the reform of universal service that is underway, not by suppressing local competition, whether by blocking a procompetitive merger or otherwise.[46]

IV. The merger will create jobs.

As previously described, a principal reason for this merger is to create a company that will offer significant competition to the incumbent local exchange monopolies. Indeed, the merger will be a failure unless the combined company vastly increases its market share beyond the minuscule share of the local exchange market that MCI and WorldCom now have. This growth will benefit not

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[46] CWA's argument on universal service is discussed at more length in the Joint FCC Reply at 23-26.

only WorldCom and MCI shareholders and consumers; it will also create new jobs. The companies anticipate addition of 10,000 *new* positions in the next 18 to 24 months -- a 14% *increase* in the total employee base. As stated by Bernard J. Ebbers, WorldCom's Chief Executive Officer, at the press conference held on November 10, 1997 to announce the merger agreement between WorldCom and MCI, "As a 20% growth company, *we're going to add employees, not remove employees.*"

CWA argues that the merger "translates into the loss of 75,000 telecommunications jobs that would have been created by the year 2002, absent the merger." *CWA Petition* at 23. CWA arrives at its predicted job loss by assuming every dollar of saved capital expenditures, and half the amount of saved operating expenses, represent employment costs. *Id.* But the MCI WorldCom savings projections are based primarily on the avoidance of non-cost based access charges otherwise paid directly to incumbent local exchange carriers, the ability to use WorldCom's existing local networks to be able to execute MCI's plans to expand in the local market at a lower cost than MCI would be able to do on a stand-alone basis, and other purely financial savings.[47] On that basis alone, CWA's calculations are wrong. But more significantly, CWA totally ignores the employment *growth* that must inevitably occur if the merger is successful and the combined company significantly increases its sales and market share. As Scott Sullivan, WorldCom's Chief Financial Officer, stated at the November 10, 1997 press conference, "One thing I want to emphasize . . . is that we have the ability to hit every SG&A number that we've put out and still add 10,000 people in the next 18 to 24 months."

CWA cites the fact that a few weeks after the merger announcement, MCI announced "1500

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[47] *See* WorldCom's Registration Statement, Attachment G to MCI WorldCom Joint FCC Reply at 40-43.

layoffs." *CWA Petition* at 24.[48] However, nothing in this announcement links the job cuts to the merger. Indeed, the announcement makes it plain that the job cuts relate to difficulties MCI has been having entering the local market -- which the merger should help resolve. If the synergies achieved by the combined company achieve their goal of greatly expanding the present minuscule market share that the two companies now have in the local exchange market, the number of employees will inevitably increase. On the other hand, blocking the merger would lessen the chances of significant expansion and thereby lessen the chances of significant future employment growth.

V. The merger will not harm competition on the Internet, and will do nothing to alter the vibrant, explosive growth of the Internet.

Competition on the Internet presents inherently interstate, nationwide issues, which are presently being addressed by the U.S. Department of Justice and the Federal Communications Commission. The arguments that CWA is making on that issue in this proceeding are the identical arguments it is also making before the FCC. It would be duplicative and cumulative for this Commission separately to cover the same ground, even if it had authority to do so under section 364.33.

In any event, there is no merit to the contentions that the merger will have an adverse effect on competition in the Internet. CWA asserts that the combined company will control half or more of the so-called Internet backbone, and thereby wield market power over the Internet. *CWA Petition*

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[48] The news release CWA cites states that while MCI cut "as many as 1,500 jobs," of these "as many as 1,000 were contractors who work on special projects." LA Times (Bloomberg News), "MCI to Take Up to $750 Million in Pretax Charges for Quarter" (Dec. 25, 1997).

at 13-21. This assertion, however, ignores the fact that the so-called Internet backbone is made up of basic telecommunications transmission facilities and equipment that are widely available and easily affordable by new market entrants. In fact, the number of backbone providers has grown dramatically in the last year.

On a threshold point, WorldCom and MCI vigorously disagree with the suggestion that there is a separate "Internet backbone" market. An Internet backbone is generally understood to consist of TCP/IP[49] routers, switches and other equipment, such as modems, connected to basic underlying telecommunications transmission facilities. Because the same transmission facilities are used for Internet backbone and other services, including traditional voice and data services, any communications company that wishes to become a backbone provider can do so by purchasing the appropriate TCP/IP equipment and connecting such equipment to the transmission facilities that it leases or owns. None of the commenters claim that acquiring this equipment is a significant barrier to entry, and since neither MCI nor WorldCom manufactures this equipment, the merger will not affect equipment sales. The fungibility of transmission facilities used for Internet services and other circuit-switched and packet-switched services precludes any finding of an independent and distinct market for "Internet backbone" services.

The natural consequence of this fact is that competition to provide Internet backbone services is as vigorous as competition to provide the interexchange telecommunications services supported by telecommunications transmission facilities. Existing providers, low barriers to entry, continued

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[49] "TCP/IP" stands for "Transmission Control Protocol/Internet Protocol," which is the common communications protocol that joins the thousands of interconnecting networks that form the Internet.

exponential growth, and a protocol specifically designed to provide flexibility and accommodate change, combine to ensure that no company could conceivably dominate the provision of Internet services.

The ability of customers to change ISPs means that MCI WorldCom could not try to take advantage of them without triggering a market backlash. Customers change ISPs on a regular basis. The merger will have no effect on the ease of making such changes.

Nor will the merger have any effect on peering. MCI WorldCom will have the same imperative to interconnect with other ISPs (whether by peering or otherwise) that each company has now -- MCI WorldCom will be only one of the thousands of ISPs that provide Internet service, and it must be able to offer its customers access to all of these networks through interconnection with other ISPs.[50]

VI. Other parties' comments before the FCC are not properly before this Commission.

GTE attempts to incorporate the comments made by other parties opposing the merger in proceedings before the FCC. *GTE Petition* at 37-38. These commenters, however, have chosen not to participate in the proceeding before this Commission -- strongly indicating that they have no Florida-specific concerns. There is no reason for this Commission to consider comments made by parties who did not take the trouble to submit them in this proceeding. In any event, the Joint FCC Reply filed by WorldCom and MCI, and attached hereto, fully responds to the contentions made in these other comments.

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[50] For a more detailed discussion of the peering issue, see the Joint FCC Reply at 80-86 and Atch. B at ¶ ¶ 74-77. For a more detailed discussion of the Internet generally, see the Joint FCC Reply at 65-91, and Atch. B at ¶ ¶ 59-77.

VII. A hearing is neither required nor appropriate.

GTE argues that there should be an adjudicatory hearing on the application under section 120.57, Florida Statutes. Section 120.57(a) requires a hearing for "disputed issues of material fact." GTE has not identified any such issues. Rather, the questions GTE raises in this case involve economic predictions as to competitive impacts. Even if the Commission had authority to consider these issued under section 364.33, a hearing would not be required. The Commission should follow the practice of the FCC, which is also required to hold hearings where there is a "substantial and material question of fact." 47 U.S.C. § 309(d). The FCC's practice is not to hold hearings in merger cases, on the ground that in such cases the points at issue "do not reflect disputes over material facts but focus primarily on inferences and conclusions to be drawn from the facts, namely, the competitive impacts of the merger." *Applications of Craig O. McCaw and American Telephone and Telegraph Company*, 9 FCC Rcd 5836, ¶ 173 (1994). On this basis, the FCC concluded in a major contested merger proceeding that "[n]o persuasive showing has been made that a full evidentiary hearing would produce additional facts that would assist us in any meaningful way to resolve the various claims and arguments raised by the parties." *Id.* The federal court of appeals affirmed the FCC's decision, agreeing that the dispute before the Commission involved "just the sort of 'legal and economic conclusions concerning market structure, competitive effect, and the public interest' that 'manifestly do not' require a live hearing. . . . . [A]n 'evidentiary hearing would less promote reasoned decisionmaking in this case than it would delay and impede' the Commission's decision." *SBC Communications, Inc. v. FCC*, 56 F.3d 1484, 1497 (D.C. Cir. 1995) (affirming the Commission's approval of the AT&T - McCaw Cellular merger), quoting *United States v. F.C.C.*, 652 F.2d 72, 89-90 (D.C. Cir. 1980).

The Commission can fairly accurately predict what a hearing in this matter would entail. A lengthy prehearing conference would be followed by the customary plethora of discovery forays, disputes, and law and motion hearings. When the hearings themselves actually commence, the Commission will be treated to the usual battle of expert witnesses whose opinions will fill volumes of transcripts. And at the end of this long, laborious process, the ultimate questions will be issues of law and policy which the Commission can resolve now. A hearing would serve only to "'delay and impede' the Commission's decision." *SBC Communications, Inc. v. FCC*, *supra*, 56 F.3d at 1497.

Contrary to the impression GTE seeks to create, several States in which MCI and WorldCom have filed applications for approval of the merger have decided that hearings are not necessary.[51] For example, in New York, the Commission held that neither GTE nor the other intervenor in the case "have shown that there are factual issues which would require" evidentiary hearings.[52] The Commissions in Louisiana and Ohio have also rejected GTE's requests for evidentiary hearings on the grounds that such hearings are not necessary.[53] The staff of the Minnesota Commission has

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[51] Moreover, more than half of all jurisdictions in the nation do not even require transfer of control applications for the transaction proposed by MCI and WorldCom. In those jurisdictions, pre-merger notification or post-consummation notification satisfies the State commission's review criteria.

[52] Petition of WorldCom, Inc. for Approval to Transfer Control of MCI Communications Corporation to WorldCom, Inc., Case 97-C-1804, *Order Denying Motions for Evidentiary Hearings and Inviting Comments*, (NYPSC, Jan. 26, 1998) at 1.

[53] On February 18, 1998, the Louisiana Public Service Commission approved a staff recommendation not to hold hearings. No Order has yet been issued. Docket No. U-22861 (La. PSC), *Staff Report and Recommendation* (Feb. 12, 1998) at 4. *See also* Ohio Public Utilities Commission, In the Matter of the Application of WorldCom, Inc. and MCI Communications Corporation for Approval of an Agreement and Plan of Merger, Case Nos. 97-1580-CT-ZCO,

reached the same conclusion.[54] In addition, the Delaware, Maryland, Mississippi, and Utah Commissions have considered the transfer of control application and have approved it, or declined to exercise their authority over the transaction, without holding evidentiary hearings.[55]

Conclusion

For the foregoing reasons, WorldCom and MCI respectfully request that the Commission deny GTE's Petition on Proposed Agency Action and Request for Section 120.57 Hearing and

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97-1581-TP-ACO, *Entry* (Ohio PUC, Dec. 30, 1997) at 3, 4 (rejecting GTE's request for hearings).

[54] The Minnesota staff recommendation reflects the reasoning of the FCC and the D.C. Circuit in the AT&T-McCaw merger case, described in the text. Joint Petition of WorldCom, Inc. and MCI Communications Corporation for Approval of the Acquisition of All the Outstanding Shares of Stock of MCI by WorldCom, Docket No. P443-3012/PA-97-1532, *Minn. PUC Staff Briefing Papers for Meeting Date Mar. 3, 1998* at 7:

> The questions raised by GTE do not appear to be factual matters relating to the specifics of the WorldCom/MCI merger agreement, but requests for projections of what the competitive marketplace will look like in the future and what marketing or pricing decisions WorldCom or MCI will consider. Many of the questions would be impacted by other variables in addition to the proposed merger transaction. It appears that the [WorldCom and MCI] have provided the necessary information for the Commission to consider their merger petition.

[55] Application of WorldCom, Inc. for Authority to Transfer Control of MCI Communications, Corporation to WorldCom, Inc., Docket No. 97-362 (Del. PSC), *Order No. 4672* (Dec. 9, 1997); Letter from Daniel P. Gahagan, Executive Secretary, Maryland P.S.C. to Jean L. Kiddoo, Esq., Dec. 10, 1997; Joint Petition of WorldCom, Inc. and MCI Communications Corporation for Approval to Transfer Control of MCI Communications Corporation to WorldCom, Inc., Dkt. No. 97-VA-667 (Miss. PSC), *Order* (Dec. 17, 1997); Application of WorldCom, Inc. for Approval to Transfer Control of MCI Communications Corporation to WorldCom, Inc., Dkt. No. 97-2245-02 (Utah PSC), *Report and Order* (Jan. 14, 1998).

CWA's Petition to Intervene and Protest of Proposed Agency Action.

Respectfully submitted,

MCI COMMUNICATIONS CORPORATION

By: Tom Bond by FHS

Tom Bond
MCI COMMUNICATIONS CORPORATION
780 Johnson Ferry Road
Atlanta, GA 30342
(404) 267-6315 (Tel)

By: Richard D. Melson by FHS

Richard D. Melson
HOPPING, GREEN, SAMS & SMITH
123 South Calhoon Street
Tallahassee, FL 32301
(850) 222-7500 (Tel)

Its Counsel

WORLDCOM, INC.

By: Jean Kiddoo by FHS

Jean L. Kiddoo
Robert V. Zener
Kathy L. Cooper
SWIDLER & BERLIN, CHARTERED
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7834 (Tel)

By:

Floyd R. Self
MESSER, CAPARELLO & SELF, P.A.
215 S. Monroe Street, Suite 710
P.O. Box 1876
Tallahassee, FL 32302
(850) 222-0720 (Tel)

Its Counsel

March 3, 1998

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of Joint Answer of WorldCom, Inc. and MCI Communications Corporation to GTE Petition on Proposed Agency Action and Request for Section 120.57 Hearing and CWA Petition to Intervene and Protest of Proposed Agency Action in Docket No. 971604-TP has been furnished by Hand Delivery (*) and/or U.S. Mail to the following parties of record this 3rd day of March, 1998:

Martha Brown, Esq.*
Division of Legal Services, Room 370
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Mr. Richard Tudor*
Division of Communications, Room 270
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

Richard D. Melson*
Hopping Green Sams & Smith
123 S. Calhoun St.
Tallahassee, FL 32301

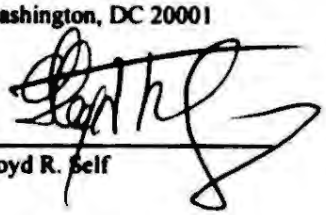
Thomas K. Bond
MCI Telecommunications
780 Johnson Ferry Road, Suite 700
Atlanta, GA 30342

Mr. Brian Sulmonetti
LDDS WorldCom
1515 S. Federal Highway, Suite 400
Boca Raton, FL 33432

Jean L. Kiddoo, Esq.
Swidler & Berlin, Chartered
3000 K Street, N.W., Suite 300
Washington, DC 20007

Kimberly Caswell, Esq.*
c/o Ms. Becki Edmondston
GTE Florida Incorporated
106 E. College Ave., Suite 810
Tallahassee, FL 32301

George Kohl
Debbie Goldman
Communications Workers of America
501 Third St., N.W.
Washington, DC 20001



Floyd R. Self

Attachment

Joint Reply of MCI and WorldCom, filed January 26, 1998 in FCC merger review proceeding (separately bound volume)

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Applications of WorldCom, Inc. and	)	
MCI Communications Corporation for	)	CC Docket No. 97-211
Transfer of Control of MCI Communications	)	
Corporation to WorldCom, Inc.	)	

To: The Commission

JOINT REPLY
OF WORLDCOM, INC. AND MCI COMMUNICATIONS CORPORATION
TO PETITIONS TO DENY AND COMMENTS

MCI COMMUNICATIONS CORPORATION

Michael H. Salsbury
Mary L. Brown
Larry A. Blosser
MCI COMMUNICATIONS CORPORATION
1801 Pennsylvania Ave., N.W.
Washington, D.C. 20006-3606
(202) 872-1600

Anthony C. Epstein
John B. Morris
Ian H. Gershengorn
JENNER & BLOCK
601 Thirteenth St., N.W.
Washington, D.C. 20005
(202) 659-6000

WORLDCOM, INC.

Andrew D. Lipman
Jean L. Kiddoo
Michael W. Fleming
SWIDLER & BERLIN, CHTD.
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

Catherine R. Sloan
Robert S. Koppel
WORLDCOM, INC.
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 776-1550

Dated: January 26, 1998

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Applications of WorldCom, Inc. and	)	
MCI Communications Corporation for	)	CC Docket No. 97-211
Transfer of Control of MCI Communications	)	
Corporation to WorldCom, Inc.	)	

To: The Commission

JOINT REPLY
OF WORLDCOM, INC. AND MCI COMMUNICATIONS CORPORATION
TO PETITIONS TO DENY AND COMMENTS

MCI COMMUNICATIONS CORPORATION

Michael H. Salsbury
Mary L. Brown
Larry A. Blosser
MCI COMMUNICATIONS CORPORATION
1801 Pennsylvania Ave., N.W.
Washington, D.C. 20006-3606
(202) 872-1600

Anthony C. Epstein
John B. Morris
Ian H. Gershengorn
JENNER & BLOCK
601 Thirteenth St., N.W.
Washington, D.C. 20005
(202) 659-6000

WORLDCOM, INC.

Andrew D. Lipman
Jean L. Kiddoo
Michael W. Fleming
SWIDLER & BERLIN, CHTD.
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

Catherine R. Sloan
Robert S. Koppel
WORLDCOM, INC.
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 776-1550

Dated: January 26, 1998

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SUMMARY

1. **Local exchange market.** The local exchange markets at present are subject to the near-total monopoly domination of the incumbent carriers. Bringing meaningful competition to these markets, in the face of fierce resistance from the entrenched incumbents, requires not only forceful regulatory and legal action, but a strong and aggressive competitor to lead the way. The combined MCI WorldCom will be that strong and aggressive competitor. MCI has a national brand name and a broad residential and large business customer base. WorldCom has an extensive local exchange network and predominantly business customer base that includes many small businesses. That combination -- plus the efficiencies and financial savings the merger will achieve -- will allow the combined company to mount a more serious challenge to the entrenched incumbents than the two companies could accomplish separately.

The combined company will have at least as much motivation as the separate companies to challenge the incumbents' present market domination. Indeed, the merger will be a failure, and a waste of the billions that each company has invested in the local markets, unless the combined company can substantially cut into the incumbents' market share by aggressively winning over their customers.

There is no substance to the charge that the merger will result in a cutback of MCI's previous commitment to residential local exchange service. Given the importance in today's market of "one-stop shopping," the combined company will offer local service to MCI's present base of long-distance residential customers, among other things, to help retain those customers for its other services. As both companies' Chairman will confirm in writing to Chairman Kennard, both MCI and WorldCom are fully committed to continuing MCI's longstanding commitment to residential customers. Nor will the merger harm universal service. Increased local competition, by driving

down local phone rates for all consumers, should help make local telephone service more universally available. To the extent that this process drives down high local rates that may have provided an implicit subsidy for universal service, that will be replaced by universal service fund contributions, which MCI WorldCom will pay along with other industry participants.

2. Long distance market. The merger will enhance vigorous competition in the long distance market. Vigorous competition demonstrates that coordinated interaction is not occurring with the current market structure. That market is already competitive. This fact, together with low entry barriers, sophisticated customers, and other factors would foreclose any attempt post-merger to increase prices through tacit collusion. Moreover, the industry is becoming less concentrated, as the number of significant facilities-based competitors grows. Additional entry is both easy and actually occurring. New entrants are building extensive new facilities and resellers can quickly acquire the facilities they need to compete, at cost-based rates that entail little or no sunk cost. Significant new facilities-based entry will continue as the market continues to grow and as new entrants take advantage of the decreasing unit cost of constructing new fiber networks or expanding existing ones. In the last 12 months, at least three carriers have started to construct, or announced plans to expand significantly, national networks.

In addition, there are several significant potential entrants -- including the BOCs, who, upon satisfying the requisite regulatory conditions, are reported to be planning "a jihad in long distance." Other potential entrants abound, including electric power companies, independent phone companies and foreign carriers. Given the ease of entry and declining cost of building facilities, there is simply no possibility that the merger would enable MCI WorldCom to restrict output and raise prices; if it did, existing competition would seize the opportunity to capture business, and if the attempt were even partially successful (which it could not be), additional facilities-based entry would only be

encouraged.

Nor will the merger increase the likelihood of collusion. Given WorldCom's present market share, the merger will not alter MCI's position as the number two firm in the interexchange market either in absolute terms or relative to AT&T, which will still be twice the size of MCI WorldCom. This fact, together with low entry barriers and the increasingly "commodity" nature of the long distance market, forecloses any attempt to increase prices through tacit collusion, and will continue to do so after the merger.

The merger will also not reduce residential interexchange competition. The residential market is presently fiercely competitive, as witnessed by declining prices, the approximately 50 million PIC changes a year, and the surge in "dial around" services. If GTE and the BOCs truly believed that excess profit margins existed in the residential long-distance business, they would be competing for these customers outside their home regions (as they are presently free to do). Their failure to do so demonstrates how effective residential interexchange competition really is.

Despite the fiercely competitive nature of the residential business, there is no reason why the merger would decrease the individual companies' existing commitment or incentive to service this market. It made sense for MCI to sell directly to residential consumers before the merger, and it will continue to make sense after the merger. It also made sense for WorldCom to reach the residential market through resellers before the merger, and it will make sense after. Residential customers are important users of network capacity that would otherwise be relatively idle during evenings and weekends, and thus help spread the sunk costs of the network. In addition, residential customers provide a broader market for innovative products.

Finally, there is no basis for the charge that the merger will reduce competition in the wholesale market. At bottom, there is no separate wholesale market, since long distance capacity

is essentially fungible. Any attempt to increase wholesale prices would necessarily fail, because other facilities-based carriers could easily make wholesale services available at lower rates and take advantage of the marketing opportunity. In addition, the resellers themselves could build their own facilities -- as has happened frequently in the past.

3. International. Similarly, the merger will have procompetitive effects in the international market. MCI and WorldCom have complementary international competitive operations, which the combined company will expand upon, with the goal of becoming the first truly global end-to-end competitive carrier offering a complete range of telecommunications services.

GTE's singular assertions that the merger will have anticompetitive impacts are based on its mistaken definition of product markets; its failure to recognize the growing competitiveness and steadily declining prices for international services; the lack of a meaningful distinction between IMTS and international private line services; the relative ease of entry and the presence of hundreds of other competitors; and the fact that after the merger AT&T's market share will still be nearly twice as large as the combined company's. Nor will the merger give the combined company the ability to control undersea cable capacity, as GTE mistakenly alleges.

4. Internet. The assertion that the merger will, in some amorphous manner, enable the combined company to control the Internet "backbone" does not withstand scrutiny. Internet "backbone" consists essentially of telecommunications transmission facilities and supporting equipment, which are being constructed and expanded at an unprecedented rate by virtually every major telecommunications carrier. Any fiber optic transmission capacity can be utilized for this purpose: there is nothing unique about WorldCom's, MCI's or other major carriers' networks. And anyone can buy the necessary routers, servers and other supporting equipment from third party vendors. Thus the commenters' figures on present market shares of traffic would be meaningless

even if they were accurate (and they are not). The key points are low barriers to entry, rapidly expanding capacity, dynamic routing, and explosive growth in demand inducing further expansion and entry.

Nor are the network access points a bottleneck. Anyone can build a new network access point at a low cost and connect to the Internet at any one of multiple locations. Moreover, of the 39 network access points in the U.S., WorldCom operates only seven (and MCI none). Further, there is no validity to concerns expressed by commenters regarding peering arrangements or alleged difficulty in ISPs switching transmission providers.

5. Other Issues. MCI has a proud record of programs serving minority and immigrant communities, and WorldCom's network is predominantly situated in urban areas adjacent to low income housing concentrations. There is thus no basis for raising concerns of potential "redlining."

There is no legal or policy basis for linking approval of the merger to approval of BOC entry into the in-region, interLATA market. The BOCs are entitled to enter the interexchange market only upon satisfaction of the requirements set forth in Section 271 of the Telecommunications Act of 1996.

The record currently before the Commission is ample to permit an informed and reasoned resolution of straightforward issues concerning a merger of two non-dominant carriers. This case does not involve disputes over facts, but rather disputes over inferences and conclusions to be drawn from facts, as well as legal and economic conclusions concerning market structure, competitive effect and the public interest. It is well established that these are not issues that would benefit from a hearing, which would only lead to interminable delay.

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Applications of WorldCom, Inc. and	)	
MCI Communications Corporation for	)	CC Docket No. 97-211
Transfer of Control of MCI Communications	)	
Corporation to WorldCom, Inc.	)	

To: The Commission

JOINT REPLY
OF WORLDCOM, INC. AND MCI COMMUNICATIONS CORPORATION
TO PETITIONS TO DENY AND COMMENTS

WorldCom, Inc. ("WorldCom") and MCI Communications Corporation ("MCI," and, together with WorldCom, hereafter, the "Joint Applicants"), by their undersigned counsel, hereby submit this Joint Reply to the Petitions to Deny and Comments filed in this proceeding on January 5, 1998, with respect to the above-captioned applications (collectively, "Application").[1]

I. INTRODUCTION.

The Commission should approve the merger between WorldCom and MCI because it will increase competition in key telecommunications markets, and poses no significant risk to competition in any market. Consumers of all types in every community in all parts of our nation will benefit from the investment, the innovation, and the competition that the merger will generate. This merger is plainly in the public interest.

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[1] The Applications were filed by WorldCom on October 1, 1997, and were amended by the Joint Applicants on November 21, 1997, to reflect the Joint Applicants' agreement to merge.

The MCI WorldCom merger will improve prospects for solving the most pressing problem in telecommunications markets: the continued dominance of the local exchange by incumbent local exchange carriers, including the Bell Operating Companies (BOCs) and GTE Corporation (GTE). Although two years have passed since enactment of the landmark Telecommunications Act of 1996 (the "1996 Act"), local incumbents continue to control more than 98 percent of local revenues and access lines. That is because the 1996 Act's market-opening provisions have not worked as Congress expected. Incumbents have been too successful at undermining the most procompetitive provisions of the 1996 Act in the courts and in the marketplace. Resale of the incumbent's services holds no prospect for genuine, sustainable competition because it precludes product differentiation and because resale discounts are too low to permit profitable entry. The 1996 Act's most promising innovation -- unbundled access to elements of the existing local network -- has been drained of its power by the intransigence and legal maneuvering of the incumbents. The inability of new entrants to obtain combinations of network elements at economic cost, the absence of final forward-looking cost-based prices for elements in most of the country, and the continued foot-dragging of the incumbents in implementing operations support systems, have all contributed to the defeat of this aspect of Congress' plan for local competition. The only near-term prospect for local competition is through the slowest, and most capital-intensive, method -- construction of local facilities by new entrants.

For meaningful local competition to develop in this challenging environment, there must be *stronger*, not merely more, competitors. Successful entry will encourage, not deter, additional investment in local markets -- just as it has done and continues to do for long-distance and Internet services. The contention of some opponents that WorldCom and MCI would use the merger to

somehow reduce local competition by slowing WorldCom's and MCI's growth is nonsensical -- WorldCom and MCI have invested billions of dollars precisely so that they can capture customers from the incumbents through competitively priced packages of innovative services. Less growth and less competition would benefit only the incumbents.

MCI and WorldCom together have a far greater chance of succeeding in a facilities-based strategy than would either entity standing alone. On the day of closing, MCI WorldCom will be able to pursue facilities-based entry in many more local markets than could either company standing alone. The two companies will have local networks in approximately 100 cities. The merger will enable MCI WorldCom to expand the reach of these networks further and faster. In local markets where both MCI and WorldCom are now trying to establish a presence, their facilities provide complementary, not redundant, capacity. Because the merged company can expand and accelerate the reach of its local facilities and draw on the existing customer bases of the two companies, it will be far better able to compete in more locations than would either entity standing alone.

The merger will also create a stronger local competitor by combining two companies with complementary advantages: MCI's national brand name, marketing experience, and broad residential and large business base, with WorldCom's more diverse business base and the local expertise and local systems of MFS Communications, Inc. and Brooks Fiber Properties, Inc. And MCI WorldCom's substantial base of long distance customers will provide additional strength because it will allow for more efficient provisioning of exchange access -- and stoke the competition on which the Commission is relying to drive down rates. Thus, MCI WorldCom will be in a position to provide a competitive choice for more local customers, and to do so faster than would either entity alone -- first using its own facilities, and then (as pricing, operations support systems ("OSS") and

other obstacles erected by the incumbent local carriers ("ILECs") are broken down) by using unbundled network elements to extend its reach to both residential and business customers.

At the same time, the combined entity poses no risk of domination of any market, and hence no threat to consumer welfare. The interexchange market is robustly competitive today. Rapid growth fueled by declining prices coupled with falling costs, have induced a flood of new facilities-based entry. The merger will permit MCI and WorldCom to compete more efficiently in this dynamically competitive market. Nor should the Commission heed the call of some petitioners to regulate MCI WorldCom's provision of Internet services. The national policy is "to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, unfettered by Federal or State regulation." 47 U.S.C. § 230(b)(2). No single company could even begin to dominate this huge and complex network of networks connecting thousands of ISPs through a protocol designed specifically to permit the routing of transmissions over an almost infinite variety of paths.

There is no substance to the charge that the merger will diminish the two companies' commitment to residential service. MCI's large base of long-distance residential customers represents a significant marketing opportunity for the combined company's local exchange and other services. Residential customers will also be important to the combined company in filling network capacity that might otherwise be idle during off-peak business hours. WorldCom, which presently reaches large numbers of residential customers through resellers and some of its own direct marketing, should find it profitable to continue to do so. The management of both companies is firmly committed to continuing their companies' present commitment to residential service, following the merger.

The public interest posture of this merger is confirmed by the identity of the principal critics -- GTE, a disappointed bidder for MCI (trying to keep its hopes alive by obstructing and delaying this merger), an incumbent local monopolist and a facilities-based interexchange and Internet services provider (understandably disquieted by the prospect of intensified competition resulting from the merger); and two BOCs that share GTE's dread that this merger will provide the spark that ignites local competition (and that also all too predictably seek to use this proceeding to advance their Section 271 agenda.) The issues raised by commenting parties either reflect a misconception of MCI's and WorldCom's current activities and future plans, or are simply unrelated to the Commission's inquiry. As demonstrated in the Application and in this Joint Reply, the concrete and immediate competitive benefits of combining MCI and WorldCom far outweigh any speculative concerns that the merger might decrease competition in any way.

Finally, GTE frivolously asserts that the Application did not contain sufficient information for the Commission even to reach a consideration on the merits. As the Joint Applicants conclusively demonstrate in their Joint Opposition to the Motion to Dismiss,[2] the Application and its supporting documents contain more than sufficient economic justification and other information for the Commission to determine that the transfer of control of MCI's licenses and authorizations to WorldCom is in the public interest.

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[2] Pursuant to the Public Notice dated Jan. 12, 1998, the Joint Opposition to the Motion to Dismiss will be filed tomorrow, January 27, 1998. "Correction," Commission Seeks Comment on GTE Service Corporation Motion to Dismiss Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI to WorldCom, *Public Notice*, DA 98-49 (rel. Jan. 12, 1998).

II. THE MERGER WILL FURTHER THE PUBLIC INTEREST BY ENHANCING THE CHANCE OF ACHIEVING A COMPETITIVE LOCAL EXCHANGE MARKET, WHILE RAISING NO ANTITRUST OR REGULATORY CONCERNS.

The local exchange market is still dominated overwhelmingly by the incumbent telephone companies, with market shares in the high ninety percent range. That is the central, ineluctable fact against which all of the oppositions to the MCI WorldCom merger must be evaluated. It is the incumbent monopolists, not a combined MCI WorldCom, that pose the clear and present danger to the development of local competition, and, in fact, control the only bottleneck that could adversely affect growth of the Internet. The opposition of some of them, especially GTE, to this merger is the best evidence we could present of the pro-competitive nature of this merger. This merger should be approved precisely because it enhances the chance that the incumbent companies' monopoly stranglehold on the local exchange market will be broken.

In the *Bell Atlantic/NYNEX Order*, the Commission concluded that the most significant issue in a merger case is "the extent to which the merger is likely to affect future market structure, conduct and performance."[3] With effective enforcement of the market-opening provisions of the 1996 Act by Federal and state agencies, the merger carries the promise -- and the likelihood --that the local exchange market, which has long been the central focus of the FCC and other telecommunications policy makers and the principal goal of the 1996 Act, will finally become competitive. The merger will create a strong, aggressive nationwide competitor that is better positioned than either of the two

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[3] Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, *Memorandum Opinion and Order*, FCC 97-286, 9 Comm. Reg. (P&F) 187, at ¶ 98 (rel. Aug. 14, 1997) ("*Bell Atlantic/NYNEX Order*").

companies would be separately to challenge successfully the monopoly control presently exercised by the incumbent companies.

Implementation of the 1996 Act has not yet opened local exchange markets to competition. The Act envisioned three avenues for the introduction of local competition in the order of anticipated ease of entry: resale, leasing of unbundled local network elements, and facilities-based competitive local exchange service. Competitive entry through resale is not currently feasible because resale discounts are insufficient to support the business costs of any reseller, OSS is inadequate and resellers cannot independently differentiate their services by offering new or innovative services. Competitive entry through leasing of unbundled elements is encountering severe roadblocks both as a result of high costs (particularly recurring and non-recurring charges), inadequate OSS, and as a result of restrictive judicial interpretations that make this manner of entry technically and economically infeasible. In stark contrast, this merger, by creating a combined entity in a position to offer strong, facilities-based competition, offers a real prospect of introducing significant competition in local exchange markets, where the competitive goals of the 1996 Act might otherwise still be a long way off. The ILECs have come to this forum to further their competitive strategy of imposing resistance at every step of the way to local competition.

The merger does not raise any antitrust concerns. On the local side, the present local markets are monopolies, with the incumbent companies having an overall market share of nearly 100% in their respective service areas. Combined competitive local exchange market share ranges from 0% to less than 6% in those few markets where competitors have been operating for nearly a decade. Under the Department of Justice Merger Guidelines, an increase in concentration among companies

sharing the remaining portion of the market raises no antitrust issue, because their shares are so small and because the incumbents are so entrenched.

Mergers can be adjudged to be anticompetitive when they enhance the chance that the remaining companies will engage in coordinated pricing. There is no realistic likelihood of that here. The point of the merger is to better enable WorldCom and MCI to attack the incumbent companies' dominant market share, not to coordinate prices with them. New entrants price at discounts off the incumbent because that is what fringe players do and it would be self-defeating for the merged firm to discount less because that would only enable the incumbent to keep more business.

It would make no conceivable sense for MCI WorldCom to compete less aggressively than MCI and WorldCom would individually. Such a strategy would make only the ILEC more successful -- not MCI WorldCom. The dynamics of the local business drive new entrants, especially facilities-based entrants like MCI WorldCom with substantial sunk costs, to grow and expand by increasing customers and traffic as rapidly as possible. It would be an admission of failure, not a declaration of success, for the management of MCI WorldCom to tell its shareholders that it had kept its market share to the same minuscule level that MCI and WorldCom had achieved pre-merger. In short, the incentives of the combined company to compete aggressively will be at least as great as the incentives of each company individually.

A. The combined company will be in a better position to compete with incumbent local exchange monopolies than MCI and WorldCom separately. The merger will strengthen local competition and benefit consumers.

To date, competitive local exchange carriers ("CLECs") have had relatively little success in penetrating local markets. For example, even in the New York metropolitan area, some ten years after the first competitive local switch was installed, the total CLEC share (including resellers) of

the total access lines is 2.5% and of business access lines is 5.9% (a portion of the market which MCI and WorldCom share with other CLECs.)[4] In other areas, the CLEC share is far less. MCI and WorldCom, after this merger, intend to rectify that situation. The two companies bring complementary strengths to the merger. MCI has, among other things, a widely-recognized brand name and recognized marketing expertise, together with a broad base of both business and residential customers for its long distance service. WorldCom, following its acquisition of Brooks Fiber Properties, Inc., will have among other things, local exchange facilities in both first- and second-tier cities, including facilities in thousands of customers' buildings. *See* Declaration of Dennis W. Carlton and Hal S. Sider ¶ 9, attached hereto as Attachment B. The combination of MCI's reputation and customer recognition, with WorldCom's more extensive network of local exchange facilities, presents a unique opportunity to provide facilities-based local exchange competition that has the potential to significantly challenge the incumbents' monopoly.

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[4] Bell Atlantic's statistics on CLEC lines in New York State do not specify what market share these lines represent. *Petition to Deny of Bell Atlantic*, in CC Docket No. 97-211, at 16 (filed Jan. 5, 1998) ("*Bell Atlantic Petition*"). Recent figures compiled in the New York Section 271 proceeding remedy this deficiency. Attached hereto as Attachment A is an analysis of Bell Atlantic and CLEC access lines, sent by the New York Public Service Commission on January 15, 1998 Memorandum, to the parties in the Commission's 271 proceeding. More than a dozen CLECs compete in this market. The study shows that the CLEC's combined share of business access lines in the New York Metropolitan area is 5.9%.

While the analysis notes that only the carriers represented at the Commission's Technical Conference held in December 1997 responded, the attendees at that conference included the major CLECs operating in New York: MCI, WorldCom, AT&T, Time Warner, Teleport, Manhattan Telecommunications, Sprint, Infonxx, RCN, LCI, Cablevision, and Intermedia.

The 1996 Act "contemplates three paths of entry into the local market -- the construction of new networks, the use of unbundled elements of the incumbent's network, and resale."[5] Of these entry strategies, resale is not a viable strategy today because resellers cannot differentiate their products, OSS is deficient, and the level of wholesale discounts is generally inadequate. Reliance on unbundled elements of the incumbent's network has been stalled by the Eighth Circuit's decision, non-cost based recurring and non-recurring charges, and unsatisfactory and technically infeasible OSS. *Iowa Utilities Board v. F.C.C.*, 120 F.3d 753 (8th Cir. 1997), *cert. granted* (U.S. Jan. 26, 1998); *Ameritech Michigan Order*, ¶¶ 128-221;[6] *BellSouth South Carolina Order*, ¶¶ 101-169.[7] That leaves facilities-based entry, which has been widely recognized as the type of competitive entry offering the best opportunity for significant long-term local exchange competition, provided that competitors emerge with the financial strength to build and operate their own networks. That is the type of competition on which MCI WorldCom intends to place its primary reliance, following the merger. After the merger, it will become more feasible than it has been for either company operating on its own.

In addition to the combination of MCI's and WorldCom's customer base, name recognition and local exchange networks, the merger will result in other competitive synergies and efficiencies

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[5] Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶ 12 (rel. Aug. 8, 1996) ("*Local Competition Order*").

[6] Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Michigan, CC Dkt. 97-137 (rel. August 19, 1997) ("*Ameritech Michigan Order*").

[7] Application of BellSouth Corporation et al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in South Carolina, CC Dkt. 97-208 (rel. Dec. 24, 1997) ("*BellSouth South Carolina Order*").

enhancing the combined company's ability to challenge the incumbent local exchange monopolies through facilities-based competition. The combined company will have a greater ability to sell a broader package of services, including not only local and long distance, but also international and Internet services, as well as state-of-the-art telecommunications services which WorldCom has developed (such as new broadband and advanced data services). Carlton/Sider Decl. ¶ 10. With the cost savings and efficiencies the merger will bring, and the combined company's financial strength, significant facilities-based competition has a real prospect of success.

The combined company will achieve significant cost savings and efficiencies, and have greater financial strength and enhanced ability to raise capital. As explained recently in WorldCom's S-4 on file with the SEC ("WorldCom S-4"):[8]

> 1. Reduced domestic network costs: As a result of WorldCom's existing local network, the combined company will carry an increased proportion of its domestic traffic on its own local network facilities resulting in a reduction in leased line costs and access costs associated with switched traffic. WorldCom S-4 at 42. Savings can also be achieved in collocation costs, where the separate companies would otherwise separately collocate at the same central office.
>
> 2. Reduced costs in MCI's local activities: As a result of WorldCom's existing extensive local network and operations, the combined company will be able to execute MCI's plans to expand in the local market at a lower cost than MCI would be able to on a stand-alone basis. The combined company will avoid the need to duplicate certain sales, marketing and administrative functions and will have reduced network costs resulting from the more rapid transfer of traffic to the combined company's network facilities. WorldCom S-4 at 42-43.
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> 3. Capital expenditure savings: Capital expenditure savings are expected to be realized in local network build out and information technology, primarily as a result of avoided duplicative capital expenditures. WorldCom S-4 at 43.

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[8] WorldCom, Inc. Amendment No. 3 to Form S-4 Registration Statement under the Securities Act of 1933. A copy of the Amended S-4 is attached hereto as Attachment G.

4. Core SG&A. Core sales, general and administrative cost savings will be achieved because the increased scale of activities in the combined company's operations will result in opportunities to reduce costs by avoiding expenditures on duplicative activities, greater purchasing power, and the adoption of best practices in cost containment. WorldCom S-4 at 43.

Because many of these savings will reduce the cost of providing local service, they should generally accelerate local market entry and make it more economically feasible for the combined company to offer local service to customers who might not be able to provide the revenues needed to support a higher cost structure. In addition, these cost savings should make the combined company able to build and operate additional local network facilities faster and further than the two companies could do separately. From both standpoints, the merger will enhance the ability of the combined company to provide all types of local service, and introduce the possibility of broad-based competition into the now monopoly-dominated local exchange.

Given its vigorous level of opposition, GTE no doubt sees a competitive threat from MCI WorldCom. Ordinarily, one discounts the views of a competitor like GTE because the antitrust laws were enacted for "'the protection of competition not competitors.'" *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 488 (1977), *quoting Brown Shoe v. United States*, 370 U.S. 294, 320 (1962); *Telecommunications Inc. and Liberty Media Corp.*, 9 FCC Rcd. 4783, ¶21 n. 52 (1994) ("antitrust laws are designed to protect competition, not competitors"). The simple fact that GTE opposes the merger is convincing evidence that it fears the enhanced competition for local exchange services that will result from a merger of MCI with WorldCom. The proposed merger will make the local market more competitive precisely because the combined company will be far better positioned than either applicant alone to compete against GTE and the BOC incumbents. That is apparently what GTE fears most.

B. Local exchange markets are now overwhelmingly dominated by the incumbent carriers. A merger of two competitors in the tiny remaining portion raises no antitrust issue.

In local exchange markets, the incumbent companies' overall share is roughly 99%. Carlton/Sider Decl. ¶ 7 and Table 1. Even if one takes the narrowest possible market definition and searches for what could possibly be the most favorable case for local competitive penetration, the incumbent's present market domination is still near-total.[9]

The Commission has utilized the Herfindahl-Hirschman Index ("HHI"), adopted by the Department of Justice's 1992 Merger Guidelines, as one tool for analyzing the market impact of horizontal mergers. *Craig O. McCaw & American Tel. & Tel. Co.*, 9 FCC Rcd. 5835, 5856-57, ¶ 30 (1994), *recon. denied*, 10 FCC Rcd. 11786 (1995), *aff'd sub nom. SBC Communications Corp. v. FCC*, 56 F.3d 1484 (D.C. Cir. 1995). Under the Merger Guidelines, in a "highly concentrated" market, "a horizontal merger that produces an increase to the HHI of less than 50 points generally does not raise significant antitrust concerns." *Craig O. McCaw*, 9 FCC Rcd. at 5857, ¶ 30, citing the 1992 Merger Guidelines, 4 Trade Regulation Reports at ¶ 13,104, § 1.51(c).[10] For example, even if we assume that the CLECs' 5.9% share of business lines in the New York Metropolitan area (which is generally considered one of the most competitive local markets in the country) were generously allocated 50% to MCI and WorldCom, while dividing the remaining 50% among at least

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[9] Recent information from the New York Public Service Commission, for example, shows that the total CLEC share of the business lines in the New York metropolitan area (including resellers) is 5.9%; and that 5.9% is shared by 15 CLECs. *See* Attachment A. Even in this market, focusing solely on business lines, the competitive share of the market is minuscule some 10 years after the first competitive local switch was installed.

[10] In *McCaw*, the Commission approved the merger of AT&T (60% market share) with McCaw Cellular (0.3% market share). The increase in HHI was 36. *See* 9 FCC Rcd. at 5856, ¶ 30.

13 other New York Metro CLECs in the market (including Teleport, Sprint and AT&T), the merger would increase the HHI by less than 5 points -- far short of the 50-point HHI threshold for "significant antitrust concerns" in highly concentrated markets.[11]

To attain the 50-point HHI threshold, MCI and WorldCom would have to share equally a market share of at least ten percent.[12] We know of *no* local market, however defined, in which that threshold is even approached. The New York Metro business market is likely one of the most competitive local exchange markets in the country (although it remains highly concentrated, as witnessed by NYT's 94% share). But even in that market, the MCI WorldCom merger does not come close to approaching the HHI threshold for significant antitrust concern.

A basic antitrust concern regarding horizontal mergers is that they might enhance the likelihood of coordinated pricing. As the 1992 Merger Guidelines explain, "[a] merger may diminish competition by enabling the firms selling in the relevant market more likely, more successfully, or more completely to engage in coordinated interaction that harms consumers." Merger Guidelines, § 2.1. There is no conceivable danger that MCI WorldCom will engage in "coordinated interaction" with incumbent local exchange carriers. At present, there is no local exchange market in which the combined company will have more than a tiny share. In this situation,

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[11] The HHI calculation sums the square of each market participant's share. A merger of two market participants with a 1.5% share each would increase their combined HHI score from 4.5 (1.5 squared plus 1.5 squared) to 9 (3 squared). The 1992 Guidelines define a market as "highly concentrated" when its total HHI is above 1800. Assuming an incumbent share of 94%, the HHI for the New York Metro area business market is over 8800.

[12] Under HHI analysis, the highest point increase is obtained where the merger partners have an equal share. A merger of two 5% participants would produce a 50-point increase. (Pre-merger, their combined score would be 50 -- 5 squared plus 5 squared. Post-merger, their combined score would be 100 -- 10 squared.)

the only rational business strategy for the combined company is to attack the incumbents' customer bases and seek to erode their market share. Indeed, the merger would be pointless if MCI WorldCom were satisfied with the minuscule share of the local exchange market it will have when the merger is consummated. To attack the incumbents' market share, MCI WorldCom must undercut the incumbents' pricing structure. There is simply no realistic scenario in which the combined company would engage in coordinated pricing with the ILECs. Nothing could be more alien to the economic situation or the corporate cultures of either WorldCom or MCI.

GTE argues that the merger raises "competitive questions" because, given "AT&T's equivocation in its resolve to enter local markets, MCI, WorldCom, and Sprint are left as the three remaining most significant nationwide market participants."[13] GTE argues that the merger "would thus eliminate one actual local exchange competitor by merging it with one of the remaining two most significant market participants." *GTE Petition* at 43. Putting aside GTE's egregious misreading of AT&T's attitude towards local markets (which AT&T has evidently shown that it does not share -- AT&T's proposal to acquire Teleport was announced after GTE's comments were filed),[14] the argument is, bluntly, ridiculous. Every single local exchange market consists of whatever CLECs (if any) are in the market, *plus the incumbent local exchange carrier*. Those incumbents are referred to as "dominant" for a reason: on a nationwide basis, they control 99% of the local markets.

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[13] *Petition to Deny of GTE Service Corporation and its Affiliated Telecommunications Companies* in CC Docket No. 97-211, at 43 (filed Jan. 5, 1998) ("*GTE Petition*"). Interestingly, in the Commission's recent *Bell Atlantic/NYNEX Order*, the Commission did not identify WorldCom (or MFS Communications Company, Inc.) as among the five most significant actual and potential players in the New York City local exchange market. *Bell Atlantic/NYNEX Order*, *supra* note 3, at ¶ 99.

[14] "AT&T To Buy Teleport for $11.3 Billion," Wall Street Journal, Jan. 9, 1998, at A3.

No matter how the market is defined (*i.e.* local or national), the incumbent carriers are the dominant market participants. Under traditional and well accepted antitrust economic theory, a reshuffling or combining of market share among companies controlling only a minuscule portion of any market raises no antitrust concern.

GTE, itself a disappointed suitor for MCI, also tries to manufacture competitive concern by maintaining that there is an "overlap of 84 percent of the two companies' markets," because WorldCom has some existing facilities in 26 of the 31 markets in which MCI also has facilities or plans to build facilities. *GTE Petition* at 44. Although it is a difficult argument to grasp, GTE suggests that the reduced competition *between MCI and WorldCom* in these local exchange markets will have anticompetitive implications. This argument borders on the absurd: in each of those markets, there is an incumbent carrier, such as GTE itself, with overwhelming market dominance. As previously discussed, the merger of two "overlapping"[15] competitors with only a minuscule market share between them raises no antitrust concern.

Contrary to GTE's assertions, there is no "overlap" in the sense of duplicate or redundant facilities. Frequently, MCI and WorldCom networks in the same city do not reach the same customers, do not serve the same buildings, do not traverse the same streets or are not configured in a similar manner. Moreover, most of the customers in these cities are unserved by any competing

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[15] The term "overlapping" is itself very misleading. It suggests that if WorldCom and MCI have any facilities at all in the same city, they provide blanket coverage for that city such that the merger eliminates that competition. There is no support in the record for such a proposition and it is factually inaccurate.

carrier (but *all* could be served by the ILEC).[16] Significantly, the term "overlap" suggests that after the merger, some of the facilities will become "redundant" and will be idled. To the contrary, MCI WorldCom's intent is that the combined company will aggressively market its services to the point where all its existing facilities are optimally utilized and new facilities will be needed. This merger is fundamentally different from a merger of, for example, two steel plants that will result in the closing of one of them. Here, there will be no "overlap" because the combined company's switching, transmission and other network facilities will be fully utilized. The history of both companies has been one of continual rapid expansion as their existing facilities become fully utilized. WorldCom fully expects that pattern to continue after the merger, as the combined company deploys its combined resources to expand its customer base.

Finally, GTE's analysis rests on the assumption that there are only three "significant" CLECs (or four, counting AT&T). But in fact there are many others -- as noted, the New York Public Service Commission counts at least 13 CLECs in addition to WorldCom and MCI in the New York market alone. Those CLECs -- as well as many others throughout the country -- are all potential competitors in local exchange markets. Moreover, other potential competitors include electric and gas utilities, wireless, other interexchange carriers, independent telephone carriers, construction companies, cable companies and out-of-region ILECs.[17] Once MCI WorldCom leads the way into

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[16] GTE's argument has merit in theory only (if it exists at all) for that fraction of the 1% of local customers for which WorldCom and MCI have built local loops to the same end users.

[17] At a minimum, adjacent ILECs would have to be considered potential competitors. *Bell Atlantic/NYNEX Order*, *supra* note 3, at ¶ 99 (prior to merger, Bell Atlantic considered potential competitor in local exchange market in New York Metro area); "Ameritech Corp.: St. Louis Area Is Targeted In Local Phone Service Plan," *Wall Street Journal* (Nov. 7, 1997); *see also* n.26, *infra*.

local markets as an "icebreaker," the path into active local exchange competition will be cleared so that other CLECs may follow. As the history of competition in the long distance market demonstrates, the success of one entrant will inevitably lead to entry by others (*e.g.*, MCI's success led to entry and expansion by Sprint, WorldCom, LCI International, Inc. ("LCI"), IXC Communications, Inc. ("IXC"), Qwest Communications International, Inc. ("Qwest"), and a host of other carriers with mixed facilities-based and resold services). Successful entry into the local market by MCI WorldCom will lower entry barriers for other competitors, which can only serve to benefit all customers.

It is particularly curious for GTE, as an incumbent local monopoly, to be expressing concern over the state of local competition, given its historical and continuing resistance to local competition.[18] GTE, as this Commission well knows, sought to merge with MCI itself and its

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[18] MCI chronicles the "Bad Acts" of GTE and other ILECs on its web page. Examples of GTE's anti-competitive behavior that are cited include reports that GTE wrongly told some customers that GTE no longer would repair the customer's phone lines if the customer switched to MCI for local toll calls, and that a customer would be charged extra for billing if MCI handled their local toll calls. *See* <http://www.mci.com/mcisearch/aboutyou/interests/publicpol/you_local/badactqr.shtml#gte>.

Similarly, Mark Rosenblum of AT&T testified before the Senate Antitrust Subcommittee that GTE is actively working to thwart competition. He testified that: "GTE...is starkly flouting its obligation to permit competitors to purchase network element combinations. GTE has now gone to each of its State commissions asking that its interconnection agreement with AT&T be 'reformed' in such a way as to effectively nullify its statutory duty, and contractual commitment, to provide network element combinations." Rosenblum further argued that "GTE claims that it has the legal right -- and states that it will exercise this asserted right -- to go to the trouble and expense (which would be reimbursed by new entrants) to disconnect unbundled network elements that are already connected in its own network before providing them to new entrants, which it would do for the sole reason that the new entrants would then have to bear the additional cost of reconnecting them."

Rosenblum also asserted that "GTE has essentially declared all-out war on all regulators, both federal and state, that are trying to enforce the terms of the Act. GTE even asked 20 states to

opposition to this merger must be seen for what it really is -- an attempt to protect its own incumbency from competition and an attempt to derail this merger so that it can attempt its own takeover of MCI -- a takeover that truly would raise serious anticompetitive questions.

C. The combined company will not cut back residential service.

Some commenters argue that the merger will result in some unspecified reduction of service to residential customers.[19] BellSouth adds that MCI WorldCom is likely to "jettison" MCI's residential long-distance customers.[20] Nothing could be further from the truth. One of the principal reasons for this merger is that the combined company will have an enhanced ability to offer consumers a total package of services: local, long distance, wireless, international and Internet. MCI already has a strong base nationwide of millions of residential customers for its long-distance service. Many residential customers prefer buying all their telecommunications services from a single company and receiving a single bill. The merged company will have every incentive to offer them a total package, including local and long distance services, as fast as regulatory and economic

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exempt it entirely from complying with the local competition requirements under a provision of the Act that is designed to apply only to small rural carriers (and GTE was naturally rebuffed)." Testimony of Mark C. Rosenblum, AT&T, before the Senate Judiciary Committee Subcommittee on Antitrust, Business Rights and Competition, Sept. 17, 1997.

[19] *Petition to Deny of Rainbow/PUSH Coalition* in CC Docket No. 97-211, at 18-19 (filed Jan. 5, 1998) ("*Rainbow/PUSH Petition*"); Comments of the Communications Workers of America in CC Docket No. 97-211, at 19-23 (filed Jan. 5, 1998), as amended Jan. 6, 1998 ("*CWA Comments*") *Comments of American Federation of Labor and Congress of Industrial Organizations* in CC Docket No. 97-211, at 5-6 (filed Jan. 5, 1998) ("*AFL-CIO Comments*").

[20] *Petition for Conditional Approval of the Applications of WorldCom, Inc. for Transfers of Control of MCI Communications Corporation of BellSouth Corporation* in CC Docket No. 97-211, at 16-19 (filed Jan. 5, 1998) ("*BellSouth Petition*").

conditions permit.[21] And beyond those customers, the combined company will have every incentive to expand MCI's current local service offering to attract new customers who might then also purchase its other services, as well as enhance and better balance the combined companies' network and switch utilization.

In short, the more customers the combined company has for its local services, the more potential customers it has for its other services. If the combined company does not offer full service packages, including local service, other companies will. At bottom, the whole point of this merger is to gain and retain customers, not lose them.

Moreover, in order to recover embedded investments, the combined company will have a powerful financial incentive to fully load its local networks, including by carrying traffic of residential customers in off-peak hours.[22]

CWA asserts that WorldCom plans "abandonment of facilities-based competition in the local exchange residential and small business market." *CWA Comments* at 23. CWA is wrong. The SEC filing which CWA erroneously cites is WorldCom's estimate of "Operating Cost Savings" and "Capital Expenditure Savings" resulting from the merger. These figures represent neither reduced

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[21] *See also* Section III, *infra* (discussing benefits the merger will bring to long distance service.)

[22] According to Tim Price, President and Chief Operating Officer of MCI Communications Corporation, "[Y]ou build capacity to handle the needs of your business customers during the work week in the daytime, and you have to start recruiting residential customers who use the network mostly at night and on weekends. That's the only way you can get efficient use of your capacity." J. Van, "MCI Deal May Cut Consumer Phone Bills $37 Billion," *Chicago Tribune*, Nov. 11, 1997.

expenditures, nor reduced service. Rather, as CWA well knows, they represent cost efficiencies in carrying out present plans to *expand* local service.[23]

In a further attempt to misrepresent WorldCom's residential service commitment, CWA quotes remarks attributed to a WorldCom executive, John Sidgmore, in a *Washington Post* article of October 3, 1997. *CWA Comments* at 19-20. But what CWA does not say is that the next day, the *Washington Post*'s Assistant Managing Editor took the unusual step of publicly admitting that the "wording [of the Oct. 3 article] was stronger than Sidgmore's remarks warranted"[24]; WorldCom also widely disseminated a press release disclaiming any intent to abandon residential customers.[25]

The Rainbow/PUSH Coalition argues that MCI, without WorldCom, might still pursue residential local service, despite the huge losses it has suffered. *Rainbow/PUSH Petition* at 20. But the issue is not what MCI might or might not do without the merger; the issue is whether the merger will adversely affect MCI's or WorldCom's separate plans for residential service. As we have

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[23] WorldCom explained to the SEC that its estimated savings in local services will occur because "[a]s a result of WorldCom's extensive local network and operations, the combined company *will be able to execute MCI's plans to expand in the local market at a lower cost* than MCI would be able to on a stand-alone basis." Amendment No. 3 to Form S-4 at pp. 42-43 (filed Jan. 9, 1998) (emphasis added). WorldCom further explained that the combined company "will avoid the need to duplicate certain sales, marketing and administrative functions and will have reduced network costs resulting from the more rapid transfer of traffic to the combined company's network facilities." *Id.* Finally, WorldCom explained that it estimated these cost savings based on "the projected operating costs associated with MCI's *plans to expand its presence in the local market*" and the proportion of these costs that "could be avoided *by combining MCI's and WorldCom's business.*" *Id.* (emphasis added).

[24] M. Mills, "WorldCom Clarifies MCI Plans," *Washington Post*, Oct. 4, 1997.

[25] "WorldCom Will Not Abandon MCI's Residential Long Distance Customers; Combined Company to Offer Competitive Choices For Both Local and Long Distance Service," Press Release, Oct. 3, 1997.

shown, the combined company will be better positioned than the separate companies to provide local service, including residential service, faster and further, and will have an economic incentive to retain and expand MCI's existing residential base as a platform for selling total service packages.

None of the commenters has shown that there is *any* reason why residential service that made economic sense for either of the companies to pursue separately should become uneconomic simply because the companies are combined. Indeed, the opposite is true. As we have described, the merger will achieve savings which will allow the combined company to provide local service, and to expand present capacity, at a lower cost than the companies could do separately. That will make it feasible to provide local service to customers at revenue levels below the levels needed to support the pre-merger cost structure. Thus the merger will enhance, not hinder, the company's efforts to provide service to small business and residential customers.[26]

WorldCom plans neither a reduction of local service, nor a shrinkage of expenditures for local service. The "savings" referred to in its SEC filings reflect the fact that the combined company will be able to achieve the same or even greater rate of expansion at a lower cost and in a more efficient and timely manner. MCI's millions of residential customers are an important part of this expansion. WorldCom realizes that in a competitive telecommunications market it must offer local service if it wants to reach these customers for its other services. That is one of the principal facets

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[26] The BOCs themselves, in their few forays into the local exchange business outside their established territories, have either pursued business customers exclusively or residential customers only as part of a strategy to offer other services to these customers. *See* "Pacific Bell Agrees to Open Network to Ameritech Competition," *San Jose Mercury News* (Jan. 11, 1998) (Ameritech to offer resold local service in California, but only to businesses that already are Ameritech's customers in the Midwest; by contrast, Ameritech will offer residential service in St. Louis and Cape Girardeau, Missouri where it is the local cellular company and many customers have Ameritech service in their homes or businesses across the Mississippi River).

of this merger. Similarly, if WorldCom hopes to expand beyond these customers, WorldCom realizes that it must offer a package including all types of service. Once again, the purpose of this merger is to gain customers, not lose them.

D. The merger will not undermine universal service.

CWA's argument that the merger will "hurt universal service" is seriously flawed in that it ignores the developments that have occurred as a result of the Telecommunications Act of 1996. *CWA Comments* at 27-31. The premise of CWA's argument is that the merged company will be more effective, indeed too effective, in taking business away from incumbent carriers. CWA is right that the merger will permit MCI WorldCom to be a more effective competitor, but it is wrong in concluding that increased local competition is bad for consumers or for universal service. Not only is that argument contrary to the established policies of the Commission and the 1996 Act, it misses the point that local competition will drive down the price of local services for all consumers and thereby make telephone service more affordable and more universally available. To the extent that service to some customers should be subsidized to keep rates affordable, these subsidies should be provided through the reform of universal service that is underway, not by suppressing local competition, whether by blocking a procompetitive merger or otherwise.

CWA alleges that universal service will be undermined in two ways: (1) the diversion of local exchange service to businesses from the public switched network to a private CLEC network will drain resources available to ILECs for their universal service obligations, *CWA Comments* at 26-27; and (2) by having ubiquitous networks on which CLECs can provide local exchange and exchange access service, CLECs will be able to bypass the access charge regime that compensates LECs for the use of their local exchange facilities. *Id.* at 27-31. Although it does not appear that

these observations arise from the merger itself, CWA's argument rests entirely on the faulty foundation that universal service support is implicit in local business rates and in access charges. Under the 1996 Act and the Commission's *Access Charge Reform Order*,[27] these implicit subsidies are to be eliminated and replaced with explicit subsidies.

The 1996 Act requires that "there should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service,"[28] and that "[a]ny such support should be explicit and sufficient to achieve the purposes of this section."[29] As a result of this mandate, the Commission, in its *Access Charge Reform Order*, adopted rules to make universal service support explicit and eliminate implicit subsidies. With respect to the interstate contribution to universal services, the universal service support revenues generated from access charges have been replaced by a new Universal Service Fund. Contributions to the Fund are to be made by MCI WorldCom and other providers of interstate telecommunications services based upon their end-user intrastate, interstate and international telecommunications revenues. Because state funding mechanisms for universal service based upon intrastate revenues must also be made explicit, the implicit subsidies contained in intraLATA toll, local business line and other local exchange service rates must also be replaced by explicit funding mechanisms.

As these explicit funding mechanisms become fully implemented, access charges are to be reduced to cost, thereby eliminating the implicit subsidy for universal service. Consequently, the

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[27] In the Matter of Access Charge Reform, *First Report and Order*, CC Docket No. 96-262 (rel. May 16, 1997) ("*Access Charge Reform Order*").

[28] 47 U.S.C. § 254(b)(5).

[29] 47 U.S.C. § 254(e).

implicit subsidies that CWA fears will be lost as a result of the MCI WorldCom merger will in fact be replaced by explicit subsidies. As the second-largest provider of interstate telecommunications services in the country, MCI WorldCom expects to pay a substantial share of its interexchange revenues to support universal service.

The Commission also intends to rely on competition provided by CLECs to determine the proper rates for local exchange access free of implicit subsidies.[30] The fact that ILECs will lose customers, and the revenue generated by those customers, to CLECs in a competitive market was clearly contemplated by the 1996 Act, the *Universal Service Order*,[31] and the *Access Charge Reform Order*. However, revenue losses of ILECs will not jeopardize the provision of universal service because the 1996 Act and the *Universal Service Order* ensure that universal service will be maintained through explicit subsidies to eligible telecommunications carriers, including ILECs. CWA's fears over the loss of universal service funding are simply unfounded, and in any event, would not be caused by the merger of two non-dominant competitive telecommunications carriers.

CWA argues that the transition from a system of implicit subsidies to the explicit subsidy regime contemplated by the 1996 Act will not happen immediately, and that the merger will "undermine the economics of the transition." *CWA Petition* at 29. That argument conflicts with the Commission's standard for assessing mergers, under which the Commission looks to the effect of the merger on the assumption that the 1996 Act will be implemented. *Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 98. Under this principle, the fact that this merger will hasten the

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[30] *Access Charge Reform Order*, *supra* note 27, at ¶ 7.

[31] In the Matter of Federal-State Joint Board on Universal Service, *Report and Order*, CC Docket No. 96-45, 12 FCC Rcd. 8776 (rel. May 8, 1997) ("*Universal Service Order*").

implementation of the competitive regime envisioned by the 1996 Act -- a regime under which the subsidy for universal service is explicit rather than implicit -- is a favorable consideration. Moreover, the CWA's argument ignores the fact that funding for explicit universal service subsidies has already reached significant levels.[32] CWA's argument that the Commission should withhold approval of the merger because it will hasten the arrival of the competitive local exchange market envisioned by the 1996 Act turns the Act completely on its head.

III. THE MERGER WILL NOT HARM, AND CAN ONLY ENHANCE, VIGOROUS COMPETITION IN THE INTEREXCHANGE MARKET.

As demonstrated in the Application, the merger will produce procompetitive synergies and efficiencies resulting in better services at lower prices in interexchange as well as local markets. The expanded and accelerated local reach of the merged company will benefit its long distance customers, by producing significant access charge savings that will result in lower long distance prices, and by enabling MCI WorldCom to provide integrated packages of innovative services including local, long distance, data, wireless, and international telecommunications services. Moreover, integration of the long distance operations will permit MCI WorldCom to achieve savings in designing and operating its long distance network and in procuring the equipment and facilities needed to run it. Lower costs, including lower costs of capital, mean lower prices and increased ability to make the investments needed for further innovation and continued growth.[33] Moreover,

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[32] The Commission has established contribution factors for the first quarter of 1998 at a level designed to produce a total universal service contribution of $884.4 million. *First Quarter 1998 Universal Service Contribution Factors Revised and Approved*, CC Docket No. 96-45 (rel. Dec. 16, 1997).

[33] The tremendous potential for cost savings belies BellSouth's suggestion that the "astronomical" WorldCom is paying for MCI reflects the possibility of anticompetitive market

because MCI's and WorldCom's retail businesses are largely complementary, with MCI stronger in direct residential and larger business sales and WorldCom stronger with small and mid-sized business customers, the merger of these two companies will blend and reinforce their respective strengths.[34]

Against these important sources of improved efficiency and complementarity, only three principal petitioners -- GTE, Bell Atlantic, and BellSouth -- suggest that the proposed merger will have anti-competitive effects in the long distance market. It is notable who has not weighed in to oppose the merger, especially -- given these petitioners' purported concerns about the competitiveness of the wholesale market -- the large number of sophisticated resellers that are both customers of and competitors to MCI and WorldCom. Moreover, consumer representatives have agreed that the merger will not harm long distance competition.[35] Instead of knowledgeable

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power. *See BellSouth Petition* at 1. In fact, the premium paid reflects both the opportunity for significant savings described above and, more importantly, the recognition that the merged company will be a more formidable competitor in the efforts to break the local monopolies currently possessed by the BOCs and other ILECs. *See* Carlton/Sider Decl. ¶ 6 ("[a]vailable evidence suggests the transaction creates potentially large benefits to consumers by enhancing the likelihood of timely and significant entry into the provision of local exchange services").

[34] *See, e.g., GTE Petition* at 25 (noting that "[WorldCom's] own brand name is largely unrecognized in the retail mass market"); *Petition to Deny the Application of WorldCom or in the Alternative To Impose Conditions* of Bell Atlantic in CC Docket No. 97-211, at 14 (filed Jan. 5, 1998) ("*Bell Atlantic Petition*") and AuBuchon Aff. ¶4 (discussing MCI's strength in value-added business services).

[35] Protest of the Office of Ratepayer Advocates, at 4 ("While the combined company will have a greater market share in the interexchange market, WorldCom/MCI will have to continue to price aggressively to maintain or to increase its market share."), *In re Application of WorldCom, Inc. and MCI Communications Corporation for Approval to Transfer Control of MCI Communications Corporation to WorldCom, Inc.*, Docket No. A.97-12-010 (filed Jan. 7, 1998, Public Utilities Commission of the State of California). Some advocacy groups have, of course, filed petitions opposing the merger. These petitions, however, generally reflect particularized concerns about the

customers without any axe to grind, the primary opponents of the long-distance aspect of the merger are GTE, a disappointed bidder and competitor that still hopes to acquire MCI if it can torpedo the merger, and a pair of BOCs, BellSouth and Bell Atlantic, which misuse this proceeding primarily to advance their agenda to provide in-region interexchange services without having to comply with the requirements of Section 271. The general acceptance of the merger by consumers with no ulterior motive speaks more eloquently than the self-serving submissions from GTE and the BOCs ever could.

Unsurprisingly, the arguments against the merger set forth in these petitions are internally inconsistent, *see, e.g.*, ***BellSouth Petition*** at 17-18, 23-24 (arguing both that the long distance market is characterized by excess profits and that the merged company will nonetheless abandon large segments of the business), and wholly baseless. The GTE and BOC submissions begin with the false premise that the long distance market is not vigorously competitive, and end with the equally flawed conclusion that the merger will further reduce competition. Section III.A sets forth the facts that make clear that competition is already intense in this market, where growth opportunities and declining costs have attracted and continue to attract substantial facilities-based entry. Section III.B demonstrates that the merger will not reduce competition because the merger will not change the basic structure and dynamics of the market, including low barriers to entry. Sections III.D and III. E. demonstrate that the merger will not reduce competition for residential consumers or for facilities-based and switchless IXCs that purchase interexchange service for resale.

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effects of the merger, including its effect on the minority community. These issues are important, but, as demonstrated below, *see infra* Section VI.A, the merger creates no cause for concern.

A. The long distance market is currently competitive.

The fundamental premise of the GTE/BOC oppositions is that the long distance market is not competitive. *See, e.g., GTE Petition*, at 16 ("The long distance market already is beset by cooperative rather than competitive pricing"); *BellSouth Petition* at 7 ("Long distance market is highly concentrated and not performing competitively"). That premise is false.

As Robert E. Hall, Professor of Economics at Stanford University, has concluded, "the long distance industry is substantially competitive," *See* Declaration of Robert E. Hall ¶ 32, attached hereto as Attachment C, resulting in "benefits to the consumer in the form of substantial reductions in the price of long-distance service as well as numerous technical improvements and the development of new services," Hall Decl. ¶33. Real average revenue per minute for long distance carriers has declined substantially since the divestiture of AT&T, and it continues to fall. *See* Hall Decl. ¶38. More importantly, and contrary to the assertions of BellSouth and GTE, *see BellSouth Petition* at 13; *GTE Petition* at 18-19, real long distance prices have fallen even when access charges are netted out. *See* Hall Decl. ¶¶40-43.[36]

In an effort to refute these compelling indicia of competition, GTE and the BOCs rely heavily on the concentration in the industry. *See GTE Petition* at 12-13; *BellSouth Petition* at 8-9. This reliance is misplaced. First, the analysis of GTE and the BOCs focuses insufficient attention on the

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[36] Nor is there any merit to the argument that, to the extent that low-volume purchasers pay more for long distance service, it is an indication of a lack of competition. Instead, any higher price reflects the economic reality that the costs of obtaining and serving these customers are higher. *See* Hall Decl. ¶ 57; *see also id.* ¶¶ 57-60. Professor Hall also conclusively refutes the contentions of Professors Hausman and Schmalensee in the affidavits attached by petitioners. *See generally* Hall Decl. ¶¶ 115-116 (responding to Prof. Hausman); *id.* ¶¶ 117-122 (responding to Prof. Schmalensee); *cf.* Carlton/Sider Decl. ¶ 30.

"other" carriers category, a category that BellSouth even affirmatively excludes from consideration. *see BellSouth Petition* at 10 n.19. According to the most recent figures from the Commission, this category accounted for over 12.1% of presubscribed lines in 1996. *See* J. Zolnierek & K. Rangos, *Long Distance Market Shares-Third Quarter 1997*, Table 2.2 (FCC Common Carrier Bureau, Industry Analysis Division, Jan. 1998). This category comprises over 600 competitors, at least 20 of whom have annual revenues over $100 million, and several of whom have revenues exceeding $1 billion, including LCI, Excel, Frontier, and GTE. *See id.* at 4 and Table 3.1. Smaller companies, too, can and do compete cost-effectively against larger carriers.

Second, and more important, GTE's and the BOC's static view obscures the increasing competitive importance of this "other" category. This group is the fastest growing segment of the industry with annual growth rates *exceeding 40 percent* (*see id.* at Table 2.3) -- and this growth does not include the several carriers that began building huge new national networks within the last few years and are now beginning to carry revenue-generating traffic. *See infra* pp. 35-37. These statistics are not surprising to anyone familiar with the industry. As explained below, all IXCs have access to long-distance capacity at competitive prices, dozens of long distance carriers own facilities and can expand their facilities-based networks at relatively low and decreasing cost, and new competitors can become important market participants virtually overnight.[37]

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[37] As Professor Hall makes clear, the fact that AT&T's dwindling market share has not yet dropped below 50% provides no reason to doubt the competitiveness of the industry. *See* Hall Decl. ¶¶ 63, 66-67.

B. The merger will not reduce -- and will in fact enhance -- competition in the long distance market as a whole.

As WorldCom demonstrated in its initial application, the merger will not reduce -- and will in fact enhance -- competition in the already vibrantly competitive long distance market. Approval of the proposed transaction will enhance competition by "increasing the resources, facilities, and personnel available to the combined company and [by] allowing it to take optimal advantage of operational synergies, cost savings, and complementary service offerings." Application at 29-30. The merger will enable MCI and WorldCom to "create a preeminent provider of one-stop-shopping advanced communication services." *Id.* at 29; *see also* Hall Decl. ¶ 95 (noting efficiencies resulting from the merger); Carlton/Sider Decl. ¶12-14 (discussing financial market's endorsement of savings projections).

In their oppositions, GTE and the BOC petitioners nevertheless suggest the merger will reduce competition in the long distance market. It bears emphasis that although the sole issue in this proceeding is the effect of the merger, these petitioners offer no economic testimony addressing that issue, and instead recycle affidavits submitted in another proceeding not involving the instant merger.

Instead of evidence, petitioners rely primarily on a mechanical analysis of market concentration measured by the HHI. Even on its own terms, the flaws of GTE's static analysis of HHI are immediately obvious. Under GTE's analysis of the interexchange market, the merger of the second- and fourth-largest long distance carriers presumptively creates or facilitates the exercise of market power. In fact, just such a merger has already occurred, and at time when concentration measured by HHI was higher: in 1990, MCI (which was then the second-largest interexchange

carrier) acquired Telecom*USA (which was then the fourth-largest IXC).[38] Despite this acquisition, the market for long distance services remained vibrantly competitive, and indeed the HHI of the industry declined, as it has in every year since 1984. *See Long Distance Market Shares-Third Quarter 1997*, Table 3.2; Hall Decl. ¶66.

More important, petitioners' approach, with its slavish reliance on HHIs, is facially deficient. Neither the Commission nor the U.S. Department of Justice ("DOJ") has ever suggested that mergers that do not fall within the Merger Guidelines' safe harbor are necessarily anticompetitive. *See, e.g., Bell Atlantic/NYNEX Order, supra* note 3, ¶ 136. Instead, the Commission and the DOJ have consistently made clear that calculation of market concentration based on HHI is the first, not the last, step in the analysis. *See* Carlton/Sider Decl. ¶ 31, 32; Hall Decl. ¶¶ 2, 61. Only by fully considering the economic realities of the market can the Commission make any realistic assessment of the anticompetitive effect of any proposed merger.[39] *See* Carlton/Sider Decl. ¶¶ 32-33. For example, even if the HHIs are high, a merger may be unlikely to create or enhance market power or facilitate its exercise when understood in the context of "recent or ongoing changes in the market" and of merger-generated efficiencies that enhance competitiveness.[40] The context is particularly

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[38] *See In re Applications of Telecom*USA, Inc., Transferor and MCI Communications Corporation, and MCI Capital, Inc., Transferees, For Consent to the Transfer of Control of SouthernNet Systems, Inc., SouthernNet of South Carolina, Inc., Teleconnect Long Distance Services & Systems Company, TS Communications, Inc., Teleconnect Company, and Southland Telephone Company*, FCC DA 90-1018, 5 FCC Rcd. 4857 (1990).

[39] The Merger Guidelines explicitly warn against GTE's approach: "Because the specific standards set forth in the Guidelines must be applied to a broad range of possible factual circumstances, mechanical application of those standards may provide misleading answers to the economic questions raised under the antitrust laws." Merger Guidelines, ¶ 0.

[40] *See* Merger Guidelines ¶¶ 1.52, 1.521, and 4.0.

crucial in a dynamic industry such as telecommunications, where companies that stand in place can quickly lose market share to more agile competitors.[41]

Despite this, petitioners present no evidence other than their HHI figures to support their claim that competitive conditions would change so as to reduce competition after the proposed merger. *See* Carlton/Sider Decl. ¶ 31.[42] A complete understanding of the marketplace makes clear that the MCI WorldCom merger will have no anticompetitive effect. In particular, as we explain below, (1) the merger will not affect the ability of firms easily to enter and expand in this market, and (2) the merger will cause no increased likelihood of collusion.

1. Significant entry will continue with or without the merger.

Under the Merger Guidelines on which the FCC and petitioners have relied, it is necessary to examine the ease and likelihood of entry. As the Merger Guidelines indicate, "[i]n markets where

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[41] *See Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 136 ("Because the telecommunications industry has a relatively unique history and is characterized by economic, legal, and technical circumstances that are not shared by many other industries, we generally conduct our own expert analysis developed through our experience dealing with telecommunications and competition policy. We still use tools of general application, but we are not bound by rigid adherence to their results where our independent expert analysis produces differing outcomes.")

[42] GTE professes concern about the impact of the merger on competition to provide bundled services. *GTE Petition* at 47-48. As the Commission has recognized, any market consisting of bundled local and long-distance services "is still nascent in most markets and nonexistent in many others" *Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 52, so competition in any such market can only increase. GTE's concern is expressly predicated on "a growing local presence," *GTE Petition* at 48, and the merger will indeed permit that presence to grow faster than it otherwise would. *See supra* Section II. And as MCI WorldCom's local presence expands, so too will that of its competitors, and when local competitors have broken the BOCs' current bottlenecks, the BOCs will be able -- as GTE is now -- to offer bundles themselves. Able now to offer bundled local and long-distance service to a large local customer base without meaningful competition, GTE is trying to lengthen its head start, and its real concern is that the merger will help increase, not decrease, competition against it on equal terms.

entry is easy . . . , the merger raises no antitrust concern and ordinarily requires no further analysis."[43] Indeed, the principle that such entry completely forestalls any anticompetitive concerns is the linchpin of the BOCs' submissions.[44] Despite the centrality of entry analysis to the assessment of the competitive impact of the merger, the BOCs and GTE omit any substantive discussion of the large-scale entry and dramatic increases in wholesale capacity in the United States. *See* Carlton/Sider Decl. ¶ 50.

In the long distance market, additional entry is both easy and certain to occur. As shown below, competition at the wholesale level to provide services to interexchange carriers is robust and will not be affected by the merger. Interexchange carriers will therefore continue to purchase interexchange services -- including switched services purchased by switchless resellers, and transmission capacity (private lines) purchased by carriers to use with their own switching capacity -- at cost-based rates that entail little or no sunk cost. New entrants can therefore quickly acquire the facilities they need to compete.

Significant new facilities-based entry thus will continue to occur as the interexchange market continues to grow and the costs of constructing capacity continue to decline; any merger-related (or non-merger-related) decrease in wholesale competition would only cause facilities-based entry to

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[43] Merger Guidelines ¶ 3.0.

[44] The BOCs acknowledge that new entry will eliminate any alleged competitive problem that the merger would create, but suggest that they are the only potential entrants that will provide the competitive cure. Of course, new entry does not have to be by the BOCs to have procompetitive effects. In fact, as Professor Hall makes clear, contrary to the BOCs' claims, *see, e.g., BellSouth Petition* at 24, entry by the incumbent LECs (like SNET) at this stage is unlikely to have a significant procompetitive impact on the long distance market. *See* Hall Decl.¶83-86. The DOJ confirms that the BOCs significantly overstate the benefits of their entry. *See* Supplemental Affidavit of Marius Schwartz (submitted by DOJ in South Carolina Section 271 proceeding).

accelerate. In the last twelve months alone, a number of carriers -- including Qwest, IXC, Williams Co., and Level 3 Communications ("Level 3") -- have started to construct national fiber networks, or announced plans to expand significantly. *See, e.g.*, Hall Decl. ¶ 12.

- Qwest, with a market capitalization of nearly $6 billion, is constructing a 16,000 mile nationwide fiber optic transmission network, to be completed by early 1999, and has already acquired 94 percent of the necessary rights-of-way for this network. The Qwest network is expected to reach 125 cities throughout the United States.[45] Qwest's proposed network will be about 30 percent longer than the existing WorldCom network.[46] Qwest states that its network is "designed to be the highest-capacity digital infrastructure in the world" and "can carry more than any other U.S. long-distance network."[47] Qwest has entered into long-term contracts to provide substantial amounts of capacity on its nationwide network to other carriers, including GTE. (Indeed, GTE conveniently omits any mention of the capacity it will own on the Qwest network even though it is the foundation of its national network that it claims will be "100 times bigger than today's Internet."[48]) *See generally* Carlton/Sider Decl. ¶ 53-57.

- IXC is another recent facilities-based entrant into the market. IXC has achieved a market capitalization of over $1 billion based on its plans to construct a 20,000 mile digital (fiber optic and microwave) network by 1998-99, a significant portion of which has already been

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[45] *See* Qwest's website at <http://www.qwest.net/networkframe.html> for a map of the network. Additional details on network construction, arrangements with other carriers, and the company's plans are available at <http://www.qwest.net/pressframe.html>.

[46] As of 1996, WorldCom operated 12,060 route-miles of fiber optic lines. *See* J. Kraushaar, *Fiber Deployment Update End of Year 1996*, Table 1 (FCC Common Carrier Bureau Industry Analysis Division, 1997) <http://www.fcc.gov/ccb/stats>.

[47] *See* <http://www.qwest.net/whoframe.html>.

[48] Qwest has leased 24 dark fibers along its entire route to GTE and 24 fibers to other carriers, and intends to retain 48 fibers (plus a spare conduit for future expansion) for its own use. Press Release, "Qwest announces major fiber sale to GTE; GTE Corp. to acquire dark fiber in new Qwest network," May 5, 1997, <http://www.businesswire.com/>. *See* advertisement of GTE, appearing in *The New Yorker*, Oct. 20 & 27, 1997, at pp. 22-23. *See also* advertisement of GTE, appearing in *The Washington Post*, Jan. 7, 1998, at A11.

constructed. IXC has already entered into a number of facility leases with major carriers assuring it of a substantial revenue stream.[49] *See generally* Carlton/Sider Decl. ¶ 53-57.

- Williams currently has an 11,000-mile system (which it claims makes it the fifth largest fiber optic network in the country) and has announced plans to expand that network to 18,000 miles by the end of the year and ultimately to 25,000 miles. Williams has also announced some $1 billion worth of long-term customer agreements for capacity on that network.[50]

- Level 3 recently announced plans to spend $3 billion to build a global Internet-based local and long-distance network. Level 3's network is expected to encompass 20,000 route miles. Completion is planned in late 1999.[51]

The competitive significance of these new networks is further magnified by the number of firms that will own and operate significant capacity on them. *See* Carlton/Sider Decl. ¶ 56. Qwest has sold significant portions of its network to Frontier and GTE, and IXC has sold capacity to WorldCom, LCI, Vyvx, Inc., MCI, DTI, Consolidated Communications Telecom Services, and GST. *See* Carlton/Sider Decl. ¶ 41. Nor are these national facilities-based carriers the only significant new entrants. Significant facilities-based entry is also occurring at the regional level, where companies such as Norlight Telecommunications, Minnesota Equal Access Network, Iowa Network Services, KIN Network and others have banded together. *See* Carlton/Sider Decl. ¶ 43.

These new facilities-based competitors take advantage of the decreasing unit cost of constructing new fiber networks or expanding existing ones. Arrangements like that used by Qwest in which a number of carriers share the costs of laying large quantities of fiber have significantly

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[49] *See* <http://www.ixc-investor.com/press.html>.

[50] *See* Fiber Optics News, "Williams Reincarnates Carrier's Carrier Business," Jan. 12, 1998. Williams' reentry followed the expiration of the non-compete agreement it entered into following the January 1995 sale of much its fiber network to WorldCom. *See id.*

[51] *See* Carlton/Sider Decl. ¶ 59.

reduced the costs to individual interexchange carriers of laying cable to create national networks. Moreover, new and existing competitors can dramatically expand their network capacity without acquiring an additional mile of fiber. Rapid improvements in electronics, including developments in multiplexing and laser technology, enable new and existing competitors to increase exponentially the amount of traffic that a single strand of fiber can carry, allowing rapid expansions of a carrier's network capacity. The rapid growth of interexchange usage for voice and data services spurred by dramatic declines in price has created an enormous market more than sufficient to support multiple carriers, including multiple facilities-based carriers. *See* Hall Decl. ¶ 16.[52] In sum, there is no shortage of facilities-based contenders -- and no shortage of capital for those contenders to draw on, *see* Hall Decl. ¶¶ 14, 24 -- competing for market share in the burgeoning telecommunications industry.

The same factors that have produced such significant entry in past years make it inevitable that new entry will continue to occur for the foreseeable future. The Commission's implementation of the World Trade Organization ("WTO") Agreement will make it easier for foreign carriers, attracted by the size and openness of the burgeoning long-distance market in the United States, to pursue their global expansion plans.[53] The Commission indicated in the *Bell Atlantic/NYNEX Order*

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[52] GTE's contention that new entry is likely to be deterred by excess capacity in the long distance industry is frivolous. *See GTE Petition* at 23, 14 n.31. Rather than deterring entry, such excess capacity *encourages* entry by providing a means of rapid expansion that keeps the market competitive. *See* Carlton/Sider Decl. ¶ 60. Moreover, the suggestion that entry is being deterred simply cannot be seriously maintained in light of the significant new entry described above that has characterized the industry in the last decade.

[53] *See* Rules and Policies on Foreign Participation in the U.S. Telecommunications Market, *Report and Order and Order on Reconsideration*, IB Docket No. 97-142, FCC 97-398 (rel. Nov. 26, 1997) ("*Foreign Carrier Participation Order*").

that merger analysis should "examine not just the markets as they exist today, but as [the Commission] expect[s] they will exist after a Bell Company receives authorization to provide in-region intraLATA services" – in addition to the out-of-region and specified in-region services they currently provide.[54] The Commission is well acquainted with the BOCs' relentless desire to offer in-region interexchange services.[55] The *Wall Street Journal* recently reported that "[t]he Bells plan a jihad in long distance."[56] In addition, non-traditional competitors such as electric power companies and gas companies (some of whom are constructing and operating their own networks) will also be able enter and exploit any competitive opportunity left open by existing competitors.[57]

The experience of MCI and WorldCom confirms the absence of significant entry barriers. When MCI broke into the long-distance business, it proved wrong the then-conventional wisdom that high entry barriers and economies of scale precluded competition. Five years ago, few had

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[54] *Bell Atlantic/NYNEX Order*, *supra* note 3, at ¶ 7.

[55] BellSouth's suggestion that the merger should somehow accelerate BOC entry into in-region long-distance services is bizarre. Having failed to persuade the courts, Congress, or the Commission to permit them to enter long distance markets while their local bottlenecks remain intact, the BOCs now try to delay a merger that promises to accelerate the pace and scope of local competition. Moreover, as the BOCs well know, they control the timing of their entry in the interexchange market: when the BOCs open up local markets to competition and local competition takes root, they will be able to meet the requirements of Section 271. ICP/COM argues that it is anticompetitive for parties like MCI and WorldCom to urge this Commission and state commissions to keep the BOCs out of long distance until they comply with the requirements of the 1996 Act. *Petition to Deny* of Inner City Press/Community on the Move in CC Docket No. 97-211, at 6 (filed Jan. 5, 1998) ("*ICP/Com Petition*"). The appropriateness of MCI's and WorldCom's advocacy cannot seriously be questioned, especially since the Commission has agreed in the three applications on which it has ruled that the BOCs have not satisfied the statutory requirements.

[56] *Wall Street Journal*, Jan. 16, 1998, at C2.

[57] *See* Carlton/Sider Decl. ¶ 61.

heard of WorldCom (then LDDS), and no one included it in the top tier of interexchange carriers. As recently as 1994, WorldCom was one of "a handful of companies running neck-and-neck for fourth place in the competitive long distance market."[58] Since that time, WorldCom has distinguished itself from the pack so successfully that GTE now describes WorldCom as part of "the Big 4." *See GTE Petition* at 14; *see also Long Distance Market Shares - Third Quarter 1997*, at 9, Table 2.2, (showing WorldCom's share of presubscribed lines growing from 0.1% in 1991 to 2.7% by the end of 1996).

Petitioners point to nothing to indicate that it is more difficult today than it was in the recent past to follow a strategy of initial entry through resale followed by increasing investment in switching and transmission capacity. *See* Hall Decl. ¶ 69. As shown by the success of MCI, WorldCom, and myriad other interexchange carriers that began as switchless resellers and now have substantial networks, it is becoming easier, not harder, to become a facilities-based interexchange carrier. *See* Hall Decl. ¶¶ 70-72 (discussing the absence of barriers to entry). Indeed, even a cursory glance at the current market reveals the rapidity with which new competitors can emerge as significant market forces. The annual operating revenue of VarTec Telecom, for example, grew from virtually zero in 1993 to $470 million in 1996; LCI's annual operating revenues grew from $317 million in 1993 to over $1.1 billion in 1996. *See Long Distance Market Shares - Third Quarter 1997*, at 13 (Table 3.1). Experience shows that the long distance business can easily support a large number of national facilities-based carriers, and several substantial new entrants obviously believe that it can support even more. *See also* Hall Decl. ¶18.

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[58] *Washington Post*, "Long-Distance Firm Bids to Grow," Aug. 23, 1994, at D1.

In sum, there is simply no basis for GTE's claim that MCI WorldCom will have the ability or incentive to raise long-distance prices and restrict output. Even if MCI WorldCom tried to do so (and no such attempt would occur), existing competitors would seize the opportunity to capture business; and if the attempt were even partially successful (and it could not be) the increased profitability of the long distance business would only induce more of the facilities-based entry that experience demonstrates is, and continues to be, feasible.[39] *See* Carlton/Sider Decl. ¶ 51. Indeed, the only way GTE can come to the contrary conclusion is to completely ignore in its petition any mention of Qwest, IXC, and Williams, an omission that is particularly striking given GTE's affiliation with Qwest described above.

C. The merger will not increase the likelihood of collusion.

GTE and the BOC petitioners raise concerns that the merger will effect a significant change in the structure of the market for long distance services and thereby "aggravate the tendency toward coordinated interaction." *GTE Petition* at 19; *see also BellSouth Petition* at 11-12. Both the premise and the conclusion are unfounded. *See generally* Carlton/Sider Decl. ¶¶ 48-62.

The competitive performance and easy entry of the current interexchange market demonstrate that no such coordinated interaction occurs today notwithstanding the concentration levels emphasized by GTE and the BOCs. And none would occur post-merger both because the continued ease of entry and because the market structure pre- and post- merger will remain substantially the

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[39] The BOCs suggest that the movement in stock prices of all interexchange carriers after the merger announcement demonstrates that the merger is bad for competition. *See, e.g., BellSouth Petition* at 18. The BOCs cite no evidence or analysis to support this suggestion. Nor could they because "the general pattern of changes gives no support to the hypothesis that Wall Street viewed the merger as anticompetitive." Hall Decl. ¶¶ 100, 113.

same. *See* Carlton/Sider Decl. ¶ 62. According to the latest available FCC figures, in the market for long distance services, WorldCom has only 2.7% of presubscribed lines,[60] and the merger would thus raise the merged company's share of such lines only from 14.5% to 17.2%. The merger will thus not alter MCI's position as the number two firm in the industry either in absolute terms[61] or relative to AT&T, which maintains a market share of 50 percent based on revenue (and an even greater percentage of presubscribed lines), which will still be twice the size of MCI WorldCom. Nor will the merger affect the existence and importance of the most notable element of the industry's structure, the "other" category, which accounts for upwards of 20 percent of interexchange revenues and is growing at an annual rate of over 40 percent. *See supra* pp. 29-30. In sum, the market structure post-merger is unlikely to differ in significant ways from the competitive pre-merger market structure.

Moreover, to the extent that long distance services are becoming a commodity bought and sold at publicly available prices, any attempted price increase through tacit collusion (pre- or post-merger) would simply attract additional entry that would bring prices back to competitive levels. *See* Hall Decl. ¶¶ 68-69. To the extent that long distance services are highly differentiated products sold to large customers at non-published prices, tacit coordination would be impossible to achieve and enforce. In fact, both retail and wholesale customers often purchase interexchange services under long-term contracts tailored to their individual needs. Wholesale contracts are not publicly filed,

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[60] *Long Distance Market Shares-Third Quarter 1997*, Table 2.2.

[61] Bell Atlantic's concern that "WorldCom and MCI together will be the second largest long distance company in the United States," *Bell Atlantic Petition* at 13, is hard to understand. MCI is *already* the second largest long distance company in the United States, and thus the merger will not affect its position.

and the terms and conditions of retail contracts are published only after the fact. *See* Hall Decl. ¶¶ 21, 24. Tacit collusion in these circumstances is extremely difficult, and in fact the Commission has acknowledged the intense competition that occurs to provide these services.[62]

Nor will the likelihood of tacit collusion be enhanced by the elimination of any pricing "maverick." First, there is no basis for GTE's and the BOCs' portrayal of WorldCom as a "maverick" compared to MCI. WorldCom does pride itself as a vigorous competitor on both price and service. But MCI's prices are competitive with WorldCom and other large and small interexchange carriers, and MCI has taken the initiative on several major price reductions. And, as discussed in Section D, MCI sells service to resellers on a scale comparable to WorldCom. In sum, both MCI and WorldCom were forged in the same crucible of competition, and MCI WorldCom will carry on the maverick traditions that each company has epitomized and continues to epitomize.

The structure, performance, and dynamics of the industry thus confirm that no tacit collusion occurs now, and none will emerge post-merger.

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[62] *See, e.g.*, In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd. 3271, 3318 (1995) ("*AT&T Domestic Non-Dominant Carrier Order*"); In the Matter of Competition in the Interstate Interexchange Marketplace, 8 FCC Rcd. 3668, 3671 (1993); In the Matter of Competition in the Interstate Interexchange Marketplace, 6 FCC Rcd. 5880, 5887, 5991 (1991). There is no merit to BellSouth's suggestion that the *Bell Atlantic/NYNEX Order* announces a general rule that the merger of two of the five most significant market participants necessarily increases the potential for collusion. *BellSouth Petition* at 16. Instead, the Commission found it "not unreasonable to conclude" that there was a high risk of coordinated interaction in local markets, relying heavily on the ILEC's control over essential inputs that give it the power to discipline uncooperative firms. *Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 122. This factor is wholly absent from the interexchange market.

D. The merger will not reduce residential competition.

The FCC has found that the long distance business includes several segments, including one segment that includes residential consumers.[63] Perhaps the clearest example of the internal inconsistencies and implausible arguments that mark GTE's and the BOCs' petitions involves this residential market. GTE and the BOCs argue both (1) that residential markets are uncompetitive, with the prices charged far exceeding the costs of serving the customers, *see GTE Petition* at 18-19; *BellSouth Petition* at 23-24, and (2) that the merged company is likely to abandon the residential market, *see BellSouth Petition* at 17-18. Petitioners never attempt to explain how both of these propositions can be true -- why MCI and WorldCom would abandon a business that in petitioners' view is returning oligopoly profits. *See* Hall Decl. ¶ 100; Carlton/Sider Decl. ¶ 39.

In fact, neither proposition is true. First, the residential market is vigorously competitive, and second, MCI and WorldCom have absolutely no intention of abandoning this market. In fact, the merged company has compelling reasons to continue to compete in this market, none of which

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[63] *See Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 53. The Commission also included small businesses in this segment, but because the petitions focus on residential customers, so will we, although the same analysis applies to both groups. The Commission's approach to market definition focuses on demand-side substitutability, but supply-side substitutability must, at a minimum, be considered in determining the number and significance of competitors in a market defined only in terms of demand. *See* Hall Decl. ¶ 4. As explained above, the retail businesses of MCI and WorldCom are generally complementary. In any event, to the extent that MCI and WorldCom have higher combined shares in some segments than in others, the merger will not produce anticompetitive effects for the reasons discussed above, including entry from competitors who compete primarily in other segments but who can easily compete in additional new segments, from existing competitors expanding capacity, and from new facilities-based entrants. The merger of MCI and WorldCom will thus not permit the merged company to profitably increase prices above competitive levels in any segment.

has anything to do with the existence of oligopoly profits and which instead have everything to do with effective and efficient competition.

1. Residential competition is vigorous.

The suggestion of GTE and the BOCs that the market for residential customers is not competitive is meritless. As Professor Hall establishes, residential consumers enjoy as much competition as other types of long distance purchasers. *See supra* Sectin III.A. One indicator of dog-eat-dog competition for residential consumers is the tremendous rate at which residential customers change interexchange carriers: this Commission has noted that there were expected to be some 30 million carrier changes in 1995 alone,[64] and this number has only grown in the ensuing years. *See* Carlton/Sider Decl. ¶ 46. Moreover, these numbers substantially understate the true level of competition because they do not account for the recent surge in "dial around" services, which permit customers to use alternative carriers without having formally to change carriers.[65] Numerous interexchange carriers -- both facilities-based carriers and non-facilities-based resellers -- market to residential customers, and those that have chosen to focus on business customers, which buy the same services that residential consumers buy, could easily make these services available to residential customers. *See* Carlton/Sider Decl. ¶ 38. In fact, this ease of entry is demonstrated by the extremely rapid growth that new entrants to this market have achieved. For example, between December 1994 and December 1996, the number of Excel subscribers rose from roughly 75,000 to

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[64] *See AT&T Domestic Non-Dominant Carrier Order*, *supra* note 62, ¶ 63 (1996).

[65] *See, e.g., Orange County Register*, "Off the Hook," Oct. 12, 1997 (quoting estimates that 11.2% of households used "dial around" services for some or all of their long distance calls last year).

3.8 million. *See* Carlton/Sider Decl. ¶ 37. And Telco, a provider of dial-around services, increased its annual income from $1 million in 1993 to $428 million in 1996. *See id.*

In fact, by their words and deeds, the BOCs and GTE make clear their recognition that the residential market is competitive. First, a close reading of the petitions themselves confirms that residential competition is intense. Despite all the BOC rhetoric about neglected and abused residential customers that only they (subsidized) will serve, Bell Atlantic and BellSouth say that they really want to compete for the allegedly "lucrative business customers," *BellSouth Petition* at 4, because long distance business markets are "where the real profits are," *Bell Atlantic Petition* at 15. This strategic focus on business customers belies their rhetoric that the residential market is non-competitive (although the BOCs will eventually learn, if they do not already know, that business consumers benefit from competition every bit as cut-throat as do residential consumers).

Second, if GTE and the BOCs truly believed that residential long-distance consumers are looking for a better choice and that excess profit margins exist, they would presumably compete for such customers outside their home regions, where the BOCs are as free as GTE to provide long distance service.[46] The fact that these ILECs have shown no significant interest in competing for customers outside their local monopoly territories demonstrates how effective residential (and, for that matter, other types of) interexchange competition has been. Moreover, if excess profits truly existed, the BOCs would have had even greater incentive to open their local markets to real competition so that they could take advantage of the opportunities created by the 1996 Act to

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[46] For example, Bell Atlantic's wholesale rate is reportedly 1.5 cents per minute ("Bells, GTE Lay Out Marketing Strategies, Swap Success Stories at New York Conference," *Telecommunications Reports*, Sept. 23, 1996, at 8 - about a 90 percent discount from the standard retail rates the BOCs claim residential customers are paying.

compete in long distance markets. That the BOCs have chosen to try to protect their monopoly profits in the local market rather than enter the long distance market provides further evidence that there are no excess profits to be made in the latter market.

2. The merged company will retain its residential focus.

Despite this intense competition, both MCI and WorldCom are strongly committed to remaining in the residential markets. The residential market has constituted a cornerstone of MCI's and WorldCom's business for years. As petitioners themselves concede, both MCI and WorldCom have been dedicated to serving the residential market, and only their strategies differ: "MCI has focused on the residential market for many years and has millions of residential customers," *BellSouth Petition* at 6, and "WorldCom has followed a strategy of distributing its services through resellers with known brands, such as GTE." *GTE Petition* at 25-26. Indeed, given the tremendous time and expense that has gone into attracting these residential customers, it is hard to understand the logic of petitioners' assertion that the merged company would want to abandon them. *See* Hall Decl. ¶ 94 ("It would be economically irrational for the merged entity not to capture the value of that reputational capital by failing to continue the business.").

In fact, there is no conceivable reason why the merger would diminish this commitment to serving the residential market, and it will not. If it makes sense for MCI and WorldCom individually to pursue residential consumers, it makes sense for MCI WorldCom to do so. It should be obvious that as publicly traded corporations, MCI and WorldCom would not compete so vigorously for residential consumers unless they were making money,[67] and the merged company will have no

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[67] Of course, as noted above, if the residential market were characterized by oligopoly prices and profits, see *BellSouth Petition* at 12 -- which it is emphatically not -- MCI and WorldCom would

desire to "jettison," *see BellSouth Petition* at 18, a business that continues to provide reasonable rates of return -- and certainly not to turn over a profitable business to its major competitors, such as AT&T. *See* Carlton/Sider Decl. ¶ 40 ("If it is now profitable to serve such customers, there is no reason to expect that this situation would change as a result of the transaction."); Hall Decl. ¶107 ("if MCI is currently maximizing profits, raising prices or shedding customers would lower, not raise profits").[46]

Moreover, the residential customers are important users of network capacity that would otherwise be idle. Because business customers are heavier users of long distance services than residential customers, interexchange networks are generally designed to handle the peak demands of business customers. As a result, the greatest utilization of the network's capacity comes during business hours on business days. In contrast, the greatest utilization by residential customers generally occurs on evenings and weekends. Residential traffic therefore fills up the network when capacity would otherwise remain idle. MCI and WorldCom are like other IXCs in this respect. MCI WorldCom will therefore have a strong incentive to continue to serve residential customers in order to remain competitive and to spread the fixed costs of its network over a larger customer base, thereby enabling MCI WorldCom to charge lower prices to all customers and to invest more in keeping its network state-of-the-art.

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have even greater incentives to continue to serve it.

[46] Given these reasonable rates of return, there is simply no evidence to support BellSouth's suggestion that Wall Street would want the merged company to spin off long distance service. *See BellSouth Petition* at 17. To the contrary, as long as the residential business continues to generate a reasonable rate of return, one would expect the pressure from Wall Street to be to hold on to this business and to make it grow.

Finally, the residential market provides MCI and WorldCom a broader market for innovative products that may be developed in the first instance for the large volume high-end business customer. These services require substantial up-front investment, and it is more efficient to recover these costs from a broader base of customers. For example, the same research and development efforts that led to advanced 800 services for business customers support personal 800 numbers for residential consumers. By expanding the potential market for each new service, the availability of a significant residential customer base increases the potential returns for new services and encourages and facilitates product innovation and development.[69]

For all these reasons, MCI WorldCom will continue to serve residential consumers as aggressively and competitively as MCI does directly and as WorldCom does through its own direct sales as well as through resellers. The management of both companies is firmly committed to continuing their companies' present commitment to residential service, following the merger.

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[69] Like MCI, MCI WorldCom will also be able to use residential services to meet the needs of its larger business customers. Business customers are more often asking bidders to provide service not only to business locations but to their employees as an employee benefit. By offering residential service to a business customer's employees, MCI can better provide the total package of services sought by the business customers.

In addition, with the expansion of telecommuting and the increasing reliance on the home as place of business, the lines between residential service and business services are blurring. MCI WorldCom will thus have to serve both sectors so as to avoid losing market share in either sector.

E. The merger will not reduce wholesale competition.

GTE and the BOCs also argue that the proposed merger will reduce competition in the "wholesale market."[70] This contention is meritless.

At the outset, it is important to emphasize that, despite petitioners' discussion of wholesale services as if such services constituted a distinct market, no bright line separates wholesale and retail "markets." Wholesale customers buy the same services as retail customers. The clear reason for this is that long distance transmission capacity is fungible (a DS-3 is a DS-3 whether a wholesale or retail customer buys it) and switches perform the same function whether the service is marketed by the owner of the switch or by a reseller. Switch-based and switchless resellers simply buy dedicated and switched services in the volumes that qualify them for the same discounts that large retail customers obtain for basically the same services.[71] The Commission's long-standing prohibition against unreasonable restrictions on the resale of interexchange services complements market pressure to make interexchange services available to resellers on nondiscriminatory terms and conditions.[72]

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[70] Here, as elsewhere, GTE's comments must be taken with a grain of salt. While portraying itself as an exploitable reseller, GTE neglects to mention that it has acquired a large nationwide long distance network of its own. *See supra* p. 35 and note 48. One is left to wonder whether GTE fears the merger will threaten it as a vulnerable customer or instead make MCI WorldCom an even more formidable competitor.

[71] Market definition focuses on demand substitution factors or, simply put, whether consumers could react (by either switching to other products or switching to the same product offered by firms at other locations) if a hypothetical monopolist raised the price of its product. Merger Guidelines ¶ 1.0. GTE offers no economic analysis for the proposition that services offered to interexchange customers are in a different market from the identical services offered to end-user customers by the same interexchange carriers.

[72] *See* In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Domestic Public Switched Network Services, 83 F.C.C.2d 167 (1980), *aff'd sub nom., National Association of Regulatory Utility Commissioners v. FCC*, 746 F.2d 1492 (D.C. Cir. 1984);

In short, from the demand side, resellers have ready access to retail services, including those retail services with large volume driven discounts, and from the supply side, facilities-based carriers that market to retail customers can easily market to resellers. The upshot is that any attempt by MCI or WorldCom to increase prices for wholesale services to a level that produces greater-than-competitive profits would fail. Carriers that do not currently market to resellers would jump at that opportunity, and they can easily increase wholesale sales because the same capacity that is used for retail services can be used for wholesale services and that capacity can be expanded at relatively low cost.

In any event, even if there were a separate "wholesale" market (and there is not), it is a highly competitive business with multiple suppliers.[73] And it is growing more competitive with the entry of significant new carriers that have positioned themselves as carriers' carriers catering to IXC customers. *See supra* p. 35-36 (discussing Qwest, IXC, Williams, and Level 3).[74]

Moreover, any attempt to raise prices to resellers would fail because resellers themselves can build or purchase their own facilities rather than pay inflated prices. A typical path for interexchange carriers -- successfully followed by MCI and WorldCom among others when the market was

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see also In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities, 60 F.C.C.2d 261 (1976), *motion for reconsideration granted in part and denied in part*, 62 F.C.C.2d 588 (1977), *aff'd, AT&T v. FCC*, 572 F.2d 17 (2d Cir. 1978).

[73] Bell Atlantic claims that it "has seen very little wholesale price competition." AuBuchon Aff. at 7. The fact that Bell Atlantic is purchasing long distance services for a 90 percent discount off retail prices is evidence enough of the absurdity of this claim. *See supra* note 66.

[74] GTE's claim that "only the Big 4 IXCs can effectively compete to provide nationwide wholesale long distance capacity for resale," *GTE Petition* at 27, is refuted by GTE's own decision to obtain significant capacity for its nationwide network from Qwest. *See supra* p. 35 and note 48.

dominated by AT&T and much more concentrated than it is today -- was to go into business primarily as a reseller and then, over time, to add their own facilities. In fact, most carriers that buy services for resale own at least some of their own switching and transmission facilities, including significant regional networks, and the cost to these carriers to expand the capacity of their transmission networks through enhanced electronics may be lower than the cost of constructing new networks from scratch, although the per-unit costs of laying fiber are also decreasing as carriers join together to share these costs. *See supra* p. 36. Facilities-based carriers thus could not overcharge significant wholesale customers because many of those customers would simply accelerate construction of their own facilities. Then, having built these facilities, the former wholesale *customer* would be likely to become a wholesale *competitor*, since carriers that choose to build their own facilities often include sufficient capacity to supply not only their own needs but also those of other carriers. The fact that many carriers are currently choosing to build or purchase rather than lease in a competitive wholesale market demonstrates that the option of building and purchasing new facilities constrains wholesale prices.[75]

Given these market conditions, tacit collusion among wholesale providers is out of the question, and petitioners' purported concern about such collusion is misguided. Even putting aside the inducement to new entry that increased prices resulting from hypothetical collusion would create, tacit collusion could not occur as a practical matter because wholesale services are sold under carrier-to-carrier contracts that are not publicly filed and that are often customized. Moreover, as petitioners

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[75] The BOCs also reportedly plan to be facilities-based carriers for a large part of their traffic. Any delay in Bell Atlantic's construction of its own network because of its frivolous misinterpretation of section 272, *see Bell Atlantic Petition* at 15, is entirely Bell Atlantic's own fault and has no relevance to these proceedings. *See also infra* pp. 93-94.

acknowledge, *see BellSouth Petition* at 16, purchasers of wholesale services are sophisticated consumers experienced in playing competing providers against each other. *See* Hall Decl. ¶ 20. In this context, it bears repeating that *none* of these sophisticated customers, but GTE, has protested the proposed merger.

Against this overwhelming evidence that the wholesale market is and will remain competitive, petitioners offer two primary arguments. First, they suggest that MCI WorldCom will not compete aggressively for fear of "cannibalization." This notion -- that a facilities-based interexchange carriers with capacity to support a successful retail business would not use that capacity to support a successful wholesale business -- lacks any factual or theoretical basis. The lack of factual basis is demonstrated by the fact that *both* WorldCom *and* MCI (like other facility based carriers) sell on a substantial scale to *both* wholesale *and* retail customers. In addition to direct sales to residential customers, WorldCom's interexchange customers use services obtained from WorldCom to compete for WorldCom's business customers, and WorldCom has not limited, and could not limit, its interexchange customers to the business segment of the market. If WorldCom is a maverick, so too are MCI and other competitors that offer competitive, nondiscriminatory prices to both wholesale and retail customers.

The lack of theoretical basis for the cannibalization theory results from the fact that interexchange carriers with retail customers (whether residential or business) understand that the interexchange carriers that want to purchase interexchange services from them have competitive alternatives. If the facilities-based interexchange carriers with a large retail customer base do not sell to the resellers, the resellers can follow the familiar path of constructing their own facilities, or they can obtain capacity on favorable terms from wholesale-oriented competitors like Qwest,

Williams and IXC. GTE itself is a good example of an interexchange carrier that began by reselling intercity services and is now rapidly becoming a substantial facilities-based provider. Facilities-based interexchange carriers therefore face a simple choice: (1) get no revenue from a competitor because the competitor obtains capacity from other facilities-based interexchange carriers or constructs its own; or (2) get some revenue by selling available capacity to the competitor on nondiscriminatory terms. It is not surprising that many facilities-based interexchange carriers, including MCI and WorldCom, choose the second option -- which incidentally also complies with their Commission-enforced resale obligations. And of course, if MCI and WorldCom each individually has an incentive to compete for wholesale as well as retail customers, so too will the merged company.

Petitioners fare no better with their second argument -- that the possibility of anticompetitive conduct is revealed by their experience with the value-added interexchange services that petitioners want to buy even more cheaply from MCI. *See Bell Atlantic Petition* at 14. MCI's and WorldCom's advanced services are provided under tariffs that make them as available for resale as any other services, and they will remain so after the merger.[76] GTE and Bell Atlantic, of course, are not really contending that MCI and WorldCom refuse to make any advanced capabilities available for resale or that either is refusing to provide the same discount that other customers receive. Instead, they

[76] Even if post-merger MCI and WorldCom were inclined to unreasonably restrict resale (which they emphatically would not be), such restrictions would violate the Commission's regulations, and resellers with legitimate complaints would then have the same remedies that they now have prior to the merger.

want MCI and WorldCom to give them larger discounts.[77] They are no different from any retail customer in this respect, and Bell Atlantic acknowledges that it has no right to wholesale discounts beyond those retail customers receive. *Bell Atlantic Petition* at 15 n.36.[78]

In sum, the proposed merger poses not the slightest threat to wholesale competition -- which helps to explain, as noted above, that not a single one of all the sophisticated wholesale consumers filed a petition opposing the merger, except three (GTE, Bell Atlantic, and BellSouth) pursuing a different agenda, which is all too clear. MCI WorldCom will continue to have strong incentives to continue to aggressively market wholesale services to compete with existing and new entrants, including carriers' carriers, and to maximize the use of the network.

F. Conclusion.

At times, a page of history is worth a volume of logic. In 1990, MCI, the number two interexchange carrier, acquired Telecom*USA, a facilities-based carrier that was then the fourth-largest interexchange carrier, and overall concentration of the long distance market nonetheless

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[77] Given that ILECs have established wholesale discounts for local service (from the most simple to the most advanced) that are a fraction of the discounts available from interexchange carriers and that make local resale completely unprofitable, it is (to say the least) ironic that the ILECs, of all carriers, are complaining that long-distance wholesale discounts are too low.

[78] Bell Atlantic asserts that MCI was willing to provide services to Bell Atlantic for resale "but only if Bell Atlantic did *not* use resold MCI capacity to compete against it." *Bell Atlantic Petition* at 14. This assertion is false. Bell Atlantic was completely free to use an MCI service designed for switchless resellers ("Carrier Network Services" or "CNS") to compete against MCI at the retail level. It could also use CNS for sales to existing MCI customers and get the maximum CNS discount. The discount would be smaller, but still substantial, only if the reseller discriminatorily targets existing MCI customers because of disproportionate costs this strategy imposes on MCI and the standard practice of providing larger discounts to attract new business. Moreover, resellers that wish to target MCI customers can purchase MCI services other than CNS on exactly the same terms as any other wholesale, or retail, customer.

continued its steady decline in 1990 and thereafter. *See supra* pp. 31-32. Other carriers continued to gain market share, including WorldCom which competed so successfully that GTE says it turned the so-called Big 3 into the Big 4. *See GTE Petition* at 14. The merger of WorldCom and MCI -- which is likewise between the number two and number four carriers -- will not harm competition any more than the MCI-Telecom*USA merger did. The interexchange market is vibrantly competitive for all consumers, including residential and wholesale purchasers, and the merger will not change this fact. Indeed, the merged company will take advantage of the significant efficiencies and savings described above to compete even more effectively in all portions of the long distance market.

IV. THE PROPOSED MERGER WILL PROMOTE COMPETITION AND WILL NOT HAVE ANTICOMPETITIVE EFFECTS IN ANY INTERNATIONAL END USER OR INPUT PRODUCT MARKET.

A. The merger will have significant procompetitive effects.

MCI and WorldCom believe that the merger will yield significant benefits for the companies' customers and U.S. consumers generally. A driving force behind the merger of MCI and WorldCom is the desire to create the first truly global end-to-end competitive carrier. As a fully integrated company, MCI WorldCom will offer a complete range of local, long distance, wireless, and international communications services. The merged company plans to move as aggressively as regulatory conditions permit to offer competitive choices to consumers on a global scale. By combining the expertise and resources of the two companies, MCI WorldCom will be a strong and efficient competitor to incumbent carriers world-wide.

WorldCom and MCI have complementary international competitive operations, which the combined company will expand upon. WorldCom has constructed and operates metropolitan fiber optic networks in London, Frankfurt, Paris, Stockholm, Amsterdam, and Brussels. WorldCom is

now connecting those city networks through the construction of its high capacity, pan-European network, Ulysses. The imminent entry into force of the WTO Agreement will present even further competitive opportunities for MCI WorldCom, particularly in Asia, where WorldCom's operations are already rapidly expanding. Likewise, MCI currently is an active participant in competitive operations abroad, including "second operators" in Mexico and New Zealand. Together, MCI WorldCom will become a potent competitor to incumbent carriers world-wide and help fulfill the promise of the WTO Agreement. U.S. consumers will be among the primary beneficiaries of this new competition.

B. The merger will not have anticompetitive effects in the international services market.

Only one party, GTE, asserts that the merger will have anticompetitive effects in any international telecommunications product market.[79] GTE makes the implausible argument that the merger will have anticompetitive effects in international end user and transport product markets and thus is contrary to the public interest. *GTE Petition* at 30.

As an initial matter, GTE erroneously asserts that International Message Telephone Service (IMTS) and non-IMTS (primarily international private line services) currently comprise separate end user product markets. *Id.* The Commission has previously noted that a relevant product market is a service or group of services for which there are no close demand substitutes.[80] GTE's assertion

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[79] Telstra's Comments raise issues concerning international Internet access that indirectly relate to the international services market. *See Comments of Telstra Corporation Limited* in CC Docket No. 97-211 (filed Jan. 5, 1998), *("Telstra Comments")*. Telstra's Comments are addressed in Section V., *infra*, concerning the Internet.

[80] *See, e.g.*, Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Areas and Policy and Rules Concerning the Interstate, Interexchange

that IMTS and international private line services constitute separate product markets is, at best, outdated given market trends and regulatory developments in recent years. There is no longer any meaningful distinction among end-users between switched voice circuits and a private line circuits. The purpose of IMTS, electronic messaging, packet-switched services, fax, switched data services, and virtual private network services is to transport information electronically between two points. These services can be provided over an international private line circuit or a switched message circuit. The choice between a switched or private line circuit is generally an economic one, as there is a cross-over point in usage when private circuits become cheaper than switched circuits. Customers simply want to transport voice or data information on the most cost-effective basis.

International private lines are increasingly used to provide switched services, whether through international simple resale (ISR) or virtual private networks. For example, where permitted, carriers often use international facilities-based or resold private lines to bypass high IMTS settlement rates on the foreign end.[81] Carriers can also use a combination of ISR and foreign IMTS tariffed rates -- known as "switched hubbing" -- to provide switched voice services to nearly every country

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Marketplace, *Second Report and Order*, CC Docket No. 96-149, and *Third Report and Order*, CC Docket No. 96-61, FCC 97-142, at ¶ 40 (rel. Apr. 18, 1997); *Bell Atlantic/NYNEX Order*, *supra* note 3.

[81] Under the new foreign carrier participation rules, carriers will be permitted to provide switched services over international facilities-based or resold private lines from the United States to WTO member countries when either the settlement rate for at least 50 percent of the settled U.S.-billed traffic on the route is at or below the relevant FCC settlement rate benchmark, or when the foreign market affords equivalent ISR opportunities. *Foreign Carrier Participation Order*, *supra* note 53, at ¶¶ 79-85. The practical effect is that ISR will be immediately available between the U.S. and almost all of Europe, as well as Australia and New Zealand.

in the world.[82] As a result, switched voice services provided over international private lines are substitutable with IMTS.[83]

Thus, there is no separate, distinguishable world-wide international private line end user product market for purposes of competitive analysis. The Commission has recognized this fact. Indeed, in *BT/MCI II*, the FCC identified the end user market for U.S.-U.K. outbound international services as a relevant market, making no distinction between IMTS and international private line services.[84]

In addition, there is no basis for concluding that MCI WorldCom's market position will vary substantially by geographic market. MCI WorldCom will not be affiliated with any dominant foreign carrier, nor will it be the exclusive U.S. facilities-based provider on any international route.[85] Thus, as in the *AT&T International Non-Dominance Order*, the Commission should examine MCI

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[82] Section 63.17(b) of the Commission's rules permits a U.S. carrier to route U.S.-outbound traffic over U.S. international private lines that terminate in equivalent countries and then to forward that traffic to a third, non-equivalent country by taking service at the published rates and reselling the IMTS of a carrier in the equivalent country. 47 C.F.R. § 63.17(b).

[83] Otherwise, international private lines are simply part of the wholesale international transmission capacity market. As demonstrated in the next section, the merger will not have any anticompetitive effects in the U.S. wholesale market for international transport.

[84] The Merger of MCI Communications Corporation and British Telecommunication plc, *Memorandum Opinion and Order*, GN Docket No. 96-245, FCC 97-302, at paras. 54-55 (rel. Sep. 24, 1997) ("*BT/MCI II Order*").

[85] *See* Federal Communications Commission, *1995 Section 43.61 International Telecommunications Data* (Oct. 31, 1996) ("*1995 FCC International Traffic Data Report*"). As the Commission is aware, MCI and WorldCom have agreed with BT to redeem BT's current share ownership in MCI.

WorldCom's market position on a world-wide basis rather than making specific route-by-route findings.[86]

Turning to GTE's specific allegations, the contention that the merger will have anticompetitive effects is grossly inaccurate. First, GTE bases its arguments almost solely on its analysis of the HHI. As we explained previously, however, the Commission has clearly recognized that market concentration measured by the HHI is only the starting point of the analysis, and a competitive analysis must take into account the dynamic nature of the growing telecommunications industry. *See supra* pp. 32-33.67.

Second, GTE fails to account for the competitiveness of the international services market. This market is characterized by growing competition and steadily declining prices. This competition is driven not just by the larger interexchange carriers, but also by hundreds of other carriers, including substantial carriers with strong capital resources.[87] Among these competitors is GTE, which is free to provide international services and own international facilities, even to and from geographic markets where GTE controls bottleneck local facilities on both the U.S. and foreign end.

This competition is even more vigorous because new carriers -- including foreign carriers -- can enter and compete in the international services market relatively easily. For example, the Commission recently granted Telstra global Section 214 authority to provide facilities-based service

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[86] In the Matter of Motion of AT&T Corp. to be Declared Non-Dominant for International Service, *Order*, FCC 96-209, 11 FCC Rcd. 17976-17977, at ¶ 35 (rel. May 14, 1996) ("*AT&T International Non-Dominance Order*").

[87] For example, Qwest recently announced that it has acquired two transatlantic circuits from Teleglobe to give it up to 600 megabits of transatlantic capacity. *See* Press Release, "Qwest Extends Network to the United Kingdom," Jan. 12, 1998, <http://www.qwest.net/pressframe.html>.

from the United States and all international points, including Australia, where Telstra is the incumbent services provider.[88] Foreign carriers such as Cable & Wireless plc (C&W), British Telecommunications plc (BT), and Telia AB (Telia), among others, have also been authorized to serve their home markets from the United States on a facilities basis. Entry by foreign carriers into the U.S. market is expected to increase significantly after the WTO Agreement enters into force. To facilitate such new entry, the FCC recently adopted new rules that generally afford open entry to foreign carriers from WTO member countries.[89]

Third, GTE places great reliance on historical market share data, which do not necessarily reflect the competitiveness of a market. Yet, even GTE's reference to historical market share data, which do not account for recent entry into the market, confirms that the merger of MCI and WorldCom will not have anticompetitive effects.[90] Based on the FCC's preliminary revenue data for 1996, MCI and WorldCom combined have only a 24.7 percent share of the total U.S.-billed revenues for international toll service.[91] AT&T's 48.3 percent market share is nearly twice as large as MCI and WorldCom's combined market share.[92] In fact, the Commission found that AT&T was

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[88] Telstra, Inc., *Memorandum Opinion, Order and Certificate*, File No. ITC-97-320 (rel. Jan. 2, 1998).

[89] *See generally Foreign Carrier Participation Order, supra* note 53.

[90] In assessing AT&T's market power in 1996 in the U.S. international market, the Commission concluded that a high market share, although not determinative of market power, is indicative of dominance. *See AT&T International Non-Dominance Order, supra* note 87, at ¶ 34.

[91] MCI has a 20.3 percent market share; WorldCom's market share is 4.4 percent. *See Long Distance Market Shares-Third Quarter 1997*, at 24.

[92] *Id.*

non-dominant for the provision of IMTS services when AT&T had a 59 percent market share.[93] The combined market share of other carriers, 27 percent, would also exceed MCI WorldCom's market share. GTE does not provide a citation for its claimed IMTS revenue and market share percentages, but its figures are wrong at best and deceptive at worst. For example, GTE claims that WorldCom has a 10.8 percent IMTS market share, while Sprint has only a 2.6 percent IMTS market share. *GTE Petition* at 33. These figures are obviously inaccurate; yet they form the basis for GTE's arguments.

Finally, even if the provision of international private line services at the retail level were to be examined separately from other international services, as GTE suggests, it is clear that the merger would not have anticompetitive effects. As an initial matter, the provision of U.S. international private line services has long been considered substantially competitive by the Commission.[94] The merger of MCI and WorldCom will not affect this competitiveness. A recent FCC circuit status report demonstrates that most international private lines are owned by carriers other than a combined MCI and WorldCom.[95] For example, in the transatlantic region, carriers other than MCI and WorldCom own a combined 65.4 percent of all active international private line and idle circuits.[96] MCI and WorldCom would together own 34.6 percent. Moreover, of the international

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[93] *See AT&T International Non-dominance Order, supra* note 87, at ¶ 37.

[94] *See* International Competitive Carrier Policies, *Report & Order*, 102 F.C.C. 2d 812, paras. 51-56 (1985), *recon. denied*, 60 R.R.2d 1435 (1986).

[95] *See* Federal Communications Commission, *1996 Section 43.82 Circuit Status Report* (Dec. 1997)

[96] These idle circuits are available for use to provide international private line services. GTE claims that for nine international routes, MCI WorldCom would have 100 percent of the revenues from international private line services. GTE fails to reveal, however, that the combined revenues on these routes represent a tiny fraction -- 0.35 percent ($2.3 million) -- of the total U.S. international

private line and idle circuits owned by carriers other than MCI and WorldCom, a large amount of these circuits -- 65.0 percent -- are idle, and thus available to MCI's and WorldCom's competitors for the provision of international private line services.[97]

C. The proposed merger would not have anticompetitive effects in the international transport market.

GTE argues that the merger will give MCI WorldCom power over the price and availability of a dominant share of undersea cable capacity through the combination of each company's existing facilities. *GTE Petition* at 35-36. GTE is wrong. A number of other international carriers own the substantial majority of existing capacity, and this capacity is distributed broadly enough to sustain the current vigorous competition in the retail services supported by this capacity. For example, in the transatlantic region, MCI and WorldCom combined would own only 16.6 percent of the total cable capacity (*i.e.*, including both western and eastern ends), and only 22.6 percent of the "western" (*i.e.*, U.S.) end of transatlantic capacity.[98] By comparison, AT&T would remain the carrier with the largest amount of capacity, owning 19.4 percent of total transatlantic cable capacity, and 25.8 percent of the western end. BT owns 13.8 percent of total transatlantic cable capacity, and 8.2 percent of

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private line revenues ($656.4 million). *See FCC Preliminary 1996 International Traffic Report.* The average number of voice grade private line circuits provided on each of these routes is only nine. Moreover, in no case would MCI WorldCom be the only carrier serving a route. Other carriers serve each of these routes on a switched message basis.

[97] *Id.* These figures also demonstrate that there are a large number of international private line and idle circuits owned by MCI's and WorldCom's competitors that may be used as wholesale international private line transmission capacity.

[98] The transatlantic facilities included in these figures are TAT-8, TAT-9, TAT-10, TAT-11, CANTAT-3, and TAT 12/13 (including the 1998 wave division multiplexing (WDM) upgrade). PTAT ownership and indefeasible rights of user acquired from other cable owners are not reflected because these figures are not publicly available.

the western end. Global One partners Sprint, France Telecom, and Deutsche Telekom (DT) together own 14.5 percent of total transatlantic cable capacity, and 11.1 percent of the western end.

In addition, new systems that will dramatically increase the available capacity will be operational in the next few months. For example, the Gemini system, a 50/50 joint venture of WorldCom and C&W, will increase transatlantic capacity by 192 whole STM-1s by the end of 1998.[99] This capacity is far more than WorldCom and C&W can use, and thus is actively being marketed to other carriers. Indeed, a primary goal of the Gemini cable system is to recover construction and maintenance costs through the sale of capacity at market-based prices.

The Atlantic Crossing transatlantic cable system, which is expected to begin service in May 1998, will add 128 whole STM-1s of capacity. MCI and WorldCom have no way of knowing how much of this capacity has been pre-sold to other carriers. But even if GTE is correct that 70 percent has been sold already, 30 percent (38.4 STM-1s or 77,414 voice grade circuits) remain available. This is a huge amount of capacity, and almost twice MCI's and WorldCom's current combined transatlantic capacity.[100]

Given the diversity of current cable systems and imminent deployment of new, high-capacity cable systems, GTE is wrong to use TAT-12/13 as a proxy for all transatlantic cable systems. Moreover, GTE's figures regarding TAT-12/13 cable ownership are misleading because they fail

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[99] Each STM-1 equals 63 E-1s. Thirty-two of these STM-1s are expected to be available by March 31, 1998; another thirty-two STM-1s are expected to be ready for service by September 30, 1998. The remaining 128 STM-1s are expected to be available by the end of 1998.

[100] In addition, MCI and WorldCom understand that not all competing international service providers use voice compression techniques, which can quadruple the amount of transmission capacity available for voice services. To the extent competitors are underutilizing these techniques, there is substantial additional capacity in these cables that could readily be made available.

to account for capacity increases as a result of the TAT-12/13 WDM upgrade that is due to be completed in the third quarter of 1998. But even assuming, *arguendo*, that TAT-12/13 may be used as a proxy for all transatlantic cable capacity, there is no reason to believe that the combination of MCI's and WorldCom's U.S.-end capacity in TAT-12/13, totaling 27.9 percent, will have anticompetitive effects. Fully 72.1 percent of the U.S.-end of TAT-12/13 will be owned by other carriers. These include AT&T (27.5 percent), Sprint, BT, C&W, DT, KDD, Teleglobe, Tele2, and Telia, each of which owns at least one whole STM-1 circuit. Each of these carriers currently hold, or will soon be eligible to hold (under the FCC's new foreign carrier participation rules), a Section 214 authorization to provide facilities-based U.S. international services.

Indeed, the proposed merger of MCI and BT involved a greater concentration of capacity than in this case. In the *BT/MCI II Order*, the FCC appropriately recognized that, although the merger would have resulted in a short-term increase in concentration, the supply of transport capacity would increase significantly in the near future.[101] As described above, the same market developments that the FCC relied upon in the *BT/MCI II Order* exist today, except that the significant increase in cable capacity is now that much closer and only a few months away. Moreover, the MCI WorldCom merger will not result in any significant increase in capacity concentration on an end-to-end basis as was the case with the proposed BT/MCI merger.

Finally, GTE incorrectly asserts that merger will have anticompetitive effects on the provision of connecting facilities between the cable landing points and the public switched network.

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[101] *See BT/MCI II Order*, *supra* note 85, at paras. 136-141.

GTE Petition at 41. In fact, the merger will have no effect in this market segment because WorldCom does not own backhaul facilities to the current undersea cables.[102]

V. THE MERGER WILL NOT HARM STRONG COMPETITION IN THE PROVISION OF INTERNET SERVICES, AND WILL DO NOTHING TO ALTER THE VIBRANT, EXPLOSIVE GROWTH OF THE INTERNET.

As the Supreme Court of the United States noted last year, the "growth of the Internet has been and continues to be phenomenal."[103] The Internet consists of thousands of interconnecting networks which link millions of computers and tens of millions of users, all joined by a common communications protocol, TCP/IP ("Transmission Control Protocol/Internet Protocol"). Virtually every communications company in the world is participating, or is preparing to participate, in the unprecedented explosion of Internet-based services. Based on the experience of WorldCom and MCI, the demand for Internet services appears to be more than doubling every year. New companies are being established monthly to exploit the opportunities offered by the emergence of new applications and capabilities that are facilitated by the connectivity of IP-based networks. The number of Internet service providers ("ISPs") in North America has tripled in twenty months, from 1,447 in February 1996 to 4,354 in October 1997.[104] Current and future providers of Internet

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[102] As a point of clarification, it is important to note that in the BT/MCI proceeding, MCI voluntarily agreed to make available to a defined set of IRU holders a limited number of U.S. backhaul circuits, under circumstances that are completely different from those presented by the merger of MCI and WorldCom. Letter from Mary L. Brown, Senior Policy Counsel, MCI to Peter F. Cowhey, Chief, International Bureau, FCC (Jul. 7, 1997). There is absolutely no basis to infer from the commitment made in the BT/MCI proceeding that the merger of MCI and WorldCom would have any impact whatsoever on the availability of U.S. backhaul circuits.

[103] *Reno v. American Civil Liberties Union*, 117 S. Ct. 2329, 2351 (1997).

[104] *Boardwatch Magazine*, Fall 1997.

services include companies offering only these services, interexchange carriers, cable companies, satellite companies, the BOCs, and utilities. The generation and development of additional applications and technology is expected to increase competition within the industry still further.

The WorldCom MCI merger will do nothing to slow the dynamic growth the Internet is experiencing or to diminish the vigorous competition among providers of Internet services. Various petitioners argue, in a scattershot of claims, that MCI WorldCom will have market power in the provision of Internet "backbone" service, and that the merged company will somehow be able to exploit its market position and dominate its competitors. These arguments are completely without merit. MCI WorldCom will not control any essential or bottleneck facilities that could be used to wield market power. Numerous ISPs operate backbone networks, and the number is growing as Internet traffic increases. The merger will not affect MCI WorldCom's incentives with respect to peering, and MCI WorldCom would have nothing to gain and everything to lose if it tried to take advantage of the ISPs with which it needs to interconnect in order to achieve the global connectivity that its customers demand. Nor will the merger produce any consolidation in the management of Network Access Points ("NAPs"), and in any event, the continuing proliferation of NAPs, and the ability to connect to multiple NAPs, make it impossible to use NAPs to disadvantage ISPs that have chosen for the time being to use one NAP instead of another. The Internet is -- by its very design -- too flexible and resilient to be dominated by any one entity, and the MCI WorldCom merger will do nothing to stunt the Internet's growth or inhibit competition. The competitiveness and growth of the international Internet business likewise precludes any competitive problem resulting from the merger. The regulatory requirements proposed by one commenter are neither necessary nor

appropriate, and could only impede MCI WorldCom's ability to participate fully in the vigorously growing and robustly competitive Internet services market.

Indeed, the petitions raise a more fundamental threshold question -- whether the merger presents an appropriate occasion for the Commission to exercise any jurisdiction it may have over Internet services. The starting point for the Commission's analysis is the express statutory policy expressed by Congress in the Telecommunications Act of 1996:

> It is the policy of the United States -- . . . to preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services, *unfettered by Federal or State regulation.*

47 U.S.C. § 230(b)(2) (emphasis added). According to the Supreme Court, "[n]either before nor after the enactment of the [1996 Act] have the vast democratic fora of the Internet been subject to the type of regulation that has attended the broadcast industry."[105]

Consistent with this principle, the Commission has appropriately refrained from regulating the Internet in any way.[106] The Commission has never exercised Title II authority over ISPs or the

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[105] *Reno*, 117 S. Ct at 2343.

[106] *See, e.g.*, Werbach, "Digital Tornado: The Internet and Telecommunications Policy" OPP Working Paper 29, March 1997 at 29:

> The Commission can and should greatly limit the extent to which its actions interfere with the functioning of the Internet services market. Communications regulation has traditionally been justified by the presence of dominant firms, by overwhelming public interest imperatives, or by the inherent invasiveness of broadcast media. *Most* of these justifications simply do not exist in the Internet realm. (Emphasis added).

Internet.[107] It is also true that the Commission's exercise of its Title II authority over common carriers has profoundly and positively influenced the development of the Internet and enhanced services generally through the pricing policies established by the Commission as part of its access charge system, and in other aspects of its implementation of the 1996 Act.[108] The Commission should not, however, single out through a merger review one of thousands of ISPs that comprise the most complex, dynamic, and explosive telecommunications phenomenon of this century for regulations applied to no other competitor. Imposing Internet-related conditions on the MCI WorldCom merger would unavoidably have the effect of interfering with the unregulated market forces that have driven the Internet's extraordinary growth.

For the reasons discussed below, the merger will not harm competition in the provision of Internet services. At a minimum, given the statutory policy of non-regulation, the Commission should not intervene without compelling evidence of imminent market failure, and the record could not conceivably support such a finding. The Commission should allow the Internet to continue to thrive as it has done to date, free of governmental interference.[109]

A. MCI WorldCom will not control the provision of Internet "backbone" services.

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[107] Amendment of Section 64.702 of the Commission's Rules and Regulations, *Final Decision*, Docket No. 20828 (rel. May 2, 1980) ("*Second Computer Inquiry*"). *See* 47 C.F.R. § 64.702(a).

[108] The Commission has retained many of the Computer Inquiry safeguards in response to Section 272 of the Communications Act. *See* In the Matter of Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, *First Report and Order*, CC Docket No. 96-149 (rel. Dec. 24, 1996).

[109] *See* 47 U.S.C. § 230(b)(2).

Petitioners make a broad range of assertions about WorldCom's and MCI's market position in the provision of Internet services in general, and Internet "backbone" services in particular, all of which boil down to the assertion that the merged company will "control" or "dominate" half or more of the so-called Internet backbone, and thereby wield market power over the Internet.[110] These assertions, however, ignore the fact that Internet backbones are made up of basic telecommunications transmission facilities and equipment that are widely available and easily affordable by new market entrants.

On a threshold point, WorldCom and MCI vigorously disagree with the suggestion that there is a separate "Internet backbone" market.[111] As detailed below, an Internet backbone is generally understood to consist of TCP/IP routers, switches and other equipment, such as modems, connected to basic underlying telecommunications transmission facilities. Because the same transmission facilities are used for Internet backbone and other services, including traditional voice and data services, any communications company that wishes to become a backbone provider can do so by purchasing the appropriate TCP/IP equipment and connecting such equipment to the transmission facilities that it leases or owns. The fungibility of transmission facilities used for Internet services

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[110] *See, e.g., CWA Comments* at 2; *Simply Internet Petition* at 4, 7; *Bell Atlantic Petition* at 3.

[111] There is no generally accepted definition of "Internet backbone." In addition to the technical definition set forth in the text, dial-up and dedicated Internet access provided on a wholesale basis by one ISP to other ISPs are sometimes called Internet "backbone" services. In reality, the difference between an ISP "backbone" provider and other ISPs is one of degree rather than a clear demarcation.

and other circuit-switched and packet-switched services precludes any finding of an independent and distinct market for "Internet backbone" services.

The natural consequence of this fact is that competition to provide Internet backbone services is as vigorous as competition to provide the interexchange telecommunications services supported by telecommunications transmission facilities. Existing providers, low barriers to entry, continued exponential growth, and a protocol specifically designed to provide flexibility and accommodate change combine to ensure that no company could conceivably dominate the provision of Internet services.

The ability of customers to change ISPs means that MCI WorldCom would not try to take advantage of them and trigger the resulting market backlash. Customers change ISPs on a regular basis. The merger will have no effect on the ease of making such changes.

Nor will the merger have any effect on peering. MCI WorldCom will have the same imperative to interconnect with other ISPs that each company has now -- MCI WorldCom will be only one of the thousands of ISPs that provide Internet service, and it must be able to offer its customers access to all of these networks through interconnection with other ISPs.

1. Wide availability of the underlying transmission facilities and commonly available routers, switches and modems that make up Internet backbones preclude any competitive threat from the merger.

An Internet backbone network is generally understood to mean an underlying structure of (a) transmission facilities that are self-provided or leased from telephone companies,[112] and (b) TCP/IP routers, switches and modems connected to the underlying physical transmission facilities. The needed transmission capacity is widely available from many carriers, and the routers, switches and modems are readily available from a variety of third-party vendors. Any telecommunications carrier or ISP could obtain the necessary hardware and software and become an Internet backbone provider -- just as any computer can use the TCP/IP protocol and thereby become part of the Internet.

Other than transmission capacity, one needs standard TCP/IP-compatible equipment and software widely available from third parties to provide Internet backbone services. No petitioner claims, or has any basis to claim, that WorldCom or MCI controls, or could conceivably achieve control of, these components used to provide Internet or Internet backbone services.

The alleged source of any competitive issue presented by the MCI WorldCom merger arises from the transmission facilities which MCI and WorldCom would utilize to provide Internet services. These transmission facilities carry all kinds of traffic -- voice and data, circuit-switched

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[112] As explained below, long-haul transmission facilities are readily available in a competitive market. There is, however, one link in the chain where competition has not yet arrived, and that is the first link controlled by ILECs. ISPs and their customers generally depend on the ILEC not only to connect the customer to the ISP, but also to connect the hubs within local calling areas. As explained in Section II, *supra*, the merger holds the promise to create competition for these facilities over which all Internet traffic must flow.

and packet-switched -- and the transmission capacity used for Internet services is fully substitutable with capacity used for voice and other traffic. *See* Carlton/Sider Decl. ¶ 61. In particular:

- digital transmission facilities can be used equally efficiently to carry voice and/or data and/or Internet traffic;
- all digital transmissions, whether voice or otherwise, are translated into bits and all bits are managed in the same manner in a transmission system; and
- the costs of building underlying transmission capacity for voice traffic and Internet traffic (or of leasing it from a facilities-based carrier) is the same; indeed the owner of the facilities usually will not be aware of what type of traffic is being carried.

The critical fact is that there is a significant and increasing amount of transmission capacity available that can be used to carry Internet traffic. As explained at pages 334-36 above, a significant and growing number of carriers have constructed national networks, and other carriers have made substantial investments in regional networks whose reach can readily be extended. Petitioners would have the Commission look only at well-established IXCs, and ignore significant recent entrants such as Qwest, IXC Communications, Williams and Level 3[113] (as well as a host of regional carriers). At year end 1996, a combined MCI WorldCom would have had a share of around 31.6 percent of total interexchange fiber miles, with AT&T having over 42.7 percent and Sprint over 15.9 percent.[114] Taken by itself, a 31.6-percent share is not indicative of dominance on the part of MCI WorldCom. But even more importantly, no reasonable analysis can exclude major recent facilities-based entry and the imminent prospect of even more. *See supra* pp. 34-36 . All of this new transmission

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[113] As discussed at page 36 above, Level 3 is proposing to construct a packet-switched network to carry Internet traffic.

[114] FCC "Fiber Deployment Update End of Year 1996." *See supra* note 46.

capacity is planned to be in, up, and running by the end of 1999, well within the two year period that the Commission considers in assessing the existence of competition.[115]

Any assessment of capacity must also take into account the fact that electronics can vastly increase the amount of traffic that these networks can carry without adding a single additional mile of fiber. *See* Carlton/Sider Decl. ¶ 61. As a result, there is a huge amount of untapped potential capacity that could be made available by existing U.S. facilities-based carriers and new facilities-based entrants for carrying Internet and other traffic.[116]

The only certainty is that existing and available capacity will continue to grow in response to growing demand for all kinds of telecommunications services, including Internet services. It is absurd to think that MCI WorldCom would decide not to participate in the growth of the Internet and instead decide to let available or easily expandable capacity remain idle and non-revenue-generating. Just as the continuing growth of capacity indicates that the MCI WorldCom merger will not harm competition in the long distance market, *see supra* pp. 34-36, the same existing and growing capacity means that the merger will not reduce competition in the provision of Internet services.

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[115] 1992 U.S. Department of Justice Merger Guidelines, ¶ 3.2. The Commission utilizes the Guidelines as part of its public interest analysis.

[116] U.S. domestic fiber capacity was most recently documented in the FCC's "Fiber Deployment Update End of Year 1996." That report lists the number of route and fiber miles for individual carriers, but it does not provide any data on the capabilities of the electronics deployed in their networks, nor do carriers publicly report this information. As a result, the true capacity of the networks is unreported and unavailable.

2. The merger will not and could not impair vigorous and increasing competition to meet the exploding demand for Internet services.

As one would expect in light of the available transmission capacity and the resulting low barriers to entry, providers of backbone services compete vigorously with each other. The industry publication *Telegeography 1997-98* (at p. 76) lists 32 major North American backbone providers, and *Boardwatch Magazine* reports that the number of U.S. national Internet backbone providers has grown from 9 in the summer of 1996, to 22 in May 1997, to 37 in the fall of 1997.[117] The relative ease of becoming a major provider and expanding the capacity or reach of an ISP backbone network is further demonstrated by recent industry developments. For example, petitioner GTE has widely advertised the fact that it is "developing a 15,000 mile data network stretching from the eastern seaboard to the California coast" that it claims will expand the GTE backbone to "100 times" the size of today's Internet.[118] Likewise, Apex Global Internet Services (AGIS) recently announced that it has acquired the right to use a 10,000-mile fiber optic cable from Qwest Communications that will enable AGIS to provide dedicated Internet service connections across the United States.[119] Finally, just last Friday, PSINet shareholders overwhelmingly approved a deal with IXC Internet Services to exchange 29% of PSINet's outstanding shares for access to a 10,000 mile OC-48 fiber network.[120]

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[117] *Boardwatch Magazine*, May/June 1997, Fall 1997.

[118] *The Wall Street Journal*, Jan. 7, 1998, advertisement at pp. A8-A9.

[119] See "AGIS to Enter National Market Through $260 Million Deal," *The Detroit News*, Jan. 7, 1998.

[120] *Communications Daily*, January 26, 1998.

Allegations by various petitioners that MCI WorldCom will control over 50 percent of the Internet "backbone" market are based on unreliable data and an analysis that is fundamentally flawed. For example, CWA's putative share analysis relies on Internet connection statistics reported in the June 1997 issue of *Boardwatch Magazine*. *CWA Comments* at 7. *Boardwatch Magazine's* methodology for calculating the number of connections is unclear, but it is abundantly clear that the universe of "backbone" networks considered in CWA's analysis is limited to the *nine* listed in the referenced table. The list of backbone providers included in the analysis is therefore far from complete because it excludes some two dozen major providers. *See also* Carlton/Sider Decl. ¶¶ 65-66.

Even if the list of providers were complete, merely adding up all the Internet connections to obtain a total, and then calculating percentages for each ISP, would yield misleading results. For one thing, there would be significant double-counting because ISPs are often connected to more than one other ISP "backbone" provider. *See* Carlton/Sider Decl. ¶ 72. In addition, the number of connections at any one point in time can change as ISPs can and do switch from one backbone provider to another. In any event, a number of connections does not necessarily translate into amounts of revenue, and revenue is a better indicator of a provider's relative position in this context. The number of ISP connections does not indicate whether the ISPs with whom those connections are maintained are large, small, or medium-sized; for this reason, among others, it does not indicate the ISP's actual position within the Internet service industry.[121]

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[121] MCI and WorldCom believe that revenue data provide the most accurate approximation of the position of ISPs in the Internet services sector. Indeed, most industry surveys of which the applicants are aware (including those by International Data Corporation, Forrester Research Group, Frost & Sullivan, Yankee Group and Meloff Group International) use revenues as the measurement

Bell Atlantic also uses a faulty analysis of Internet routing table information which yields a result that WorldCom and MCI would "own 58% of customer 'routes' on the Internet" to support its assertion that MCI WorldCom would control the Internet. *Bell Atlantic Petition* at 6. Although WorldCom and MCI do not believe that routing table entries provide an appropriate measure of ISP market position, an analysis of route entries performed by each of MCI and WorldCom, using a methodology representing a more complete picture of the Internet, indicates that WorldCom and MCI have aggregate route entries of 22.43 percent.[122]

Assuming, *arguendo*, that there were a discrete market to be measured, MCI and WorldCom believe that revenue would be the best and only reliable means for estimating relative share. Revenues provide the strongest indicator of who the providers of Internet services are and how much their customers are willing to pay for Internet services. Published estimates of revenue for Internet services vary widely,[123] but MCI and WorldCom estimate that their combined share would be approximately 20 percent.[124] MCI WorldCom's share should be viewed in the context of the many

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for market size.

[122] *See* Attachment D for methodology.

[123] *See* Frost & Sullivan, U.S. Internet Service Markets, 1996 (estimating the total U.S. Internet services market at $2.3 billion); Maloff Group International, Inc., 1996-1997 Internet Access Providers Marketplace Analysis (estimating growth of the Internet service provider marketplace from $1.85 billion in 1996 to $8.4 billion in 1997), Oct. 1997; and International Data Corporation, The Internet Service Provider marketplace, 1996-2000: A Dual Telecommunications Opportunity (estimating the market for Internet services at $3.3 billion at the end of 1996), Apr. 1997.

[124] This percentage was estimated by doubling the total 1996 Internet industry revenue figure of $2.3 billion taken from the Frost & Sullivan study (see *supra* n.29) in line with analyst growth

large and well-financed backbone providers that compete in the marketplace, such as Sprint, AT&T, GTE, and IBM -- to name only a few.

In any event, the structure of the Internet makes bottleneck control by ISP backbone providers impossible. The Internet is not a monolithic network, but rather a network of public and private networks operating under a common protocol. This network of networks is not controlled, nor susceptible to control, by ISP backbone providers. The existence of multiple national and regional backbone providers enables traffic to be routed in many different ways; indeed, the Internet protocol was designed specifically to permit the routing of transmissions over multiple paths and networks.

The provision of Internet-based services is characterized by dynamic change, rapid growth and ease of entry.[125] The merger of WorldCom with MCI will not enable the combined company to dominate the Internet -- far from it. The editor of *Boardwatch Magazine* was right about the inability of any one entity to dominate the Internet when he colorfully observed that such an attempt could be "like trying to choke a jello snake by the neck in a roomful of Wesson oil."[126] Indeed,

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estimates, and applying the 1997 estimated Internet revenues of MCI and WorldCom to that base figure.

[125] The dynamic nature of the Internet is illustrated by the fact that, according to the Fall 1997 issue of *Boardwatch Magazine*, there are now over 4,300 ISPs in the U.S. alone, far more than the 3,000 ISPs cited by CWA. *CWA Comments* at 5.

[126] *Boardwatch Magazine*, Nov. 1997, at 10. If there *are* concerns relating to dominance in this area, they should be focused not on MCI WorldCom, but on those who monopolize the provision of local transmission facilities that are an integral component of Internet backbone networks and the means of access to them -- *i.e.*, local exchange carriers like GTE and the BOCs.

according to a recent article in *Internet Week*, "most ISP's don't feel threatened by the [MCI WorldCom] consolidation."[127]

3. ISP customers can and do change ISPs, and the effort required to change IP addresses does not lock ISPs into any backbone provider.

The preceding section demonstrated the low barriers to entry for, and vigorous competition among, providers of Internet services, including Internet "backbone" services (if, indeed, these services should be considered separately). Nevertheless, Bell Atlantic asserts that the alleged anticompetitive effects of the MCI WorldCom merger will be increased because some customers may encounter administrative burdens to change ISPs. *Bell Atlantic Petition* at 10.

As a threshold matter, it is worth noting that the merger does not in any way affect the administrative steps involved in changing ISPs. The most Bell Atlantic can argue is that IP address changes would for some customers be a disincentive to change ISPs in the face of anticompetitive practices by MCI WorldCom. As demonstrated above, however, MCI WorldCom will have no ability to exert control over the provision of Internet services. Given the competitive market, MCI WorldCom will have every incentive to keep its Internet customers satisfied so that they would have no reason to want to change. Moreover, any attempt by MCI WorldCom to exploit customers allegedly locked in would only backfire because potential new customers would choose competitors instead to avoid the problem, and MCI WorldCom would thereby prevent itself from sharing in a substantial part of the spectacular growth that has attracted so many firms to provide Internet services.

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[127] *Internet Week*, Vol. 4, No. 3, Jan. 19, 1998. According to the article, David Jennett, CEO of Internet backbone provider Winstar GoodNet, stated he does not "believe that the marketplace will put up with any kind of tampering."

Ultimately, Bell Atlantic's complaint goes to the decision as to which customers are assigned portable IP addresses. On this point, MCI, WorldCom and all other ISPs, including Bell Atlantic, follow the IP addressing guidelines set by the Internet Assigned Numbers Authority ("IANA"). In the U.S., these guidelines are promulgated by the American Registry for Internet Numbers ("ARIN"). Attachment E details the history of Internet addressing policies and the organizations that are responsible for setting them.

Moreover, Bell Atlantic is simply wrong in asserting that IP address changes are a meaningful obstacle for existing customers to change ISPs. Simply put, customers change ISPs all the time. Both WorldCom and MCI experience churn among customers for Internet access service. MCI's and WorldCom's customers change ISPs now when they decide they have a reason to change, and they will continue to do so after the merger. Moreover, carriers like AT&T, Sprint, Qwest, GTE, IXC, Level 3, and others investing billions of dollars in Internet infrastructure, additional carriers like Bell Atlantic and the other BOCs planning to follow suit, doubtless intend to win existing customers over from other ISPs as well as attract customers not yet connected to the Internet.

In practice, changing ISPs (or backbone providers) is, in most circumstances, straightforward and relatively inexpensive. For the majority of customers, switching ISPs is largely an administrative matter. Although some switches involve more effort than others, it is possible for any customer to switch, and one ISP cannot prevent a customer from switching to another ISP.

Significantly, for most types of ISP customers, IP addressing is not a concern at all. The vast majority of Internet users use dial-up access to obtain Internet services. In nearly all of these cases, customers use Internet client software which permits the *dynamic* assignment to the customer of an IP address, service addresses of the domain name service and electronic mailbox service at the time

of dial-up. This assignment changes with each session but the change is essentially invisible to the customer. In some cases, to change ISPs, customers may need new Internet access software, but this is commonly supplied by the service provider and usually at no additional cost.

Changing ISPs may be somewhat more involved for dedicated access customers. Large organizations (those with a need for at least a few thousand IP addresses or connectivity to multiple ISPs) qualify under IANA guidelines for "portable IP addresses," and can transfer their IP addresses to new ISPs if they choose to do so. Smaller customers do not qualify for such addresses, and they are provided with IP addresses by their ISP. These customers can, if they choose, configure IP addresses into various points in the customer's network. Many of these customers, however, are now using the Dynamic Host Configuration Protocol ("DHCP") and other means which eliminate the need to configure IP addresses in individual computers. Thus, Bell Atlantic's entire complaint in fact boils down to a situation that affects a subgroup of dedicated access customers that may not yet have adopted, but could readily adopt, measures that would facilitate changing IP addresses. These customers can and do change ISPs, with moderately more effort than other categories of ISP customers.

At bottom, Bell Atlantic's IP address concern is a non-issue. The vast majority of customers can change ISPs with little effort. Customers that are directly connected to an ISP and do not have portable IP addresses have tools available to facilitate IP address changes.

4. MCI's and WorldCom's peering policies are appropriate, and the proposed merger would have no effect on peering.

CWA raises spurious allegations with respect to WorldCom's peering policies. *CWA Comments* at 12-16. CWA's argument begins with a false premise -- that, as a "dominant" backbone

provider, WorldCom has already engaged in anticompetitive practices with respect to peering -- and predictably reaches an incorrect conclusion about the effect of the merger on MCI WorldCom's peering policies. *Id.* at 15. CWA's argument is wrong on the facts, and reflects a complete misunderstanding of the nature of peering.

First, neither WorldCom, MCI nor the combined MCI WorldCom is or will be dominant in the provision of Internet-based services, as already demonstrated. Second, WorldCom's and MCI's peering policies have supported, and will continue post-merger to support, mutually beneficial peering arrangements.[128] Third, the merger will not change WorldCom's or MCI's incentive to peer when peering is appropriate, and to interconnect with ISPs through other arrangements when peering does not compensate one of the parties for the terminating function it provides.

There are two main types of interconnection between ISPs: "dedicated access" and "peering."[129] Many ISPs achieve global interconnectivity by purchasing dedicated access from one or more ISPs. Dedicated access service includes transit across an ISP's network: two ISPs may interconnect through a third ISP that performs a transit function by carrying Internet traffic over its network between the networks of the other ISPs. In a dedicated access arrangement, an ISP agrees both to deliver traffic to any of its own customers (whether those customers are end users or ISPs), and to make arrangements with other ISPs for delivery of traffic to any of their customers. Entities --

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[128] WorldCom's May 1997 press announcement describing its peering policy has been described as a decision to "charge for peering." *CWA Comments* at 15. Rather, the announcement explains that WorldCom offers dedicated access services to those ISPs who do not meet its peering policy guidelines.

[129] For those not familiar with the history and terminology of Internet interconnection, Attachment F provides "A Brief History of Network Access Points (NAPs) and Internet Exchanges."

ISPs and end-users alike -- that purchase dedicated access from WorldCom and MCI. for example. can exchange Internet traffic with customers of essentially all ISPs in the world even though WorldCom and MCI peer with only a small portion of those ISPs.

"Peering," in its simplest terms, is a technical arrangement by which two ISPs exchange traffic either through a public exchange point (public or NAP peering) or over point-to-point connections between hubs of each ISP (direct peering). The connections that ISPs pro ide to "dedicated access" customers differ from the connections they provide to "peers" in that the former involve a transit function and the latter do not. In a peering relationship, each ISP delivers the traffic received from the other ISP only to the receiving ISP's own customers, whether such customers are ISPs or end users, but not to ISPs with which it peers. Like peers, ISPs that interconnect through dedicated access arrangements exchange traffic directly with each other, and they also receive the benefit of transit beyond the directly interconnected networks, to the networks of all interconnected ISPs. The lack of transit in a peering relationship means that a peer must make other arrangements with other ISPs to have traffic delivered to the customers of those other ISPs.[130]

Peering may be viewed as involving payment in kind, rather than in cash - a kind of "barter" arrangement. Peering does not involve the exchange of traffic for "free." Peering involves a *quid pro quo* - one ISP agrees to terminate the traffic of another in exchange for the second ISP's agreement to terminate traffic from the first. Each peer incurs a cost to achieve connectivity with

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[130] The fact that peering does not include transit serves two purposes: it reduces the cost of providing peering because the peer does not have to arrange with other ISPs to deliver traffic to destinations on other ISPs' networks; and peering arrangements that included transit to any destination on any ISP network would create a disincentive for ISPs to continue to build and expand their own networks and, thereby, discourage growth of the Internet.

the other. Where two ISPs derive mutual benefit from interconnection, it makes sense for them to establish a relationship where no money changes hands, which simplifies the relationship and avoids the costs associated with invoicing, collection and other administrative activities.[131] *See* Carlton/Sider Decl. ¶ 76.

In general, peering makes sense when the peers exchange roughly comparable amounts of traffic. That is why a number of ISPs, including MCI and UUNET, have established peering policies designed to ensure they get as much as they give in a peering relationship. Peering entails an equivalency of obligation so that neither ISP is providing a "free ride" to the other.

Peering policies of ISPs have changed as the Internet and ISPs have changed. When peering began in the early days of the Internet, all ISPs were roughly equal in size and geographic coverage, and peering developed as a cooperative arrangement to permit mutual connectivity. As the Internet has grown, different ISPs have made different choices about how much to expand their networks and their subscriber base, and a wide variation among ISPs exists in terms of the number of customers, the type of customers, and the size and geographic scope of their networks.[132] As a result, ISPs now

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[131] Trying to create and maintain cross-charging systems would involve significant costs, both for the development of measurement and billing systems and for computer capacity to run those systems on an ongoing basis.

[132] For example, the "*quid*" would not equal the "*quo*" if an ISP with a network and customers in one city peered with an ISP that had invested in a network connecting multiple cities throughout the United States; the obligations would not be reciprocal because the second ISP would incur the cost of delivering traffic nationwide while the first would incur the cost of constructing a much more limited network. The national ISP would be subsidizing the metropolitan ISP by giving it the benefits of a national network without the costs. *See* Carlton/Sider Decl. ¶ 77.

decide on a case-by-case basis whether to peer with each other or to interconnect through dedicated access.

It is critical to emphasize that two ISPs need not have the same revenues or the same number of customers for each to want a peering relationship. Traffic between two ISPs of different sizes may be in balance: any individual customer of a small ISP may be as likely to send traffic to any individual customer of a large ISP as vice versa, so even though the large ISP may have many more customers, each ISP may send equivalent amounts of traffic to the other. Similarly, if the smaller ISP has customers from the same broad geographic area as the larger ISP, peering may be mutually beneficial because each ISP is likely to carry traffic exchanged under the peering arrangement the same distance. Thus, each ISP would add approximately the same amount of incremental capacity to its network as a result of the peering arrangement.

This type of cooperative arrangement will continue -- where it makes economic sense -- after the MCI WorldCom merger. The merger will not alter the incentives to peer with ISPs with which WorldCom and MCI now peer. WorldCom and MCI each already has a network used for Internet traffic with broad geographic reach. Moreover, both companies already peer with numerous ISPs of varying sizes in terms of numbers of customers and revenues, and both companies continue to pursue and accept new peering arrangements to the extent consistent with their respective peering policies. Because the amount of revenues or number of customers has no necessary correlation with the scope of its network or the balance of traffic exchanged with other ISPs, the size of the Internet business resulting form the merger will have no effect on the willingness of MCI WorldCom to interconnect with other ISPs. The merged company will continue to interconnect with other ISPs in order to provide its own customers with the connectivity they demand, and to use the most cost-

effective means to do so. Whether the interconnection occurs via peering, or via dedicated access arrangements, is simply a function of economics.

MCI WorldCom will have no incentive or ability to force their peers to convert to a payment-based connection where peering is economically justified. If the merged company tried to force an ISP into a paid customer relationship when a peering relationship was appropriate, the ISP could still give its customers the ability to exchange traffic with MCI WorldCom's customers *without* becoming a customer of MCI WorldCom. Specifically, the ISP could achieve the same interconnectivity with MCI WorldCom's customers by interconnecting via dedicated access with an ISP that interconnected with MCI WorldCom. Thus, any attempt by MCI WorldCom to impose any unreasonable conditions on interconnection would simply cause the affected ISP to utilize the diversity and flexibility of the Internet to reach MCI WorldCom's customers through alternative methods and routes and result in increased revenues for MCI WorldCom's competitors.

Indeed, it is hard to imagine a more certain way to destroy the merged company's reputation and viability in the Internet community than to make it difficult for other ISPs and their customers to exchange traffic with MCI WorldCom and its customers, or to refuse to interconnect on reasonable terms. Because the essence of the Internet network of networks is global connectivity, a purported ISP that did not offer seamless interconnectivity with other networks would, by definition, not be part of the Internet and would not be providing Internet services. The merged company will therefore need to interconnect with other ISPs as much as other ISPs need to interconnect with it -- and as much as MCI and WorldCom each need interconnection today. With only about 20 percent of today's Internet business (as explained above), and with that business growing at exponential rates, MCI WorldCom's overriding incentive would be to continue to

interconnect with other ISPs on reasonable terms that enable it to achieve the connectivity that its customers expect and demand.

B. The merger will not give MCI WorldCom market power through operation of network access points, which are not bottlenecks that allow their operators to exercise control over the Internet.

Bell Atlantic argues that the MCI WorldCom merger should be blocked because WorldCom operates a number of network access points ("NAPs") and those NAPs supposedly give WorldCom leverage over other ISPs. *Bell Atlantic Petition* at 11. Bell Atlantic's claim is wholly without merit for several independent reasons.

One simple fact disposes of Bell Atlantic's contentions at the threshold: MCI does not own or operate any NAP. As a result, the merger will have *no* effect either on the degree of concentration in any putative "market" for NAPs or on the "leverage" that Bell Atlantic contends that NAPs give to WorldCom. If WorldCom has any leverage (and it does not), that leverage has nothing to do with this merger.

In any event, no individual NAP is a bottleneck because low barriers to entry have led to a rapid and continuing increase in the number of NAPs, and an ISP can change the NAP or NAPs at which it exchanges traffic with other ISPs. ISPs have a choice among NAPs and can and do exercise that choice. The number of NAPs and their operators has steadily increased as the Internet has grown. In late 1994, there were four U.S. NAPs operated under contracts let by the government through a competitive bidding process: MAE East and MAE West operated by MFS (later acquired by WorldCom); the Chicago NAP operated by Ameritech; and the New York NAP operated by Sprint. Contrary to Bell Atlantic's claim that there are 11 NAPs in the United States, there are

actually 39 NAPs in the U.S. and three in Canada today.[133] The operators of these NAPs include ISPs, telephone companies including two BOCs, CIX (the Commercial Internet Exchange, a trade organization), consortia of ISPs, and independent providers such as Digital Equipment Corporation (which operates the Palo Alto Internet Exchange (PAIX) in California). WorldCom operates seven of the 42 NAPs in North America,[134] and the MCI merger will not change that figure. Simply put, an ISP has a wide variety of NAPs to which it could link.

ISPs are not locked in to any one NAP. In fact, to increase the number of ISPs with which they interconnect and to achieve redundancy in case of blockage or failure at one NAP, many ISPs interconnect at more than one NAP. ISPs do not have to go far to find NAPs because they are spread across the United States -- 13 locations on the East Coast, ten on the West Coast, seven in the Southwest, nine in the Midwest and three in Canada. Furthermore, nothing would prevent two ISPs from entirely by-passing the NAP and connecting directly to each other. Numerous ISPs, including WorldCom and MCI, have a variety of such direct connection arrangements.[135]

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[133] A list of the NAPs can be found at <http://www.isi.edu/div7/ra/NAPs/>. In addition to the 42 existing NAPs, two "independent" new NAPs, Colocation Corp. in Washington, D.C. and Colomotion in San Francisco, California, each founded by different individual entrepreneurs, were described in Inter@ctive Week, Nov. 10, 1997.

[134] GridNet, owned by WorldCom, is a member of a consortium of ISPs that operates a NAP in Atlanta.

[135] Despite its name, a "network access point" does not give access to the Internet *per se*, or even to all other ISPs connected at the NAP. An ISP connected to a NAP is generally not entitled to exchange traffic with every other ISP connected to the NAP. Instead, ISPs negotiate privately with each other regarding bilateral arrangements for exchanging traffic through a NAP.

Moreover, as reflected in the number and range of NAPs described above, the cost of establishing a NAP is low. The growth of the Internet and ISPs' demand for low cost interconnection has fueled the establishment of many new NAPs in the U.S. A new NAP with good collocation facilities, such as Digital Equipment's PAIX, will immediately attract new ISPs. Indeed, Bell Atlantic itself could follow the lead of Ameritech and Pacific Bell and create and operate one or more of its own NAPs.

For these reasons, any attempt by WorldCom pre-merger, or MCI WorldCom post-merger, to take advantage of ISPs connected to any NAP that it operated would not confer any competitive advantage. Instead, any such attempt would trigger a shift by ISPs to connect to one of multiple other NAPs and could encourage the continuing proliferation of NAPs. In light of the ease with which an ISP can route around a NAP, the ease with which new NAPs can be and have been created, and the lack of any connection between the merger and consolidation of ownership or operation of NAPs, Bell Atlantic's NAP-related contentions do not warrant any further investigation or action.

C. The merger would not adversely affect competition in international Internet services.

Telstra asserts that it does not oppose the merger *per se*. *Telstra Comments* at 12. Nonetheless, Telstra argues that MCI and WorldCom, separately or together, could restrict international ISPs' access to U.S. Internet backbone service providers or raise the price of inputs for foreign ISPs. *Id.* at 2, 7-8. Telstra's baseless arguments are premised on Telstra's misunderstandings about the state of competition in the provision of Internet backbone services and international transmission capacity.

Telstra argues that MCI and WorldCom currently possess, or would possess after the merger, market power in the provision of international private line circuits used by foreign ISPs to access U.S. Internet backbone providers. Telstra is wrong. Indeed, as demonstrated in Section IV.B, *supra*, MCI and WorldCom do not, and will not be able to, control the market for international transmission capacity. In the Pacific region, for example, AT&T will remain by far the largest owner of international transmission capacity, including capacity currently used to provide private line services. *See supra* pp. 62-63. Moreover, foreign carriers, including Telstra, have entered or will soon enter the U.S. international market. These carriers typically already own end-to-end whole circuits that may be used to obtain access to the U.S. Moreover, increased competition and declining [unit] costs are driving an increase in transmission capacity. [136]

To the extent Section 214 authority is needed to own and use U.S.-international facilities for the provision of Internet services, Telstra now has such authority. *See supra* note 90. Thus, Telstra is free to provide its own U.S. international facilities and services. Telstra already owns a significant quantity of whole circuits between the U.S. and Canada and Australia, some of which Telstra apparently already uses to provide Internet access.

Telstra also erroneously assumes that MCI WorldCom currently possess or, after the merger, would possess market power in the provision of (1) U.S. domestic private line circuits between international cable head-ends and international gateways (i.e., backhaul); (2) U.S. domestic private line circuits between international gateways and major domestic NAPs, and (3) NAP services. With

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[136] For example, the Southern Cross and U.S.-China cable systems will significantly increase capacity.

respect to backhaul, the merger would have no effect because WorldCom does not currently own its own backhaul facilities. Nor would MCI WorldCom have a dominant position in the provision of transmission facilities between international gateways and major domestic NAPs. Finally, MCI WorldCom also would not control access to NAPs, or access to the Internet via NAPs, as we have already demonstrated. Thus, MCI WorldCom has no ability to control U.S. Internet backbone access.

Based on these false assumptions, Telstra asks the Commission to require unbundling and tariffing of MCI WorldCom's international Internet access services. Telstra's proposal is misguided and contrary to the FCC's policy of refraining from regulation of the Internet. Despite Telstra's claims, it can buy a whole circuit of transoceanic capacity (or use a circuit that it already owns), purchase backhaul from a backhaul provider, and then connect via any U.S. regional or national backbone provider to the "Internet." In response to marketplace demand, a number of ISPs offer end-to-end, managed Internet access, and MCI, WorldCom and other U.S. ISP backbone providers offer foreign ISPs interconnection with their networks at the same price, and on the same terms and conditions that they offer access to domestic ISPs. The bottom line is that Telstra does not need to purchase international transmission capacity from a U.S. backbone provider; in fact, it can provide its own transmission capacity and obtain backbone access separately.[137]

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[137] It is ironic that Telstra seeks regulated unbundling in the United States when Telstra provided only bundled access to its bottleneck facilities in Australia for decades. Until only recently, the only way to deliver traffic to Australia was to lease the Australian half-circuit plus local termination from Telstra. Moreover, Telstra's rates were, and still are, well above cost.

Telstra inexplicably seeks a regulatory solution -- mandated unbundling and tariffing of traditionally unregulated enhanced services -- where there is no evidence of a competitive concern. In fact, Telstra has already shown that there are commercial solutions to its alleged problems. For example, Telstra recently entered into an agreement with Teleglobe which addresses Telstra's concern that it was incurring the costs of two-way submarine cable circuits even though most of its Internet traffic is one way (U.S.-outbound). Telstra and Teleglobe have announced that together they will provide "high-speed international Internet connectivity via the world's first megabit-per-second hybrid cable/satellite asymmetric link."[130] The connection will use Telstra's existing transoceanic capacity for the U.S.-inbound link and 45 megabit simplex satellite circuit for the return link to Australia.

Telstra's own actions confirm that the marketplace is working and that regulation would be both unnecessary and inappropriate. Telstra's arguments and its proposed regulatory "solution" are, therefore, completely without merit and should be rejected.

VI. OTHER ISSUES.

A. The allegation of redlining ignores MCI's numerous efforts to assist low-income, minority, and immigrant communities.

ICP/COM and Rainbow oppose the merger on the basis that the merged companies would be likely to target business customers and affluent households and to avoid or delay marketing of services to low-income and minority customers ("redlining"). *ICP/COM Petition* at 3; *Rainbow/PUSH Petition* at 22. In the operation of their long distance and nascent local businesses,

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[130] Teleglobe Press Release, "Teleglobe, Telstra Launch First High-Speed Internet Link Combining Simplex Satellite and Fiber Cable Facilities," (Jan. 15, 1998), <http://biz.yahoo.com/bw/980115/teleglobe_1.html>.

both MCI and Worldcom have demonstrated a strong commitment to serve consumers of all socioeconomic levels. Among other things, MCI was the first carrier to voluntarily create a long distance "lifeline" program. The program, known as MCI Family Assist (MCI-FA) is available to low-income consumers across the country.[139] MCI has also introduced 5 cent Sundays, which is available to every MCI customer as well.

With respect to the local service, the fact that MCI and WorldCom network and switching facilities to date tend to be in and around city centers is important. In effect, this means that those low-income and minority communities located in and around these cities will be well positioned to receive the benefits of local competition as MCIWorldCom builds out its networks. This competitive choice could be accelerated if the pricing of the incumbents loops and other network elements are brought down to economically reasonable levels. In addition, in areas where MCI is currently providing local residential service, it is offering and serving Lifeline customers.

While Rainbow/PUSH has asked the Commission to take action to address prospective issues including future redlining, *Rainbow/PUSH Petition* at 22, it is important to note that no allegations of past impropriety have been made.[140] Thus, there is no record evidence that either MCI or

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[139] MCI Family Assist offers a discount on all Interstate calls to qualifying low-income customers. To qualify, a customer must be participating in a state Lifeline plan through their local exchange carrier. In states without a Lifeline program, consumers can qualify through participation in any one of six public assistance programs. These programs include AFDC, Food Stamps, Home Relief, Medicaid, SSI and Temporary Assistance to Needy Families. Family Assist customers receive service at a flat rate of 9 cents per minute for up to 60 minutes per month. Additional minutes are priced at 15 cents. There are no fees or minimums associated with this service.

[140] Regarding the dispute with TMB Communications, Inc., discussed below in Section VI.D, this is a private contractual dispute and negotiations are ongoing.

WorldCom has ever engaged or would engage in objectionable behavior. There is no precedent in a common carrier merger for the Commission to adopt a prospective remedy to guard against a theoretical future concern about potential discrimination. In fact, in the *Bell Atlantic/NYNEX Order*, the Commission expressly rejected such an approach.[141]

Rainbow expresses concern that the merger would result in layoffs that would disproportionately target minorities, but does not present any evidence to support this concern. MCI and WorldCom are fully committed to equal employment opportunities.

B. There is no legal or policy basis for linking the merger to BOC interLATA entry.

BellSouth predictably argues that approval of the merger should be conditioned on BOC entry into the in-region interLATA market under Section 271 of the 1996 Act. *BellSouth Petition* at 20-25. This rather transparent and tiresome effort to create pressure for granting Section 271 applications should be summarily rebuffed. The statutory procedures for BOC entry could not be more clear. Much like Pavlov's dog, BellSouth appears conditioned to respond with pleas of Section 271 relief to any external stimulus. The BOCs should be allowed to enter the in-region interLATA market when they comply with the competitive checklist and the other requirements of Section 271. There is no statutory or policy basis for linking their compliance with Section 271 to this merger or any other extrinsic event.

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[141] *Bell Atlantic/NYNEX Order*, *supra* note 3, at ¶ 226 ("We conclude that our review of the Bell Atlantic and NYNEX merger, which is focused on the loss of a precluded competitor in LATA 132, is not the appropriate forum for determining whether Bell Atlantic-NYNEX as a merged entity should allocate a certain portion of its contracts to small and minority businesses.")

BellSouth argues that the merger will have an anticompetitive effect on the interLATA market, unless the BOCs themselves are also in that market. *BellSouth Petition* at 16-19. We have previously shown that the merger will not have an anticompetitive effect on interexchange service, but will actually promote long distance service and end-to-end telecommunications services, more generally.

Moreover, BellSouth's argument is flatly contrary to the *Bell Atlantic/NYNEX Order*, where the Commission stated that "[i]n defining the relevant product markets, . . . we will examine not just the markets as they exist today, but as we expect they will exist after a Bell Company receives authorization to provide in-region interLATA services pursuant to Section 271 of the Communications Act." *Bell Atlantic/NYNEX Order*, *supra* note 3, ¶ 7. In other words, for purposes of its competitive analysis, the Commission may assume that at some unspecified future date the BOCs will obtain Section 271 authorization. But it is up to the BOCs themselves to comply with Section 271. The keys for interLATA entry are entirely in BellSouth's hands. It may not short-circuit compliance by creating "pressure" for approval or seeking to condition approval to the instant merger. Nor may it obtain through a "linkage" proposal what it sought but could not obtain from Congress in Section 271 -- entry into the long-distance market at the same time that competitors entered the local market, regardless of whether the prerequisites for effective local competition were in place.

The "linkage" argument is a recipe for gridlock. BOC entry into the interLATA market is not likely to happen, and should not happen, until the local exchange markets become competitive. This merger will enhance the prospect for a competitive local exchange market, and when that is achieved, the BOCs will be able to obtain interLATA entry. To hold up this merger through a

linkage to BOC interLATA entry will ultimately delay both the arrival of competitive local exchange markets and the interLATA entry that the BOCs seek.

C. The Commission has ample information to resolve the public interest issues without a hearing.

Several commenters suggest that there should be a hearing on the application.[142] However, these commenters have not identified any "substantial and material question of fact," which is the statutory prerequisite for a hearing. 47 U.S.C. § 309(d)(2). As the Commission explained in *McCaw*, "the arguments and allegations presented by the parties in this proceeding do not reflect disputes over material facts but focus primarily on inferences and conclusions to be drawn from the facts, namely, the competitive impacts of the merger. No persuasive showing has been made that a full evidentiary hearing would produce additional facts that would assist us in any meaningful way to resolve the various claims and arguments raised by the parties." *McCaw, supra* 9 FCC Rcd. at 5927-5928, ¶ 173. In that case, as here, all the disputes involved "just the sort of 'legal and economic conclusions concerning market structure, competitive effect, and the public interest' that 'manifestly do not' require a live hearing. . . . . [A]n 'evidentiary hearing would less promote reasoned decisionmaking in this case than it would delay and impede' the Commission's decision." *SBC Communications, Inc. v. FCC*, 56 F.3d 1484, 1497 (D.C. Cir. 1995) (affirming the Commission's approval of the AT&T - McCaw Cellular merger), quoting *United States v. F.C.C.*, 652 F.2d 72, 89-90 (D.C. Cir. 1980) (*en banc*). A hearing would be particularly inappropriate here since the Commission is certainly familiar with the dynamics of the local and long distance markets,

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[142] *ICP/COM Petition* at 17; *Rainbow/PUSH Petition* at 2; *Petition to Deny and Request for Hearing of Simply Internet, Inc.*, in CC Docket No. 97-211, at 1 (filed Jan. 5, 1998); *Petition to Deny* of TMB Communications, Inc., in CC Docket No. 97-211, at 7 (filed Jan. 5, 1998) ("*TMB Petition*").

Internet considerations raise issues beyond the scope of this proceeding, and both merging parties are non-dominant firms with no market power in any geographical or product market.

The Commission can fairly accurately predict what a hearing in this matter would entail. A lengthy prehearing conference and resolution of scoping issues[143] would be followed by the customary plethora of discovery forays, disputes, and law and motion hearings. When the hearings themselves actually commenced, the Commission would be treated to the usual battle of expert witnesses whose opinions would fill volumes of transcripts. And at the end of this long, laborious process, the ultimate questions will be issues of law and policy which the Commission can resolve now. A hearing would serve only to "'delay and impede' the Commission's decision." *SBC Communications, Inc.*, 56 F.3d at 1497.

D. This is not the appropriate forum for the contractual dispute with TMB

TMB Communications, Inc., a former independent agent of MCI, opposes the merger on the grounds that MCI has failed to resolve to TMB's satisfaction a private contractual dispute. *TMB Petition* at 2-3 The dispute between TMB and MCI relates to the termination of TMB's written contract with MCI and the payment of certain commissions allegedly owed thereunder. TMB's dispute with MCI is also referenced in the petition to deny filed by the Rainbow/PUSH Coalition. *Rainbow/PUSH Petition* at 30. Contrary to TMB's allegations, MCI has acted fairly and responsibly in addressing TMB's allegations, and TMB's allegations of wrongdoing are ill-founded. MCI is committed to continue to work with TMB in an effort to resolve this private contractual dispute. Neither TMB nor Rainbow has shown that this dispute is representative of problems that others have

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[143] 47 C.F.R. § 1.248.

with MCI, or that any such problems would be aggravated were the Commission to consent to the merger. In such instances, the Commission routinely allows mergers to go forward, and encourages parties to resolve their contractual disputes in appropriate fora. *See, e.g., MFS Communications, Co. Inc.*, 11 FCC Rcd. 21164, 21169, ¶ 16 (Int'l Bur. 1996) Neither TMB nor Rainbow/PUSH has demonstrated that any other action is warranted in this proceeding.

E. Transfer of the DBS Authorization is being considered in a separate proceeding.

Media Access Project ("MAP"), on behalf of the Office of Communication of the United Church of Christ, Consumers Union, and the National Association for Better Broadcasting ("NABB"), urges the Commission to dismiss or deny the application for transfer of control of the direct broadcast satellite ("DBS") authorization held by MCI Telecommunications Corporation to WorldCom.[144] MAP incorporates by reference its petition to deny and related motions regarding the pending application for assignment of the MCI DBS authorization to Primestar, LHC, Inc.[145]

The crux of MAP's argument, raised in NABB's application for review of the MCI DBS Order,[146] is that the Commission's International Bureau erred in awarding a DBS license to MCI without determining MCI's qualifications to hold a broadcast license. MCI and WorldCom submit

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[144] *Petition to Dismiss or Deny Transfer of Control of Non-Final Direct Broadcast Satellite Authorization and for Referral to the Full Commission for Action of Media Access Project* in CC Docket No. 97-211, at 1-2 (filed Jan. 5, 1998) ("*MAP Petition*").

[145] *See In re Application of MCI Telecommunications Corporation and Primestar LHC, Inc.*, File No. 106-SAT-AL-97.

[146] In Re Application of MCI Telecommunications Corporation, File No. 73-SAT-P/L-96, *Order*, DA 96-2165 (rel. Dec. 20, 1996).

that the International Bureau correctly applied Commission precedent (the "Subscription Video" decision)[147] in awarding MCI a DBS authorization, and urge the Commission to act promptly to reject the NABB application for review. In the event that the NABB application for review has not been acted upon by the time the Commission completes its review of the MCI WorldCom merger, the parties would be willing to accept a transfer of control "specifically conditioned on whatever action the Commission may conclude is appropriate in connection with the pending applications for review." *BT/MCI II Order*, *supra* note 85, at ¶ 279.

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[147] In Re Matter of Subscription Video, *Report and Order*, Gen. Docket No. 85-305, 2 FCC Rcd. 1001 (1987), *aff'd, National Ass'n for Better Broadcasting v. FCC*, 849 F.2d 665 (D.C. Cir. 1988).

VII. CONCLUSION

WorldCom and MCI respectfully request that the Commission grant the applications, as amended.

Respectfully submitted,

MCI COMMUNICATIONS CORPORATION

Michael H. Salsbury
Mary L. Brown
Larry A. Blosser
MCI COMMUNICATIONS CORPORATION
1801 Pennsylvania Avenue, N.W.
Washington, D.C. 20006-3606
(202) 872-1600

Anthony C. Epstein
John B. Morris
Ian H. Gershengorn
JENNER & BLOCK
601 Thirteenth St., N.W.
Washington, D.C. 20005
(202) 659-6000

WORLDCOM, INC.

Andrew D. Lipman
Jean L. Kiddoo
Michael W. Fleming
SWIDLER & BERLIN, CHARTERED
3000 K Street, N.W., Suite 300
Washington, D.C. 20007
(202) 424-7500

Catherine R. Sloan
Robert S. Koppel
WORLDCOM, INC.
1120 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 424-1550

Dated: January 26, 1998

CERTIFICATE OF SERVICE

I, Mark T. Pasko, hereby certify that on January 26, 1998 a copy of the foregoing "JOINT REPLY OF WORLDCOM, INC. AND MCI COMMUNICATIONS CORPORATION TO PETITIONS TO DENY AND COMMENTS" was sent by First Class United States Mail, postage prepaid, to the following:

Chairman William E. Kennard*
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, D.C. 20554

Commissioner Susan Ness*
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, D.C. 20554

Commissioner Harold Furchtgott-Roth*
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, D.C. 20554

Commissioner Michael Powell*
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, D.C. 20554

Commissioner Gloria Tristani*
Federal Communications Commission
1919 M Street, N.W.
Room 826
Washington, D.C. 20554

Magalie Roman Salas* (Orig.+4+diskette)
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

John T. Nakahata, Chief of Staff*
Office of the Chairman
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, DC 20554

A. Richard Metzger, Chief*
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Room 500
Washington, DC 20554

Regina M. Keeney, Chief*
International Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 800
Washington, DC 20054

Daniel B. Phythyon, Chief*
Wireless Telecommunications Bureau
Federal Communications Commission
2025 M Street, N.W.
Room 5002
Washington, DC 20554

Thomas C. Power*
Office of the Chairman
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, DC 20554

James Casserly*
Office of Commissioner Ness
Federal Communications Commission
1919 M Street, N.W.
Room 832
Washington, DC 20554

Kyle Dixon*
Office of Commissioner Powell
Federal Communications Commission
1919 M Street, N.W.
Room 844
Washington, DC 20554

Paul Gallant*
Office of Commissioner Tristani
Federal Communications Commission
1919 M Street, N.W.
Room 826
Washington, DC 20554

Melissa Waksman*
Office of Commissioner Furchtgott-Roth
Federal Communications Commission
1919 M Street, N.W.
Room 802
Washington, DC 20554

Lawrence Strickling, Chief*
Competition Division
Office of the General Counsel
Federal Communications Commission
1919 M Street, N.W.
Room 658
Washington, DC 20554

Kent Nilsson, Deputy Chief*
Network Services Division
Common Carrier Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 235
Washington, DC 20554

Rebecca L. Dorch*
Competition Division
Office of General Counsel
Federal Communications Commission
1919 M Street, N.W.
Room 650-F
Washington, DC 20554

Office of the Chief* (2 Copies+diskette)
Network Services Division
Federal Communications Commission
2000 M Street, N.W.
Room 235
Washington, DC 20554

Anna M. Gomez, Deputy Chief*
Network Services Division
Common Carrier Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 235
Washington, DC 20554

Greg Cooke*
Common Carrier Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 235
Washington, DC 20554

Janice Myles*
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Room 544
Washington, D.C. 20554

International Reference Room (2 Copies)*
International Bureau
Federal Communications Commission
2000 M Street, N.W.
Room 102
Washington, DC 20554

Wireless Reference Room (2 Copies)*
Wireless Telecommunications Bureau
Federal Communications Commission
2025 M Street, N.W.
Room 5608
Washington, DC 20554

International Transcription Services, Inc.*
2100 M Street, N.W.
Suite 140
Washington, DC 20037

Richard E. Wiley
R. Michael Senkowski
Jeffrey S. Linder
Peter D. Shields
WILEY, REIN & FIELDING
1776 K Street, N.W.
Washington, D.C. 20006

Michelle Carey (2 copies+diskette)*
Common Carrier Bureau
Federal Communications Commission
1919 M Street, N.W.
Room 544
Washington, D.C. 20554

Ramsey L. Woodworth
Rudolph J. Geist
WILKES, ARTIS, HEDRICK & LANE,
Chartered
1666 K Street, N.W., Suite 1100
Washington, D.C. 20006

John Thorne
Sarah Deutsch
Robert H. Griffen
Attorneys for Bell Atlantic
1320 North Court House Road
8th Floor
Arlington, VA 22201

William B. Barfield
Jonathan Banks
BELLSOUTH CORPORATION
Suite 1800
1155 Peachtree Street, N.E.
Atlanta, Georgia 30309-3610

George Kohl
Senior Executive Director, Research and
Development
Communications Workers of America
501 Third Street, N.W.
Washington, D.C. 20001-2797

John J. Sweeney
President
American Federation of Labor and Congress
of Industrial Organizations
815 16th Street, N.W.
Washington, D.C. 20006

Janice Mathis
General Counsel
Rainbow/PUSH Coalition
Thurmond, Mathis & Patrick
1127 W. Hancock Avenue
Athens, GA 30603

David Honig
Special Counsel
Rainbow/PUSH Coalition
3636 16th Street, N.W., #B-366
Washington, D.C. 20010

Matthew R. Lee, Esq.
Executive Director
Inner City Press/Community on the Move &
Inner City Public Interest Law Project
1919 Washington Avenue
Bronx, NY 10457

Andrew Jay Schwartzman
Gigi B. Sohn
Joseph S. Paykel
Media Access Project
Suite 400
1707 L Street, N.W.
Washington, D.C. 20036

Thomas A. Hart, Jr.
Amy E. Weissman
M. Tamber Christian
GINSBERG, FELDMAN AND BRESS
Chartered
1250 Connecticut Avenue, N.W.
Washington, D.C.

Alan Y. Naftalin
Gregory C. Staple
R. Edward Price
KOTEEN & NAFTALIN, L.L.P.
1150 Connecticut Avenue, N.W.
Washington, D.C. 20036

Mark T. Pasko

* VIA HAND DELIVERY

US OFFICE PRODUCTS

STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

January 15, 1998

TO: All Parties

FROM: Kevin Schwenzfeier

SUBJECT: Case 97-C-0271 -- Results of Competitive Analysis

The results contained in the following analyses have been aggregated so as to protect company-specific information.

Please note that the information provided by the responding carriers was not always presented in a consistent or complete manner. In addition, the only carriers responding were those present at the Technical Conference held in December. Therefore, the analyses do not represent a precise picture of the competitive landscape throughout New York, but provide a reasonable estimate of the competitive activities of the responding carriers.

If you have any questions concerning the summaries, I can be reached at (518) 486-2814.

ACCESS LINES (1)

	NY Metro	Upstate	Total	NY Metro	Upstate	Total
CLEC Facilities-Based						
Res	3,438	0	3,438	2.4%	0.0%	2.2%
Bus	142,476	8,659	151,135	97.6%	100.0%	97.8%
Tot	145,914	8,659	154,573			
CLEC Resale						
Res	13,866	2,053	15,919	23.3%	9.4%	19.6%
Bus	45,759	19,743	65,502	76.7%	90.6%	80.4%
Tot	59,625	21,796	81,421			
CLEC FB + Resale						
Res	17,304	2,053	19,357	8.4%	6.7%	8.2%
Bus	188,235	28,402	216,637	91.6%	93.3%	91.8%
Tot	205,539	30,455	235,994			
NYT						
Res	5,148,590	1,980,331	7,128,921	63.2%	72.3%	65.5%
Bus	2,995,644	758,588	3,754,232	36.8%	27.7%	34.5%
Tot	8,144,234	2,738,919	10,883,153			

	CLEC MARKET SHARE		
Residential	0.3%	0.1%	0.3%
Business	5.9%	3.6%	5.5%
Total	2.5%	1.1%	2.1%

Note: Results based upon information provided by 15 CLECs.

(1) CLEC access lines as of 10/97. NYT access lines as of 12/31/96.

CLEC LOCAL SWITCH LOCATIONS AND CAPACITY

Location	# Switches	Capacity Access Lines
Upstate	6	43,953
NY Metro	14	289,080
Total	20	333,033

Note: Results based upon information provided by 9 facilities-based CLECs.

COMPETITIVE CHECKLIST ITEMS PURCHASED FROM NET

	i	ii	iii	iv	v	vi	vii	viii	ix	x	xi	xii	xiii	xiv
Number of CLECs Purchasing Item:	7	2	2	4	4	1	9	7	6	4	7	4	4	8

Note: Results based upon information provided by 15 CLECs.

Description of Checklist Items

- i Interconnection
- ii Nondiscriminatory access to network elements
- iii Nondiscriminatory access to poles, ducts, conduits, and rights-of-way
- iv Local loop transmission from the C.O. to the customer's premises, unbundled from switching or other services
- v Local transport from the trunk side of a wireline LEC switch, unbundled from switching or other services
- vi Local switching unbundled from transport, local loop transmission, or other services
- vii Nondiscriminatory access to (1) 911 and E911 services; (2) DA services; (3) Operator call completion services
- viii White pages directory listings
- ix Nondiscriminatory access to telephone numbers
- x Nondiscriminatory access to databases and associated signaling for call routing and completion
- xi Interim number portability through remote call forwarding, DID trunks, or other comparable arrangements
- xii Nondiscriminatory access to such services or information to allow local dialing parity
- xiii Reciprocal compensation arrangements
- xiv Telecommunications services are available for resale

DECLARATION OF DENNIS W. CARLTON AND HAL S. SIDER

January 25, 1996

TABLE OF CONTENTS

I. INTRODUCTION AND OVERVIEW

1. I, Dennis W. Carlton, am Professor of Business Economics at the Graduate School of Business of The University of Chicago. I received my B.A. in Applied Mathematics and Economics from Harvard University and my M.S. in Operations Research and Ph.D. in Economics from the Massachusetts Institute of Technology. I have served on the faculties of the Law School and the Department of Economics at The University of Chicago and the Department of Economics at the Massachusetts Institute of Technology. I specialize in the economics of industrial organization, which is the study of individual markets and includes the study of antitrust and regulatory issues. I am co-author of the book Modern Industrial Organization, a leading text in the field of industrial organization, and I also have published numerous articles in academic journals and books. In addition, I am Co-Editor of the Journal of Law and Economics, a leading journal that publishes research applying economic analysis to industrial organization and legal matters. I have served as an Associate Editor of the International Journal of Industrial Organization and Regional Science and Urban Studies, and have served on the Editorial Board of Intellectual Property Fraud Reporter. A copy of my curriculum vitae is attached as Appendix 1 to this affidavit.

2. In addition to my academic experience, I am President of Lexecon Inc., an economics consulting firm that specializes in the application of economic analysis to legal and regulatory issues. I have served as an expert witness before various state and federal courts, and I have provided expert witness testimony before the U. S. Congress and a variety of state and federal regulatory agencies. I also have served as a consultant to the Department of Justice on the Merger Guidelines of the Department of Justice and Federal Trade Commission, as a general consultant to the Department of Justice on antitrust matters, and as an advisor to

the Bureau of the Census on the collection and interpretation of economic data. I have also provided testimony on telecommunications matters before Congress, Federal Courts, state agencies and the F.C.C. and have published academic articles on telecommunications issues.

3. I, Hal S. Sider, am a Senior Economist and Principal of Lexecon Inc. I received a B.A. in Economics from the University of Illinois in 1976 and a Ph.D. in Economics from the University of Wisconsin (Madison) in 1980. I have been with Lexecon since 1985, having previously worked in several government positions. I specialize in applied microeconomic analysis and have performed a wide variety of economic and econometric studies relating to industrial organization, antitrust and merger analysis. I have published a number of articles in professional economics journals on a variety of economic topics and have testified as an economic expert on matters relating to industrial organization, antitrust, labor economics and damages. In addition, I have directed several studies of competition in telecommunications industries and have testified as an expert on telecommunications matters. I have also published an academic article (with Kenneth Arrow and Dennis Carlton) on telecommunications issues.

4. We have been asked by counsel for WorldCom and MCI to evaluate competitive conditions in the provision of local exchange service, long distance services and Internet services and to assess the likelihood that the proposed transaction will adversely affect competition in the provision of these services. We have also been asked to review and to address the concerns raised in recent comments filed before the Federal Communications Commission by BellSouth, Bell Atlantic, GTE and others (hereafter, petitioners) that the proposed merger of WorldCom and MCI will result in harm to competition.[1] While our analysis is

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1. See: Petition to Deny of GTE Service Corporation and its Affiliated Telecommunications Companies; Bell Atlantic's Petition to Deny the Application of WorldCom or, in the Alternative, To Impose Conditions; BellSouth Corporation's Petition for Conditional Approval of the Application of WorldCom, Inc. for Transfers of Control of MCI Communications

(continued...)

ongoing, the evidence that we have analyzed convinces us that: (i) the transaction creates potentially large benefits to consumers; and (ii) it is highly unlikely that the proposed transaction will adversely affect competition in light of the rapid entry, expansion and technological changes now taking place in the telecommunications industry.

5. This declaration also addresses the significant shortcomings in the competitive analysis presented by petitioners. Among others, these include petitioners' failure: (i) to provide evidence supporting their claims that the transaction will result in harm to competition; (ii) to address the effect on competition of the rapid changes now taking place in the telecommunications industry; and (iii) to recognize the significant gains to consumers that are likely to result from the proposed transaction.

6. Our major conclusions are as follows:

- Available evidence suggests the transaction creates potentially large benefits to consumers by enhancing the likelihood of timely and significant entry into the provision of local exchange services. There is no basis for claims by some petitioners that local competition will be harmed as a consequence of the transaction. The transaction also promises to yield other savings in operating and overhead costs that enable MCI WorldCom to more efficiently provide network services.
- There is extensive entry of new competitors and expansion in capacity of fiber optic networks now taking place. Several new high capacity fiber optic networks are now being deployed with yet others recently announced. Within two years or so, it is likely that there will be seven national fiber optic networks and an even larger number of independent firms supplying services along these networks.

1.(...continued)
Corporation; Simply Internet's Petition to Deny and Request for Hearing; Comments of the Communications Workers of America; all dated January 5, 1998.

Such conditions make it highly unlikely that the proposed transaction will adversely affect competition in the provision of wholesale long distance services.

- It is highly unlikely that the proposed transaction will adversely affect retail long distance competition. As petitioners acknowledge, WorldCom has relatively little brand name recognition among residential customers. Hence, there are many firms that could readily replicate WorldCom's presence in the provision of retail residential service. For retail business customers, even the experts cited by petitioners generally do not claim that competition is inadequate. There is also no economic basis to petitioners' claims that MCI WorldCom will harm long distance competition by abandoning profitable residential customers.
- The unprecedented growth and entry now taking place in the provision of Internet services, as well as the rapid entry and expansion of firms providing fiber optic capacity that can readily be used to provide Internet services, make it highly unlikely that the transaction will adversely affect competition.
- The evidence presented by petitioners fails to address the relevant question in the analysis of the competitive effect of a merger: whether a proposed transaction will adversely affect competition. Petitioners present no evidence that the market share and concentration figures they cite are relevant to the question of how prices will change as the result of the proposed transaction. The economic studies cited by petitioners fail to address how long distance competition is affected by changes in concentration resulting from this transaction. Instead, these studies, which were generally submitted in previous proceedings, address whether entry by local telephone companies into long distance is desirable. Petitioners ignore the rapid changes now occurring in telecommunications industries.

II. LOCAL SERVICE: THE TRANSACTION CREATES POTENTIALLY LARGE BENEFITS TO CONSUMERS AND SHOULD RAISE NO COMPETITIVE CONCERNS

A. THE COMPLEMENTARY STRENGTHS OF WORLDCOM AND MCI ENHANCE THE LIKELIHOOD OF TIMELY AND SIGNIFICANT ENTRY INTO LOCAL SERVICE

7. A principal goal of the Telecommunications Act of 1996 is to stimulate competition in the provision of local exchange services. As suggested by Table 1, however, this goal remains unfulfilled. Nor is it clear when the goal of significant local exchange competition will be achieved. The proposed transaction, however, promises to accelerate that process.

1. WorldCom and MCI have complementary assets

8. Given the nascent state of local competition today, it is not possible to estimate with precision the extent to which the proposed transaction will accelerate the entry of competitive local exchange carriers (CLECs) into the provision of local exchange services. Nonetheless, available evidence and analysis suggest that the proposed transaction enhances the likelihood of success of such efforts by combining complementary assets of each company.

9. Among CLECs, WorldCom is perhaps furthest along in terms of constructing local access facilities. According to the FCC, at the end of 1996, WorldCom/MFS served more than 13,000 buildings in 23 states, a far greater number than reported by any other competitive access provider (CAP).[2] MCI, on the other hand, has a large base of residential and business customers, and a well-established brand name as well as local exchange facilities being deployed in a number of cities.

10. By combining WorldCom's networks and expertise with MCI's brand name, large customer base and existing infrastructure, MCI WorldCom will be able to more

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2. FCC, Fiber Deployment Update End of Year 1996, Table 15.

Table 1

Gross Revenue by Type of Carrier

	1995		1996	
	$ million	Percent	$ million	Percent
CAPs and CLECs	623	0.6%	1,011	0.9%
LECs	102,820	99.4%	107,905	99.1%

Source: FCC, TRS Fund Worksheet Data (Nov. 1997).

efficiently provide and market a range of telecommunications services. In particular, MCI WorldCom will be in a position to provide "one stop shopping" by offering a package of local, long-distance and Internet services to a large number of customers, including multi-location customers. As Prof. Jerry Hausman claims in an affidavit submitted in support of petitioner BellSouth's application to provide within-region long distance services, "[m]ost students of telecommunications agree that customers want some degree of one-stop shopping."[3]

11. The FCC's Bell Atlantic/NYNEX Order also suggests that the "brand name" of established long distance carriers can significantly facilitate entry into the provision of local services. Apart from Bell Atlantic, the FCC considered AT&T, MCI, and Sprint to be "the most significant" potential entrants in the provision of local exchange services in New York City. The FCC found that the established long distance carriers "distinguish themselves from the universes of actual and precluded competitors and of other market participants by their experience and strong brand reputation in the provision of telephone service to the mass market."[4] The FCC also cites a customer preference survey that identified AT&T, Sprint, and MCI as having strong brand reputations.[5]

2. The transaction is likely to result in significant cost savings and synergies in the provision of local services as well as other services

12. WorldCom claims that the transaction will result in significant cost savings and synergies in the provision of local, long-distance and international services. WorldCom claims that the proposed transaction will result in "pre-tax cash operating synergies" of about 12

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3. Declaration of Professor Jerry A. Hausman, Appendix D to Bell South petition, ¶7.

4. Bell Atlantic/NYNEX Order, ¶70.

5. Ibid, ¶82.

percent of the combined (stand alone) operating expenses of the two firms by 2002.[6] In addition WorldCom estimates capital expenditure savings of 23 percent for deploying the same (or more) network capacity, compared to costs expected on a stand alone basis.[7]

13. Petitioners question these efficiencies and claim that they are insufficiently documented. While we have not independently reviewed these calculations, it is important to note that investment analysts generally appear to attach credibility to these estimates. For example, Credit Suisse First Boston, commenting on WorldCom's preliminary estimates of cost savings, concluded:

> "[o]n the face of it, $20 billion in cost savings is too large a figure to fathom. ... Digging a bit deeper, we think the number does make sense. ... By pumping more revenues through the same pipeline and generating a better mix of revenues (local plus long distance plus Internet), we think this increase is achievable"[8]

A report from Merrill Lynch concludes simply that "[s]ynergies for the MCI merger are enormous."[9]

14. More generally, it is well recognized by industry analysts that significant benefits can be achieved by combining CLECs (WorldCom) and interexchange carriers (MCI). A Lehman Brothers, Inc. report for example notes:

> "We believe that consolidation of the CLEC and long distance sectors can drive significant revenue and cost synergies and gains in shareholder value. ... The recently announced MCI-WorldCom deal clearly highlights the value of consoli-

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6. These savings include reduced domestic network costs, such as leased line and access costs; reduced costs of terminating international traffic; avoided costs in MCI's local activities, including sales, marketing and administrative expenses and core SG&A.

7. WorldCom Inc., Amendment No. 3 to Form S-4, January 22, 1998, pp. 40-44.

8. Credit Suisse First Boston Corporation, WorldCom Inc. -- Company Report, November 18, 1997, p. 4.

9. Merrill Lynch Capital Markets, WorldCom/MCI -- Company Report, November 12, 1997, p. 3.

> delion and simultaneously accelerates the need for all competitors to respond to the challenge it presents....
>
> [S]peed to market is especially important given the increase in competition that we expect to see from large competitors over the next year. The MCI-WorldCom deal has clearly upped the ante and time frame for all competitors".[10]

B. SUCCESSFUL LOCAL ENTRY IS LIKELY TO GENERATE ENORMOUS CONSUMER BENEFITS

15. To the extent that the proposed transaction accelerates entry into the provision of local services, it is likely to have enormous benefits to consumers.

16. First, the success of one entrant is likely to facilitate entry by others. Successful entry generates information that subsequent entrants can use in deploying new technology, establishing efficient interconnection arrangements with ILECs, and developing of marketing strategies. Much in this way, MCI's success in providing long distance services facilitated the entry and/or expansion of Sprint, WorldCom and other network operators and resellers.

17. Second, successful entry into the provision of local service is likely to have large consumer benefits simply because of the enormous size of the market. As summarized in Table 2, data from the FCC indicates that consumers spent about $108 billion in 1996 on local exchange services. The margin earned by local exchange providers was more than 45 percent.[11] As a point of comparison, aggregate toll revenue for long distance carriers in 1996 was about $50 billion (excluding access charges).[12] Margins earned by AT&T and Sprint

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10. Lehman Brothers, Inc., "1998: The Year of Accelerating Telecom Consolidation," p. 1, 4.

11. Gross margin is defined to reflect revenue less network operating costs as a percentage of revenue.

12. FCC, TRS Fund Worksheet Data, November 1997.

Table 2

Industry Revenue and Margins
1996

	Interexchange Carriers		Local Exchange Carriers
	Including Access Charges as Revenue	Excluding Access Charges as Revenue	
Revenue ($ billion) [1/]	$79.1	$50.4	$107.9
Gross Margin	22% [2/]	34% [2/]	49% [3/]

1/ TRS Fund Worksheet Data.
2/ Based on 10K filing for AT&T (Communications) and Sprint (Long Distance Division). Gross margin defined as revenue (excluding access charges) less SG&A and operations/network cost.
3/ Based on FCC statistics of Communications Common Carriers. Gross margin is defined as operating revenue less general and administrative expenses and plant operating expenses.

were roughly 35 percent in 1996; if access charges are included in revenue, long distance margins were roughly 20 percent.[13]

18. Under these circumstances, even a modest acceleration of entry into the provision of local service with a modest effect on price can generate very large consumer benefits.

C. THE TRANSACTION SHOULD RAISE NO COMPETITIVE CONCERN REGARDING HARM TO LOCAL COMPETITION

19. Petitioners suggest that the proposed transaction may adversely affect competition in the provision of local exchange services.[14] Any such concerns, however, are unwarranted.

20. There is no dispute that the ILECs account for an overwhelming share of local customers and revenues in all areas of the country. Combined, CLECs and CAPs, including WorldCom and MCI, today account for only a tiny share of local access customers and revenues. As shown in Table 1, FCC data for 1996 indicate that the combined revenue for CAPs and CLECs (from all sources) is roughly one percent of total LEC revenues. While the CLECs' revenue has grown, it continues to account for only a de minimis share of all local exchange revenue.[15]

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13. The rough accuracy of these calculations are confirmed in reports by industry analysts. Credit Suisse First Boston, for example, reports that MCI had an EBITDA margin of about 20 percent, with the comparable figure among RBOCs being 40-45 percent. (Credit Suisse First Boston, WorldCom, Inc. – Company Report, November 18, 1997.)

14. See GTE petition, p. 43 and Bell Atlantic petition, p. 17.

15. Even in the New York metropolitan area, the region which perhaps has attracted the most entrants into the provision of local service, the ILEC still accounts for 94 percent of business access lines. (New York Public Service Commission, January 15, 1998)

21. Under these circumstances, CLECs must price their services based on rates offered by the ILECs. There is no conceivable way that MCI WorldCom, with a de minimis share of local service customers, could exercise market power and find it profitable to significantly raise their prices. Although somewhat simplified, the textbook model of a dominant firm (e.g., an ILEC) facing a competitive fringe seems a reasonable approximation here. In that model, fringe firms compete against the dominant firm that sets price.

22. The FCC's order in the Bell Atlantic/NYNEX matter also suggests that it would be unlikely that the proposed transaction would harm competition.[16] In that case, the FCC ultimately approved a merger between the incumbent LEC (NYNEX) and a potential entrant (Bell Atlantic) that the FCC considered to be one of the four firms most likely to enter into the provision of local service in New York City.

23. In contrast, the proposed WorldCom/MCI transaction involves two non-incumbent firms that together account for less than one percent of local exchange revenue, one of which (WorldCom) the FCC did not consider to be a significant potential entrant. In the Bell Atlantic/NYNEX Order, the FCC found that AT&T, Sprint and MCI (in addition to Bell Atlantic) were the most likely entrants to the provision of local service in the New York area. WorldCom was considered among a group of less significant potential providers that included other CAPS, cable system operators, mobile telephone service providers, and non-adjacent out-of-region Bell companies. Thus, with respect to local competition, this merger at most reflects a consolidation of two of many fringe firms that are providing or could provide local service.

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16. FCC Memorandum and Order, Applications of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX and its Subsidiaries, August 14, 1997, (Bell Atlantic/NYNEX Order).

III. LONG DISTANCE: IT IS HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT COMPETITION IN THE PROVISION OF EITHER WHOLESALE OR RETAIL SERVICES

24. ; Petitioners distinguish between the wholesale and retail segments of the long distance industry, and within the retail segment, between business and residential customers.[17] Petitioners claim that the proposed transaction will adversely affect competition in each of these segments.

25. This section separately evaluates the effect of the proposed transaction on each of these industry segments. The evidence that we have examined to date convinces us that it is highly unlikely that the proposed transaction would have an adverse effect on competition. We also find that the evidence presented by petitioners is not relevant to an evaluation of the proposed transaction on competition. More specifically, we find: (i) petitioners' analysis of wholesale competition ignores the rapid entry and expansion of fiber optic capacity that is now occurring; (ii) petitioners' arguments implicitly acknowledge that the proposed transaction is unlikely to adversely affect competition for residential customers because WorldCom plays a limited role in this segment; and (iii) evidence cited by petitioners generally fails to claim that business customers face "inadequate" competition.

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17. As an approximation, the wholesale segment of the industry includes functions relating to call transport and switching; the retail segment of the industry relates to customer service, billing and marketing. In practice, however, this distinction is blurred. For example, some products, such as dedicated DS-3 lines, are sold to both wholesale and larger retail business customers. Firms such as non-facilities based resellers that participate exclusively in the retail segment would not be considered participants in the wholesale segment. The fiber optic capacity used to provide wholesale transport of long distance calls also can be used to provide Internet and other telecommunications services. Therefore, the wholesale transport of long distance telephone calls should be considered as part of the broader market of fiber optic transport capacity.

A. STANDARDS FOR MERGER EVALUATION

26. The relevant question in merger analysis is: How will the proposed transaction adversely affect competition? None of the evidence presented by petitioners directly addresses this question.

27. Petitioners' claims are based in part on economic studies submitted by the Regional Bell Operating Companies to support their applications to provide within-region long-distance services.[18] These studies attempt to evaluate whether the industry is now "competitive" and whether the entry of RBOCs into the provision of interexchange services in their home region is desirable. As a general matter, all else equal, entry into an industry is desirable. However, even in industries where entry might benefit consumers, mergers do not necessarily lessen competition and indeed generally create efficiencies . Thus, mergers are routinely approved in industries that are not perfectly competitive even though entry into such industries might be likely to benefit consumers. The studies cited by petitioners simply do not address and hence cannot be used to support the proposition that the proposed merger would adversely affect long distance.

28. Petitioners' calculations of "market shares" and HHIs based on long distance providers' revenue or subscriber base also fail to support their claim that the proposed transaction will result in harm to consumers. The use of "market share" estimates and HHIs is at best only a first step in any analysis of competitive issues. Petitioners do not rely on any economic

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18. BellSouth attaches affidavits by Jerry Hausman and Richard Schmalensee that were submitted in support of its application to provide within-region interLATA services in South Carolina. GTE cites: Affidavit of Robert Crandall and Leonard Waverman in Support of Ameritech's Section 271 Application for Michigan (filed May 21, 1997); Declaration of Professor P. MacAvoy, The Failure of Antitrust and Regulation to Establish Competition in Long-Distance Telephone Services, MIT Press, 1996; and J. Hausman's BellSouth affidavit.

study to show that changes in concentration associated with this transaction will adversely affect competition.

29. Specifically, even though an HHI analysis can be a useful starting point to judge the likely competitive consequences of a merger, the significance of industry concentration and its predicted change resulting from the merger must be judged in light of industry facts. And, as discussed below, a key new fact in this industry is the dramatic and recent large scale entry that was not widely anticipated even a few years ago. Even in an industry with a high HHI, a merger need raise no competitive concerns in the face of large-scale entry.

30. An analysis of the effect of a merger on competition needs to address forward-looking considerations, including entry conditions and the growth in industry capacity. Petitioners simply ignore the large-scale entry and expansion in capacity that has occurred and that now is being undertaken in the industry.

31. The review of mergers by antitrust enforcement agencies is based in large part on the concern that increases in concentration resulting from a merger will facilitate collusion resulting in higher prices to consumers. It is highly unlikely that collusion could succeed in the presence of rapid technological changes, entry and expansion in capacity.

B. SIGNIFICANT ENTRY OF NATIONWIDE FIBER OPTIC NETWORKS AND THE ABSENCE OF ENTRY BARRIERS MAKE IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT WHOLESALE LONG DISTANCE COMPETITION

32. Petitioners devote extended discussion to the claim that wholesale competition will be adversely affected by the proposed transaction, stressing that there are now four major national fiber optic networks. This view is far too narrow and ignores the dramatic changes now taking place in the wholesale marketplace. Moreover, the economic studies cited by petitioners do not generally address whether the wholesale segment is subject to competitive problems.

Indeed, as discussed in Section C below, evidence cited by petitioners generally does not suggest that competition for business customers is inadequate. Hence, logic suggests that there should be no complaints about wholesale long distance. If large business customers can negotiate favorable rates then large wholesale customers should be able to do so as well. This logic is further reinforced by the fact that some products are sold to both wholesale and retail business customers.

33. Today, new national, high-capacity fiber optic networks are being deployed and other entrants have recently announced plans to deploy national, high capacity fiber optic networks. In addition, regional networks are being deployed and expanded. Each of these entrants, which are discussed in more detail below, is managed by individuals with significant industry experience, are well-financed and are highly credible. Within about two years, it is likely that there will be seven national fiber optic networks (after accounting for the consolidation of the MCI WorldCom networks), not to mention a significant number of regional networks and the possibility of still further entry. These seven networks include MCI WorldCom, AT&T, Sprint, Qwest, IXC, Williams and Level 3. As described more fully below, each of these firms will have substantial national capacity. Since the new networks have pre-sold capacity to other firms that independently provide services using these facilities, there will effectively be more than seven national network operators.[19] Furthermore, these network providers sell services to highly sophisticated firms that purchase large amounts of capacity which in turn is sold to consumers of a variety of telecommunications services.

34. Petitioners, however, fail to discuss these current circumstances. They instead present "market share" calculations, but fail to show why these figures are relevant to an

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19. One of these new network operators is GTE, the firm which now complains that it will be victimized by the reduction in wholesale competition. (See GTE press release at http://www.gte.com/g/news/050697.html as well as GTE advertisement in the Wall St. Journal, January 21, 1998, pp. A8-A9.)

analysis of how competitive conditions would change as the result of the proposed transaction especially in light of the ongoing entry.

35. In light of the current and expected future entry, it is highly unlikely that the proposed transaction would adversely affect competition in the provision of wholesale long distance services. Experience indicates that competitive problems are rare in industries with a significant number of competitors, rapid entry and expansion of capacity, and sophisticated buyers. The remainder of this section documents the nature of this entry and its likely effect on competition in the provision of wholesale capacity.

1. Qwest and IXC are significantly expanding wholesale capacity

36. There is a tremendous amount of entry and expansion of wholesale fiber optic capacity now occurring in the U.S.[20] As the Wall St. Journal recently noted, "[t]he telecom industry is being shaken to its circuit switches by network upstarts that are building new systems promising far faster transmission and lower operating costs than the vast systems now being run by AT&T Corp., the Bell companies and others."[21]

37. Among several firms constructing new fiber optic networks, Qwest and IXC merit attention as significant examples of the more general phenomenon now taking place in the industry. Each of these firms are in the process of deploying national fiber optic networks, each of which promises to be greater in scope than WorldCom's current network. These two

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20. Fiber optic capacity can be used for voice telephony as well as other telecommunications applications including data, Internet, video, etc. Thus, as explained in more detail below, entry and expansion in the wholesale market also makes it highly unlikely that the proposed transaction will adversely affect competition in the provision of other telecommunication services, such as Internet backbone services.

21. Wall St. Journal, Jan. 20, 1998, p. A3.

networks alone will result in more than a 35 percent increase in the fiber optic route miles relative to the roughly 100,000 fiber route miles deployed at the end of 1996.[22]

38. Qwest is deploying a national fiber optic network that upon completion will cover roughly 16,000 route miles.[23] In comparison, WorldCom's network at the end of 1996 encompassed roughly 12,000 route miles.[24] Network construction is scheduled to be completed in the second quarter of 1999, a little over a year from now. IXC is deploying a national fiber optic network that will cover more than 20,000 route miles by the end of next year. Today, IXC's network encompasses roughly 12,000 route miles.[25]

39. Simple route mile measurements, however, implicitly understate the increase to wholesale capacity created by Qwest and IXC. First, fiber optic networks vary with respect to the number of fibers per cable deployed and FCC data indicate that the four national networks include an average of between 20 and 32 fibers per cable. In contrast, Qwest reports that it is generally deploying cables with 96 fibers throughout its network.[26] The IXC network will generally contain between 48 and 72 fibers.[27] Second, the new networks will employ advanced electronic technologies that enable a greater volume of traffic to be transmitted per fiber optic strand. Merrill Lynch, for example, reports that "Qwest will have the lowest cost, highest

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22. FCC, Fiber Deployment Update, End of Year 1996.

23. Qwest Form 10Q, November 15, 1997, p. 19.

24. At the end of 1996, MCI and Sprint each had fiber optic network encompassing roughly 23,000 route miles and AT&T's system included 39,000 route miles. FCC, Fiber Deployment Update, End of Year 1996, Table 1.

25. IXC Form S-4, October 3, 1997.

26. Qwest Prospectus, June 24, 1997, p. 41.

27. Fiber Optics News, May 5, 1997.

technology network available."[28] Another analyst describes IXC's network as "state of the art."[29] The use of enhanced electronics implies that the effect of these two entrants on industry capacity will be far greater than implied by the number of miles of fiber encompassed by their networks.

40. The competitive significance of these two new networks is further enhanced by the fact that the capacity in these networks will be owned and operated by a variety of independent firms, not only Qwest and IXC. As noted in Network World, "the new long-distance carriers have presold their capacity in gigantic chunks to second-tier retail operators and ISPs."[30]

41. Qwest, for example, has already sold significant portions of its national network to Frontier and GTE and portions of its network to other carriers, who will use this capacity to compete as independent firms.[31] IXC has sold capacity to WorldCom, LCI, Vyvx, MCI, DTI, CCTS, and GST.[32] With their remaining capacity, both Qwest and IXC intend to provide services to other carriers, such as long distance resellers, other long-distance network operators, and Internet backbone providers.[33] Services provided on the portions of the network sold to others may in turn be sold to resellers, marketed directly by the new firms or sold to yet others. In any of these circumstances, the new owners will compete with Qwest, IXC, each other and other network operators.

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28. Merrill Lynch, Long Distance, August 15, 1997, Appendix 5.

29. Research Note, Robinson-Humphrey Company, December 22, 1997.

30. Network World, January 12, 1998, p. 8.

31. Qwest Prospectus, p. 43.

32. IXC Communications Inc., Form S-4, October 3, 1997, p. 8.

33. Qwest Prospectus, p. 44; Communications Week International, October 20, 1997, p. 4.

42. In sum, these two new entrants alone will significantly increase the effective fiber optic capacity and wholesale competition. Nonetheless, petitioners never mention these firms in analyzing the effect of the proposed transaction on wholesale competition.

2. There are additional examples of entry and expansion into the provision of wholesale services

43. Qwest and IXC are only two among many examples of entry and/or expansion of wholesale capacity. For example:

- Level 3 Communications recently announced plans to spend $3 billion to build a global Internet-based local and long-distance network. Level 3's U.S. network is expected to encompass 20,000 route miles, making it comparable in size to IXC and Qwest. Completion is expected in late 1999.[34]
- Williams Co. recently announced that it will reenter the provision of wholesale telecommunications business.[35] Williams previously operated a national fiber optic network that was sold to WorldCom in 1995, retaining certain rights to use one fiber optic strand in this network. It recently revealed plans to spend $750 million over the next two years for expanding its network. This is roughly half the cost of constructing the Qwest Network.[36] Williams also announced that US West will be the "anchor tenant" in its network, which is expected to cover more than 18,000 route miles by the end of 1998.[37]

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34. Wall St. Journal, January 20, 1997, p. A3.

35. New York Times, January 12, 1998, Section D, p. 10.

36. Qwest Communications International Form S-4, June 30, 1997, p. 7.

37. US West press release, January 5, 1998 (http://www.uswest.com/com/insideuswnews/010598.html).

- Aliant Communications recently expanded its fiber optic network and formed the Midwest Carrier Consortium with a variety of regional networks including Norlight Telecommunications (Wisconsin); Minnesota Equal Access Network, Iowa Network Services, KIN Network (Kansas), and others.[38]
- LCI, which operated a 1,400 mile network at the end of 1996, has purchased more than 5,600 fiber miles of previously dark capacity in the past year from Williams and IXC.[39]
- Cable and Wireless plans to "significantly increase [its] fiber optic network within the U.S." with a $130 million investment this year.[40]

44. Future entry and expansion of capacity is also facilitated by the presence of empty conduit often installed during network construction.[41] The availability of such capacity enables network owners to deploy and sell additional capacity without acquiring new rights of way. As mentioned above, network capacity can also be expanded through the use of enhanced electronics in combination with already-deployed fiber optic cable.

45. Furthermore, a wide variety of telecommunications firms have the ability to provide wholesale long distance services. Potential entrants include foreign PTTs, and electric utilities as well as RBOCs, if they fulfill the criteria required by the 1996 Telecommunications Act. Even if RBOCs fail to fulfill these criteria, there are no barriers to their ability to provide services (at either the wholesale or retail level) outside of their home territory.

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38. Fiber Optics News, January 5, 1998.

39. LCI press releases, February 4, 1997, October 14, 1997.

40. http://www.qwix.net/about_qwix/fiberoptic.shtm.

41. Qwest Prospectus, p. 41 and Fiber Optics News, December 15, 1997.

46. Overall, current industry developments indicate that there are no significant barriers either to the expansion of existing capacity by network operators or to the entry of new firms into the provision of wholesale services and further indicate that such entry is rapidly occurring. Such circumstances make it highly unlikely that the proposed transaction will have an adverse effect on competition in the provision of wholesale long distance services.

C. IT IS HIGHLY UNLIKELY THAT THE TRANSACTION WILL ADVERSELY AFFECT RETAIL LONG DISTANCE COMPETITION

1. Petitioners acknowledge that WorldCom has little brand recognition among residential customers

47. BellSouth, GTE and Bell Atlantic each emphasize that WorldCom has historically played a limited role in marketing directly to residential consumers, instead primarily serving these customers through resellers. They acknowledge that, unlike MCI, WorldCom has little retail brand recognition among residential consumers. As GTE states in its petition (at p. 25), WorldCom "[recognizes] that its own brand name is largely unrecognized in the retail mass market."

48. There is no dispute about this claim. While WorldCom actively markets to residential consumers, it has placed greater emphasis on marketing to business consumers. WorldCom's lack of brand recognition among residential customers was one factor that led to the FCC's finding in Bell Atlantic/NYNEX that WorldCom was not among the most significant potential entrants to provide local service in New York City.

49. WorldCom's lack of brand recognition among retail customers, however, implies that the proposed transaction would not be likely to have an adverse effect on competition for residential customers. WorldCom is only one among many firms, including facilities-based and non facilities-based resellers, that provide service to residential customers. Many of these firms

have been able to expand rapidly. For example, between December 1994 and December 1996, Excel's pre-subscribed lines increased from roughly 75,000 to 3.8 million.[42] Excel claims to rank fourth (after AT&T, MCI and Sprint) in terms of revenue derived from domestic residential long distance.[43] As another example, Telco, a provider of dial-around services, realized an increase in revenue from $1 million in 1993 to $428 million in 1996.[44]

50. These facts suggest that WorldCom is just one of many firms lacking strong brand recognition that can offer long distance services to residential customers. Under these circumstances, there is little risk that the transaction will adversely affect competition in the retail segment of the long distance industry.[45]

2. The proposed transaction would not be expected to lessen Worldcom's commitment to residential service

51. Bell South simultaneously claims that (i) residential long distance service is characterized by supracompetitive pricing; and (ii) that MCI WorldCom would lessen its commitment to or abandon its residential customer base. Bell South, however, offers no explanation

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42. FCC, Long Distance Market Shares, Third Quarter 1997, Table 2.1.

43. Excel Communications Inc. Form 10-K, December 31, 1996.

44. Telco Annual Report, 1996, p. 10. Telco was acquired by Excel in mid-1997. (http://www.exceltel.com/hotnews/merger.htm)

45. Notice how our conclusion is based on an analysis of changes in competition resulting from this transaction. In contrast, petitioners cite testimony submitted in previous proceedings that residential competition is inadequate -- testimony which does not examine the likely change in competition resulting from this transaction. Even the evidence cited by petitioners has been strongly challenged. (See accompanying affidavit of Robert Hall.)

why MCI WorldCom would find it in its interest not to serve such valuable customers (or not to sell the business of providing such services to a qualified buyer).[46]

52. More generally, there is no reason to expect that MCI WorldCom would lessen its commitment to serving residential customers. If it is now profitable to serve such customers, there is no reason to expect that this situation would change as the result of the transaction.

3. Evidence cited by petitioners does not support their inference that the transaction will harm competition for business customers

53. As noted above, petitioners' claims that the proposed transaction will adversely affect competition rely principally on affidavits submitted by RBOCs in support of their applications to provide within-region interLATA service. These affidavits, however, at most permit an inference that the residential segment of the retail long distance industry is imperfectly competitive. The studies generally do not claim that the business segment of the retail long distance industry is subject to competitive problems, nor do they generally address whether the wholesale segment is subject to competitive problems.[47]

54. For example, the affidavits by Prof. Richard Schmalensee and Prof. Jerry Hausman attached to BellSouth's petition do not claim that business customers face inadequate competition. In a section of his report entitled "Inadequate Competition for the Consumer Market," Prof. Schmalensee states:

> "Although large business customers have benefited from competition in the interexchange market, competition for the consumer market is inadequate."[48]

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46. A qualified buyer would be one for whom the acquisition of the business would not violate the antitrust laws.

47. As a matter of economic logic, the absence of competitive problems for business customers implies the absence of competitive problems at the wholesale level as well.

48. Declaration of Richard L. Schmalensee, August 18, 1997, attached as Appendix C to

(continued...)

55. Prof. Hausman's affidavit includes the following statement:

"Current *residential* long distance prices are above the competitive level."[48] [Emphasis added.]

56. The absence of significant competitive problems among business customers is also recognized by Prof. Marius Schwartz in an affidavit submitted by the U.S. Department of Justice in response to various RBOCs' applications to provide within-region long distance services. He concludes that: "[h]igh volume [business and residential] customers already enjoy substantial competition."[49] This view is echoed by the U.S. Department of Justice, which stated in its brief that "higher volume residential and business customers benefit from considerable rivalry."[50]

D. THERE IS NO BASIS FOR GTE'S CLAIM THAT THE MERGER WILL ELIMINATE A "MAVERICK" FIRM

57. GTE claims that the proposed transaction will eliminate WorldCom as a "maverick" firm. Assuming that GTE is correct in its characterization of WorldCom as a maverick, there is no sound economic basis for their claim.[52] A maverick is different from a firm with a small market share. The term instead typically is applied to firms that have a history of disrupting stable industry relationships. Although MCI WorldCom will be considerably larger

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48.(...continued)
the BellSouth petition, ¶ 7.

49. Declaration of Professor Jerry Hausman, ¶ 28.

50. Supplemental Affidavit of Marius Schwartz on Behalf of the U.S. Department of Justice, November 3, 1997, p. 31.

51. Evaluation of the U.S. Department of Justice in the matter of: Application by BellSouth Corporation, et. al. for Provision of In-Region, InterLATA Services in South Carolina, before the F.C.C., CC Docket No. 97-208, November 4, 1997, p. 48.

52. Given MCI's history, it is unclear why GTE does not also describe MCI as a maverick.

than WorldCom today, the transaction does not remove the maverick from the marketplace. Instead, the transaction results in the maverick having control of more capacity with which to alter the status quo, if one can be said to exist in the telecommunications industry.

58. GTE suggests that as a result of the proposed transaction WorldCom will no longer be willing to disrupt the industry by providing services to resellers. Once again, however, GTE presents no support for this argument. As discussed above, numerous firms are acquiring control of wholesale capacity with the specific goal of providing service to other carriers. A strategy by MCI WorldCom of reducing cooperation with resellers likely would result in the loss of customers to what will soon be at least six other competing national networks without benefit to MCI WorldCom. Like WorldCom and MCI today, MCI Worldcom will need to compete vigorously with existing network suppliers and entrants to order to retain wholesale customers and attract new ones.

IV. INTERNET SERVICES: UNPRECEDENTED GROWTH AND ENTRY MAKES IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WILL ADVERSELY AFFECT COMPETITION

59. As discussed earlier, it is unlikely that a transaction would adversely affect competition in an industry characterized by rapid entry, expansion of capacity and technological change. The provision of Internet backbone services clearly meets these criteria. The rapid expansion of fiber optic capacity makes it highly unlikely that the proposed transaction will adversely affect competition because the availability of such capacity facilitates entry into the provision of Internet backbone services.

60. Petitioners' claim that the proposed transaction will adversely affect competition in the provision of Internet backbone services is based on unreliable "market share" calculations from an industry trade publication. Once again, however, petitioners present no analysis to support their claim that these market shares are relevant to an analysis of how competitive

conditions in the industry would be expected to change as the result of the proposed transaction and they ignore the dramatic recent ongoing entry.

A. THE AVAILABILITY OF FIBER OPTIC CAPACITY MAKES IT HIGHLY UNLIKELY THAT THE PROPOSED TRANSACTION WOULD ADVERSELY AFFECT INTERNET BACKBONE COMPETITION

61. The same fiber optic capacity can be used to provide telephone services, Internet services, and a variety of other data and video applications. As a result, the analysis of the proposed transaction on the provision of Internet services raises many of the same issues addressed above in the discussion of wholesale long distance issues above. In particular, the rapid entry and expansion of fiber optic capacity reduces the likelihood that the transaction will have an adverse effect on competition in the provision of Internet services, just as with wholesale long distances services.

62. The likelihood that the transaction will result in harm to Internet competition is made even more remote because entry into the provision of backbone services does not require construction of a new fiber optic network. Internet backbone providers can simply lease or buy fiber capacity from wholesale suppliers and attach the requisite routers and other equipment required to provide service. Boardwatch magazine, which follows the Internet industry, highlights the difficulty of any attempt to exercise market power in such an environment. In discussing the consequences of a hypothetical attempt to impose an undesired pricing policy on the industry, Boardwatch writes:

> "If anyone doesn't buy in – say a Qwest Communications, or anyone else capable of providing actual fiber routes, any one of now 4,535 ISPs can rent some fiber, declare themselves a backbone, and [traffic] will simply move to PSI or Qwest or AT&T or whoever is hungry enough for market share to operate an Internet in the fashion already demonstrated."[53]

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53. Boardwatch, November 1997, p. 10.

B. THERE HAVE BEEN SIGNIFICANT ENTRY AND DRAMATIC INCREASES IN INTERNET BACKBONE DEMAND AND CAPACITY IN RECENT YEARS

63. The growth in demand for Internet services has little if any precedent. A recent industry report by Maloff Group International summarizes recent trends:

> "[t]he Internet Service Provider (ISP) marketplace in the U.S., including Information Providers, grew from an estimated $1.85 billion (annualized revenue as of April 1996) to $8.4 billion (annualized revenue as of October 1997).[54]

64. There is no indication that the demand for Internet service has peaked. Maloff, for example, forecasts that the demand for Internet services will grow "to nearly $50 billion by the end of the year 2000."[55]

65. A large number of firms are competing to establish positions in this marketplace. The Fall 1997 industry directory published by Boardwatch Magazine identifies 34 "national backbone providers" (even after accounting for the proposed consolidation of UUNet, ANS, Compuserve and MCI). Rival network providers include AT&T, Sprint, GTE, IBM, PSINet, among many others.

66. Boardwatch acknowledges that its list of backbone providers is incomplete:

> "Defining a national backbone is problematic at best. There are many more backbones existing in the country that we could have included in this issue, but most of them are regional in nature, such as Colorado SuperNet, which has trunk connections throughout Colorado and a few surrounding states."[56]

67. Boardwatch's Fall 1997 list of national providers includes seven national backbone providers not identified in its Summer 1997 directory. As recently as the summer of

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54. Maloff Group International, Inc., Internet Access Providers Marketplace Analysis, October 1997, p. 7.

55. Ibid., p. 8.

56. Boardwatch Quarterly Directory of Internet Service Providers, Fall 1997, p. 27.

1996, Boardwatch identified only 9 national backbone providers.[57] Boardwatch also identifies 4,354 ISPs in its current directory. As noted above, these firms can vertically integrate into the provision of backbone services by leasing fiber optic capacity.

68. Boardwatch emphasizes that there continues to be rapid entry into and expansion of Internet backbone services:

> "... [T]his continues to a terribly dynamic and exciting area. All national providers are expanding the number of points of presence and building or upgrading backbones at an incredible rate."[58]

69. To cite two recent examples, Internet backbone provider Apex Global Internet Services (AGIS) recently obtained capacity along 10,000 miles of Qwest's network.[59] Similarly, GTE, which raises concerns regarding "the substantial anticompetitive impact of the proposed transaction on the Internet market,"[60] boasts in the advertisement cited earlier that:

> "We're now one of the largest providers of Internet solutions to business. And we're deploying a 15,000-mile data network stretching from the eastern seaboard to the California Coast. It will expand the GTE network to 100 times the size of today's Internet."[61]

70. In new and growing industries, such as the provision of Internet backbone services, differences in expectations regarding future demand and technological changes are likely to result in substantial divergences in firms' interests, greatly complicating collusion. The entry of numerous large scale firms who provide fiber optic capacity make it even more unlikely that this merger will result in supra-competitive pricing. As a result, it is highly unlikely that the proposed merger will adversely affect competition in this industry.

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57. Boardwatch Internet Service Providers Guide, Summer 1996.

58. Boardwatch Quarterly Directory of Internet Service Providers, Fall 1997, p. 21.

59. Fiber Optic News, January 12, 1998.

60. GTE petition, p. 46.

61. Wall St. Journal, January 21, 1998, pp. A8-A9.

C. "MARKET SHARE" STATISTICS CITED BY PETITIONERS ARE LIKELY TO BE UNRELIABLE INDICATORS OF COMPETITIVE CONDITIONS

71. Petitioners present estimates of "market shares" calculated by Boardwatch magazine to support their claim that the proposed transaction will result in a significant increase in concentration. As discussed above, petitioners provide no evidence that shares calculated in this way, and changes in such shares, have any relationship to competitive conditions. Even a cursory review of these market share data, however, indicate that it is very unlikely that they are reliable indicators of concentration and competitive conditions in the industry, especially in light of the large scale and on-going entry.

72. Boardwatch's "market shares" for Internet backbone providers are based on connections reported by ISPs only. This measure indicates that MCI WorldCom (including UUNet, InternetMCI, ANS and Compuserve) will account for roughly 55 percent of such connections. The Boardwatch measure, however, is likely to be quite inaccurate. The methodology used by Boardwatch is not disclosed and there appears to be double counting of ISPs that are connected to more than one backbone. Moreover, "market share" data are unlikely to be a reliable indicator of competitive conditions in the provision of Internet backbone services. First, and foremost, such calculations fail to reflect the rapid entry and expansion in the provision of such services. Second, the number of ISP connections has no necessary relationship to the availability of network capacity or the ability of backbone suppliers to expand the provision of services and constrain price.

73. More narrowly, these calculations are based on ISP connections alone and do not incorporate information on non-ISP customers, such as direct customer connections to backbone providers. Thus, the Boardwatch data indicate that IBM (which principally markets Internet access directly to corporate customers) has a "market share" of only 0.29 percent.

PSINet, a significant backbone provider which typically serves subscribers through resellers which handle customer service, billing and marketing, is reported to have a market share of 0.7 percent.[62] The Boardwatch measure undoubtedly understates the competitive impact of these firms.

D. THERE IS NO BASIS FOR CONCERNS THAT PEERING ARRANGEMENTS CAN BE USED TO HARM COMPETITION

74. Petitioners have suggested that peering arrangements can be used by MCI WorldCom to disadvantage its rival providers of Internet backbone services. There appears to be no economic basis for these concerns.

75. For reasons described above, it is unlikely that attempts by MCI WorldCom or others to disadvantage rivals through the use of peering arrangements could succeed due to: (i) the availability of many alternative providers of Internet backbone services; and (ii) the ability of ISPs to integrate into the provision of backbone services. The availability of such services is facilitated by the recent rapid entry of new firms and expansion of fiber optic capacity.

76. Petitioners' claims also appear to reflect a general misunderstanding of the economic function of peering.[63] Under such arrangements, two network providers agree not to price traffic they interexchange. Such arrangements are economically sensible only under circumstances in which peering partners provide to each other functions that are roughly comparable in value. In general, interconnection between networks may be priced. In such networks, interconnection fees provide a device for monitoring the value that the two networks provide to each other. Therefore, their existence cannot be interpreted as a reflection of market power.

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62. Boardwatch Quarterly Directory, Fall 1997, p. 187.

63. We understand that this institutional arrangement developed as matter of convenience when Internet services were provided by non-profit organizations.

77. If two networks do not provide to each other functions that are roughly comparable in value, the use of peering arrangements may result in economic inefficiency. In such cases, the network that provides the more highly valued functions will not face the appropriate incentive to make investments in network capacity and neither will the network that receives the more highly valued functions.

V. CONCLUSIONS

78. This declaration evaluates competitive conditions in the provision of local exchange service, long distance services and Internet services and assesses the likelihood that the proposed transaction will adversely affect competition in the provision of these services. The evidence we have analyzed to date convinces us that the provision of local, long distance and Internet services today is marked by extensive entry, capacity growth and technological change.

79. These circumstances make it highly unlikely that the proposed transaction will adversely affect competition. Available evidence instead suggests that the proposed transaction will accelerate entry of CLECs, including both MCI WorldCom and others, into the provision of local services. Given the enormous size of this market and the high margins earned by incumbent suppliers, the transaction holds the promise of yielding very significant gains to consumers. There are also likely to be significant efficiencies in the provision of other services based on evaluations by WorldCom and industry analysts.

80. We also find significant shortcomings in the competitive analysis presented by petitioners. Among others, these include petitioners' failure to provide evidence supporting their claims that the transaction will result in harm to competition and their failure to address the effect on competition of the rapid changes now taking place in the telecommunications industry.

Dennis W. Carlton

Dennis W. Carlton

Hal S. Sider

Hal S. Sider

January 25, 1998

DENNIS WILLIAM CARLTON
Economist

January 1998

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

Home Address: 184 Sheridan Road
Glencoe, Illinois 60022 (847) 835-8855

EDUCATION

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

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

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

EMPLOYMENT

LEXECON INC., Chicago, Illinois: President.

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

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

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

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

OTHER PROFESSIONAL EXPERIENCE

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

BELL TELEPHONE LABORATORIES (Summers 1976, 1977).

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

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

FIELDS OF SPECIALIZATION

Theoretical and Applied Microeconomics
Industrial Organization
Econometrics
Urban Economics

ACADEMIC HONORS AND FELLOWSHIPS

M.I.T., National Scholar Award, 1968
Edwards Whitacker Award, 1969
Detur Book Prize, 1969
John Harvard Award, 1970
Phi Beta Kappa, 1971
National Science Foundation Fellowship, 1972 - 1975
Recipient of Post-doctoral Grant from the Lincoln Foundation, 1975
National Science Foundation Grant, 1977 - 1985
Recipient of the 1977 P.W.S. Andrews Memorial Prize Essay, best essay in the field of Industrial Organization by a scholar under the age of thirty
Ph.D. Thesis chosen to appear in the Garland Series of Outstanding Dissertations in Economics

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

Co-editor, Journal of Law and Economics, 1980 - present
Associate Editor, Regional Science and Urban Economics, 1987 - 1997
Associate Editor, The International Journal of Industrial Organization, 1991 - 1995
Member, American Economics Association, Econometrics Society
National Bureau of Economic Research, Research Associate
Member, Advisory Committee to the Bureau of the Census, 1987 - 1990
Editorial Board, Intellectual Property Fraud Reporter, 1990 - 1995
Consultant on Merger Guidelines to the U.S. Department of Justice, 1991 - 1992
Accreditation Committee, Graduate School of Business, Stanford University, 1995
Visiting Committee, Massachusetts Institute of Technology, Department of Economics, 1995 - present
Resident Scholar, Board of Governors of the Federal Reserve System, Summer, 1995
Member, Advisory Board, Economics Research Network, 1996 - present
Member, Steering Committee, Social Science Research Council, Program in Applied Economics, 1997 - Present
Participant in meetings with Committee of the Federal Reserve on Payment Systems, June 5, 1997

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HAL SIDER
Principal and Vice President

January 1998

Business Address: Lexecon Inc.
332 S. Michigan Ave.
Suite 1300
Chicago, IL 60604 (312) 322-0229

Home Address: 386 Ramsey Road
Deerfield, IL 60062 (847) 405-0153

EDUCATION

Ph.D., UNIVERSITY OF WISCONSIN, Madison, Wisconsin: Economics, 1980.

M.A., UNIVERSITY OF WISCONSIN, Madison, Wisconsin: Economics, 1978.

B.A., UNIVERSITY OF ILLINOIS, Urbana, Illinois: Economics, 1976.

EMPLOYMENT

LEXECON INC., Chicago, Illinois (October 1985 - present): Vice President and Senior Economist.

U.S. COMMISSION ON CIVIL RIGHTS, Washington, D.C., (August 1984 - October 1985): Co-Director: Project on Minority Income Trends.

OFFICE OF POLICY: U.S. DEPARTMENT OF LABOR, Washington, D.C., (May 1982 - August 1984): Economist.

PRESIDENT'S TASK FORCE ON FOOD ASSISTANCE (on leave from U.S. Department of Labor), Washington, D.C., (September 1983 - February 1984): Research Associate.

OFFICE OF RESEARCH AND EVALUATION; BUREAU OF LABOR STATISTICS, Washington, D.C., (September 1980 - May 1982): Economist.

UNIVERSITY OF WISCONSIN, Madison, Wisconsin (1978 - 79): Teaching Assistant.

UNIVERSITY OF WISCONSIN, Madison, Wisconsin (1976 - 78): Science Writer

FIELDS OF SPECIALIZATION

Applied Microeconomics
Econometrics
Industrial Organization
Labor Economics

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	)	
	)	
Applications of WorldCom, Inc. for	)	
Transfers of Control of MCI	)	
Communications Corporation	)	CC Docket No. 97-211
	)	
	)	
	)	

DECLARATION OF ROBERT E. HALL

I. Introduction

1. I have been asked to prepare an economic analysis of the effects in the long-distance market of the proposed merger between WorldCom and MCI. My analysis is carried out within the framework of modern antitrust economics. That analysis looks to the interests of the consumer. A desirable merger will deliver superior products to the consumer at lower prices, compared to the situation in the market without the merger. An undesirable merger will reduce competition, resulting in inferior products and higher prices.

2. Merger analysis looks to market shares and to the effect of the merger on concentration, but these are intermediate steps and are useful to the extent that they help assess the effect of the merger on prices and innovation. The Merger Guidelines of the U.S. Department of Justice and Federal Trade Commission use market shares as a preliminary screening device. If a merger—such as the one proposed between WorldCom and MCI—has an immediate effect on market shares above the threshold, then the analysis proceeds to the next step, a full analysis of the effect of the merger from the consumer's perspective.

II. Relevant Markets for the Merger Analysis

3. The provision of long-distance services to users involves two vertically related markets. First is the upstream market for long-distance transmission capacity. With few exceptions, long-distance calls are carried over fiber-optic cables. Hence the upstream market is the market for long-haul fiber capacity. This market also serves other forms of communication, such as the Internet and corporate and government data networks.

4. Suppliers of long-distance services use long-haul capacity together with many other inputs to produce their services. Switching is a second important input, supplied in another upstream market. Local access is yet another input, still provided for the great majority of customers by the historical local phone company. Some sellers are vertically integrated in long-haul transmission, switching, and long distance, notably AT&T, MCI, Sprint, and WorldCom. Many other firms participate in one market or the other, and are either suppliers to or buyers from the active market in long-haul fiber capacity.

5. Purchasers of services in the long-haul fiber market include end users such as businesses and units of government, together with purchasers who use transmission capacity as an intermediate product—an input to long-distance service. The second group includes those who have their own switches and the switchless resellers of the services of other long-distance carriers.

6. As I will discuss later in this declaration, the customers for long-distance service fall into groups. It is useful to distinguish large, medium, and small business users, higher-volume residential users, and lower-volume residential users. In my opinion, these distinctions among types of customers do not create separate relevant markets for antitrust analysis, however. The boundaries of the relevant market are determined, in part, by substitution on the supply side. Because long-distance carriers who are currently active only in the business market are nonetheless capable of moving into the residential market, should higher prices in that market make the move attractive, the relevant market comprises both business and residential service. Moreover, because many business long-distance calls are made from home, the distinction between residential and business is blurred to begin with.

III. The Market for Long-Haul Fiber Capacity

7. Fiber optics made possible the "bandwidth revolution" and is participating in the phenomenal growth of high-speed long-distance transmission of data of many types. Transmission of long-distance calls was an important share of total transmission as fiber networks were first built, but the explosion of growth currently underway comes almost entirely from data. It is estimated that by 2001, 80 percent of business spending for long-haul transmission will be for data and 20 percent for voice.[1] Fiber capacity has become a commodity. Because purchasers can also become sellers, it is impossible for sellers to discriminate among purchasers.

8. Fiber circuits are used in two ways. For standard telephone calls, a circuit of adequate bandwidth is dedicated to a call for as long as the call lasts. Even if nobody is speaking, the circuit is committed to the call. For data transmission, it is generally more efficient to place the data in packets. Circuit capacity is used to send the packets only as they are transmitted; the capacity can be used to transmit data for other users between packets. The Internet, in particular, relies exclusively on packet switching. Currently, large amounts of data move over voice circuits, despite the inefficiency. Data and fax modems convert data into a form that can be transmitted over voice circuits. Larger businesses are in the advanced stages of converting data transmission to packet-switched networks. And even the smallest user can take advantage of packet switching over the Internet.

9. The fiber and much of the associated electronics that are used in conventional switched long-haul fiber networks are the same as for packet-switched networks. To convert exiting fiber from one use to the other, only the electronics for switching and routing need to be changed. Network operators are searching for ways to move voice traffic onto packet-switched networks, to take advantage of their superior efficiency and to avoid the inefficiency of two separate types of fiber capacity. Qwest has indicated that it expects to solve the remaining problems in this area and to offer voice service on its packet-switched network within the year.[2]

10. Operators of fiber networks purchase the rights to lay their cables along railroad tracks, electric utility lines, and similar locations. Their capacity can be measured in various ways.

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[1] Andrew Kupfer, "Transforming Telecom: The Big Switch" *Fortune*, October 13, 1997

[2] John Keller, "Qwest Communications to Offer Calls for 7.5 Cents a Minute Around the Clock," *The Wall Street Journal*, December 17, 1997.

First is route miles. Along a given route, the operator may lay several fiber cables or sheaths, each containing several dozen fibers. Thus sheath miles is a second measure and fiber miles is a third measure. Finally, modern fiber has a higher bandwidth or information carrying capacity. A final measure is terabit-miles per second, generally measured as miles of DS-3 equivalents. Because a large fraction of the cost of building a fiber network is the cost of the conduit carrying all of the sheaths, route-miles are a relevant measure. But the other measures help understand differences among fiber networks. Newer networks tend to have more fibers in the conduit and higher transmission rates on each fiber. For example, Sprint, with an older network, has 20 fibers at the typical point in its network, whereas Qwest has 44 and Electric Lightwave has 52. Moreover, advances in electronics now enable a single strand of fiber to carry huge volumes of traffic, even more than previous generations of fiber. Capacity to be installed in the next two years will have even more fibers and carry even more data per fiber.

A. Sellers and Shares

11. Table 1 reports available data on route miles in fiber optic networks in the United States at the end of 1996.

Table 1. Data on Fiber Optic Networks

Owner	*Fiber miles, 1996 (thousands)*	*Percent*
AT&T	1250.0	42.7
MCI	655.4	22.2
Sprint	468.7	15.9
WorldCom	276.9	9.4
QWest	113.3	3.8
IXC	70.5	2.4
Electric Lightwave	37.7	1.3
LCI	24.7	.8
Others	43.4	1.5
Total	2940.6	100

Source: Jonathan M. Kraushaar, *Fiber Deployment Update End of Year 1996*, Indust., Analysis Division, Common Carrier Bureau, Federal Communications Commission

12. Although the current fiber market is supplied by just four significant players, the situation will change rapidly over the next two years. At least four additional firms have announced credible plans to build national networks—IXC, Qwest, Williams, and Level 3. Qwest and IXC have already built substantial portions of their networks. Each plans to build a national fiber network close to the size of, for example, MCI's current network of 23,000 route miles. Because these new networks will use the most advanced designs, they will have much more capacity than MCI has today. They will deploy two or three times as many fibers per sheath and use new fiber technologies that substantially increase the bandwidth of each fiber.

13. In addition to the large new entrants in the long-haul transmission market, there are significant sellers of regional fiber capacity. For example, GST deploys about 3,000 route miles of fiber capacity that has evolved out of its role as a local access provider. GST and others plan to expand this type of capacity.

14. Rather than building additional long-haul fiber capacity by itself, MCI now joins construction consortiums. On the strength of the commitments of MCI and other initial customers to use the new capacity, the consortium can obtain financing and proceed with construction on the premise that buyers for the remaining capacity can be found as time passes. Other long-distance carriers are pursuing similar strategies. As in other competitive markets, only specialists can earn market returns in the fiber construction market.

B. Barriers to Entry

15. The current pace of new entry suggests the absence of significant barriers to entry. Even while I was writing this declaration, another substantial new entrant was announced, Level 3 Communications, Inc.[3] Like the other new entrants, Level 3 is planning to use its new capacity for packet-switched transport. Nonetheless, its entry and that of others building similar capacity has significant implications for long distance. As I mentioned earlier, circuit switched long-haul fiber capacity, build to carry voice traffic, actually carries many data call such as faxes. The new entrants expect to divert that traffic to their much cheaper packet-switched networks. As a result, the price of voice capacity will fall as it becomes redundant. In addition, a number of firms such as Qwest are planning to offer voice service over packet-switched networks.

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[3] "Ex-MFS Managers Plan Global Network Based on Internet, Rivaling Phone Firms" *Wall Street Journal*, p. A-3, January 20, 1998.

16. The new entrants seem to have no difficulty in assembling the inputs needed to build multi-billion dollar networks. Level 3 is headed by the executive who built MFS before it was purchased by WorldCom and Williams by the executive who built WilTel before its acquisition. Level 3 has been capitalized with $3 billion in cash by its backer, Peter Kiewit Sons, Inc.

C. Returns to Scale

17. Some economists have concluded that the basic transmission technology of modern long-distance service—fiber optics—has high fixed and low variable costs. In other words, according to this view, a supplier of transmission capacity must make a large investment to be in business in the first place, but can then increase its volume of business without adding much capacity or incurring additional costs that rise with volume. It would be hard for competition to thrive if smaller firms were at a disadvantage relative to larger ones because of inefficiently small scale

18. The evidence on entry reviewed earlier suggests that firms have no difficulty achieving efficient scale. The prospects of new entrants, who are currently much smaller than the incumbents, appear to be excellent. Extremely rapid prospective growth in the transmission of data also suggests that any concerns about scale will disappear rapidly.

D. The Pattern of Strategic Interaction among Rivals

19. Oligopoly theory stresses that strategic interaction is a major determinant of the degree of competition among a limited number of sellers. When one firm considers cutting its price to attract a customer, that firm's concern that its rivals might cut their prices in response ma moderate its price cut. The inhibition is greatest when prices paid by each customer are known to all sellers and each seller knows the prices that its rivals will charge before the customers do. The inhibition is least when each transaction is made secretly and individually, and where the customers are sophisticated in seeking the lowest possible price.

20. Judged by this standard, the market for bulk fiber capacity is one where competition works well even when there are only a few sellers. First, the purchasers (long-distance carriers, Internet service providers, and operators of data networks) are all sophisticated businesses making important transactions. Their livelihoods depend on getting the best possible terms in the capacity market. They can and do press hard to push price down close to cost.

21. Auction theory provides a useful benchmark for understanding competition under these conditions, though I do not believe that this market attains competition in exactly the sense of the theory.[4] If a purchaser of bulk capacity sought bids from suppliers and permitted rebidding, then bidding would continue until the seller with the lowest cost had bid just below the cost of the seller with the next higher cost. At any higher price, another bidder would be willing to make a new slightly lower bid to get the business.

22. Alternatively, if purchasers solicit a single round of bids, the Revenue Equivalence Theorem of auction theory predicts that the buyer will emerge, on the average, with as good a price as in an auction with rebidding. Although an auction with a single round does not induce any single bidder to bid all the way down to that bidder's cost, the desire to underbid others in the single round turns out to replace the effects of that process, on the average.

23. If all sellers have the same cost, then bidding theory implies that price will be forced down to cost as long as there are two or more sellers. In terms of oligopoly theory, this means that the market will be in Bertrand equilibrium, with price equal to cost. This line of thought emphasizes the value that purchasers derive when one seller begins to compete against a monopolist—price falls all the way from a high monopoly level to the perfectly competitive level.

24. Although the bidding or Bertrand model is too simple to describe the market for long-haul fiber capacity, it calls attention to features that make the market work well with only a relatively small number of significant sellers. Buyers, armed with a reasonable guess about cost, can shop for bids from all the sellers. If necessary to induce the lowest possible proposal, the buyers can promise to keep the terms of the deal completely secret. The primary factor that inhibits low pricing in other markets—that a firm setting a low price to a particular buyer will sacrifice revenue from other purchasers or induce price cuts by its rivals—is absent when each deal is separately and secretly dickered.

E. Effects of the Merger

25. WorldCom's share of long-haul fiber capacity in 1996 was 9.4 percent and MCI's was 22.2 percent based on fiber miles. The immediate effect of the merger in 1996 would have

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[4] See R. Preston McAfee and John McMillan, "Auctions and Bidding" *Journal of Economic Literature*, vol. 25, pp. 699-738, 1987. Avinash Dixit and Barry Nalebuff, *Thinking Strategically*, New York: W.W. Norton, provide a highly readable less technical discussion of these issues.

been to raise the HHI by about 420 points. According to the Merger Guidelines, this amount of increased concentration calls for a full analysis of the competitive effect.

26. The factors listed earlier in this Part suggest to me that the merger would have essentially no effect on the prices actually paid by long-distance companies and other purchasers of bulk fiber capacity. First, the absence of barriers to entry means that continuing entry keeps price close to the competitive level. As recent experience has shown, there are entrepreneurs poised to build new capacity along any route and in any part of the country where the capacity can be sold at a small profit. Financial markets are generous to firms with plans to enter the rapidly expanding market for bulk fiber capacity.

27. The second important factor behind my conclusion is the nature of the market as discussed in the previous section. If WorldCom and MCI join forces, purchasers will still have a number of established sellers and a growing number of eager new entrants who are aggressively soliciting business. Because each deal is separately dickered and can be kept secret, and the purchasers are sophisticated businesses making key decisions when they purchase capacity, the factors that may elevate price when there are only around 5 players in a standard oligopoly are inoperative. Instead, even with only that number of sellers, the deals that purchasers can make are just as good with 5 sellers as with 6. Moreover, standard thinking, focusing on counting players of substantial size, omits the effects of the countless other sellers in the actual market, who also act to keep price close to the competitive level.

28. Although I believe that the merger would have essentially no effect on the degree of competition in the bulk capacity market, I nonetheless believe that continuing entry will be good for the purchasers of capacity and thus good for the consumer of long-distance services. The entrants are most likely to have the best technology and the lowest costs. As I noted earlier, auction theory teaches that the lowest-cost sellers have dominant roles in determining the outcome, even when the majority of the bidders have higher costs. The higher-cost sellers have to squeeze their margins even more to get the business, or they have to face up to the market's dictate that they write down the value of obsolescent plant in order to keep it in operation. Thus the price of bulk fiber capacity will be set by the efficien new entrants, not by the capacity currently in place and under the control of the two merging companies.

IV. The Market for Long-Distance Service

29. In this Part of the declaration, I examine the current state of competition in long distance and the effect of the proposed merger on competition in that market. How strong is existing competition? Would the merger result in diminished competition? As noted in the previous Part, my analysis of long-distance service is based on the evidence that there is a fluid, substantially competitive market for bulk long-haul fiber capacity. In addition, long-distance carriers purchase switching in a competitive market. I do not analyze that market further in this declaration because I am not aware that there have been any suggestions that the proposed merger would affect competition in switching. With respect to local access, FCC regulations govern the terms under which regulated local carriers provide access, so that it is available in perfectly elastic supply at the regulated price. Although I believe that the merger will have favorable effects on the pricing of local access to long-distance carriers, I will not consider that topic in this declaration.[5]

A. Role of the Market for Long-Haul Fiber Capacity

30. To be more precise about the upstream market for transmission capacity, the key element is that the price paid by a long-distance carrier for incremental capacity be close to the cost of supplying it. Although this condition would be satisfied under competition, it is also consistent with some amount of market power among sellers of bulk capacity. The reason is that the deal between a supplier of fiber capacity and a long-distance seller can use two-part pricing. It is mutually beneficial in striking such a deal that the provider of capacit extract the benefits of whatever market power it possesses through the fixed part of the charge. And, in fact, deals made between businesses generally do have provisions—such as quantity discounts—that amount to two-part pricing.

31. In the presence of efficient two-part pricing—or standard pricing under competition—independent long-distance carriers can compete on an equal footing with vertically integrated rivals. Both can purchase additional capacity at its cost. The fact that, in today's market, vertically integrated carriers coexist with firms that specialize either in providing long-haul capacity or in providing long-distance service supports the premise that there is a smoothly functioning market for bulk capacity where the pricing of incremental capacity is close to cost.

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[5] See the accompanying declaration of Dennis W. Carlton and Hal S. Sider, Part II.

B. Method of Analysis

32. I have carried out a study of competition in the long-distance market using standard economic analysis. I find that the long-distance industry is substantially competitive. The industry's performance has been exceptional since divestiture in 1984—long-distance carriers have delivered steady improvements in service at continually declining prices.

33. The long-distance market in the United States is served by four larger carriers—AT&T, WorldCom, MCI, and Sprint—together with numerous others who offer services on partial national networks, facilities leased from other owners, or who resell services purchased in bulk from other carriers. In my opinion, the evidence shows strongly that these carriers compete rather than collude. The result of this competition has been benefits to the consumer in the form of substantial reductions in the price of long-distance service as well as numerous technical improvements and the development of new services.

34. The primary evidence in favor of the hypothesis of strong competition and superior performance is the behavior of prices in the long-distance market. Proper measures of price—ones that take appropriate account of the shift toward highly favorable bargain pricing plans—show huge reductions in prices. They also suggest that competition has brought the price of long distance close to the level of cost. The structure of the industry is conducive to strong competition. There are no important barriers to entry. Because there are fluid markets for basic long-distance capacity, entry can take many different forms.

C. Performance of the Long-Distance Industry

35. Increasing competition in the long-distance industry has delivered important benefits to the American economy. Traditionally, long-distance service was available only from AT&T. Regulation prevented other companies from offering long-distance service. During the 1960s and the 1970s, MCI waged a successful battle to obtain the right to offer service in competition with AT&T, but there was still little rivalry in the industry by the early 1980s.

36. Divestiture in 1984 started the transition to competition in long distance. The mid-1980s saw an explosion of service by long-distance carriers other than AT&T. During this time, MCI and Sprint expanded nationwide networks and gained acceptance as alternatives to AT&T. Divestiture was successful at stimulating major new investments with corresponding increases in market shares by new entrants to the long-distance market.

D. Prices for Long Distance

37. The public has gained substantially from this structural transformation of the long-distance industry. The primary indicator of these gains is the sharply declining price of long-distance service. Prior to the introduction of competition in long distance, the price was stable in relation to prices in general. With the advent of competition, particularly with the divestiture of long-distance services from local telephone companies at the beginning of 1984, and the provision of equal access to competing long-distance carriers, the price of long-distance service fell precipitously.

38. In my opinion, the best available way to measure the price of long distance is by revenue per minute, the ratio of toll call revenue (billed by the minute) to the number of billed minutes. Although revenue per minute is not a perfect measure of the price of long distance, it is the best available measure.[6] Figure 1 shows revenue per minute for AT&T, MCI, and Sprint, stated in 1996 dollars, adjusted by the GDP deflator. To avoid mix effects, these calculations exclude international calls. Figure 1 shows that revenue per minute has declined substantially and that the declines are continuing to occur.

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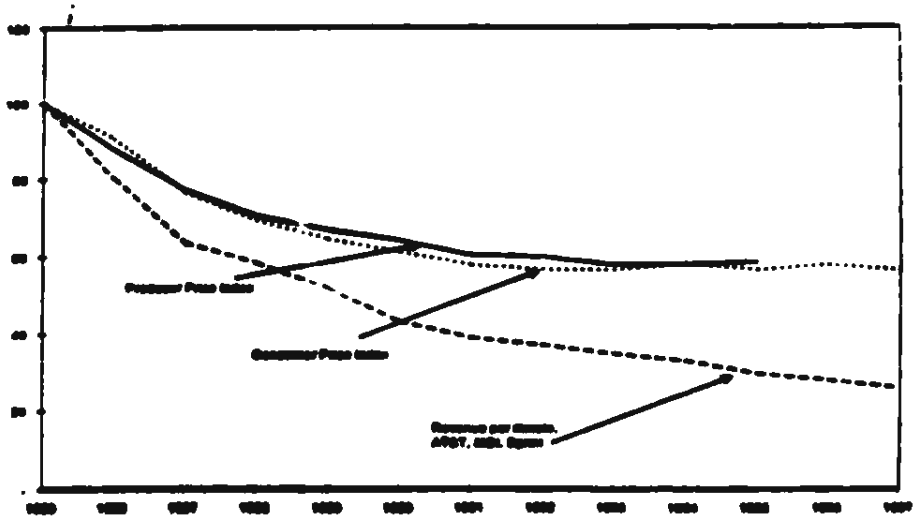
[6] One of the potential problems in revenue per minute as a measure of prices is mix effects—revenue per minute could rise even though each type of call was cheaper per minute because customers were making a larger fraction of expensive calls, such as credit-card calls. I looked at confidential MCI data by detailed product category to determine that mix effects are a minor influence on MCI's revenue per minute; essentially all the decline comes from lower prices for calls and none from changes in the mix of calls. It is entirely reasonable to conclude that mix effects are also a minor influence on revenue per minute industry-wide.

Figure 1. Index of Revenue per Minute, Relative to the General Price Level



39. Three factors were responsible for the sharp decline in the price of long-distance service relative to the general price level over the past decade: competition made possible by divestiture, improvements in productivity, and declining access charges paid to local telephone companies.

E. The Role of Declining Access Charges in Lowering Long-Distance Prices

40. Long-distance carriers pay local telephone companies access charges for carrying long-distance calls from the caller's business or home to the point where the long-distance carrier picks up the call. They pay a second access fee to a local telephone company to deliver the call to its ultimate destination. During the 1980s, the FCC imposed important changes on the structure of access fees—early in the decade, most of the fee was imposed as a per-minute charge on long-distance calls, whereas by the end of the decade, part of the fee had been shifted to a fixed monthly charge per telephone line. These access fees have declined substantially since 1984, but long-distance carriers still pay about 40 percent of their revenues to local telephone companies as access charges.[7] The FCC has recently ordered further reductions in access fees.

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[7] *Telecom Service - Long Distance*, Merrill Lynch & Co., Global Research & Economics Group, 1996, Table 6.

41. The Bells have frequently argued that long-distance rates have fallen by less than the amount that access charges have fallen. In this section I will show, on the contrary, that long-distance prices have fallen, relative to the general price level, even when access charges are netted out. Competition and productivity growth have been important factors in the improved performance of the long-distance industry over the past decade.

42. The table below shows gross revenue per minute for the three largest carriers on the top line, stated as 1996 dollars per minute. The table also shows the industry average access charge per minute of call, again in 1996 dollars per minute.[8] The average access charge fell from 22 cents per minute in 1985 to just under 7 cents in 1997 (in 1997 dollars). Revenue per minute after subtracting access costs fell from 30 cents per minute in 1985 to less than 7 cents in 1997 (in 1997 dollars), a decline of 78 percent. Claims that the only reason for the decline in long-distance prices is the declining cost of access are incorrect.

Year	*Revenue per minute, 1996 dollars*	*Access charge per minute, 1996 dollars*	*Revenue per minute net of access charges, 1996 dollars*
1985	0.528	0.217	0.311
1986	0.423	0.197	0.225
1987	0.336	0.164	0.172
1988	0.309	0.145	0.165
1989	0.273	0.125	0.148
1990	0.227	0.104	0.124
1991	0.205	0.091	0.114
1992	0.195	0.085	0.109
1993	0.182	0.081	0.101
1994	0.172	0.079	0.093
1995	0.155	0.074	0.080
1996	0.147	0.068	0.079
1997	0.135	0.067	0.068

[8] This calculation is based on the assumption that there are two minutes of access per minute of call (approximately one minute on the originating end and one minute on the terminating end). It also adjusts for call setup time and for access by means other than the local switched network.

43. The table shows that the fall in the price of long-distance service net of access charges occurred in both the period immediately following divestiture and in more recent years. Although falling access charges were an important factor in the substantial decline in the price of long distance over the period, other factors were also significant, reflecting the successful performance of the competitive long-distance industry in the United States.

44. Jim Lande of the Industry Analysis Division, Common Carrier Bureau of the FCC, has made calculations of revenue per minute for interstate direct dialed calls.[9] His results are:

Year	Revenue per minute, net of access charges, for a direct dialed call in 1997 dollars
1992	$0.086
1993	0.083
1994	0.078
1995	0.071
1996	0.073

Net of access charges, revenue per minute in 1997 dollars fell by 15 percent over the three years from 1992 to 1995. Lande's results strongly confirm the hypothesis that declining access charges were only one of the factors leading to the declining price of long distance.[10] The growing efficiency and improving competitive performance of the industry also made a large contribution, as is revealed by the data calculated net of access charges.

45. Most long-distance carriers sell their products under various pricing plans. Among these is a higher rate called the standard rate. This rate is charged to a customer who signs up for service without asking about the rates that are available and without being attracted by the promotion of a better rate. Standard rates are in the range of 28 cents per minute during the day and 18 cents in the evening; they are also slightly differentiated by distance. These rates have the same role that "full fares" have in the airline business—they are paid for a small

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[9] "Telecommunications Industry Revenue: TRS Fund Worksheet Data," December 1996.

[10] Differences between Dr. Lande's calculations of revenue per minute and mine include the following: (i) he uses only DDD calls; I include all calls; (ii) he uses only interstate data; I use interstate and intrastate data; (iii) he uses actual minutes; I use billed minutes; (iv) he uses average access charges; I use marginal access charges; (v) he includes all carriers, I include only AT&T, MCI, and Sprint.

fraction of the total volume of sales by people who cannot or will not arrange their lives to receive much better prices. The standard rates of AT&T, MCI, and Sprint are quite similar and tend to move together. They rose somewhat in the past few years, most recently in November 1996, and then fell in July 1997, when there was a decline in access charges.

46. Most long-distance service is purchased at far better prices than the standard rate, just as a large fraction of all airline travel is at fares that are far below the full fare. In the airline market, better fares are available in two ways: First, businesses negotiate special fares directly with airlines. Second, for individual travelers, airlines quote highly advantageous fares for travelers who take the trouble to make their arrangements in advance. Full fare transcontinental travel costs about 35 cents a mile whereas the cheaper fares are around 9 cents per mile. Similarly, the long-distance caller who seeks out a good deal can make calls across the country for 10 cents a minute. And the price paid by businesses can be pushed down even more if a way can be found to avoid the access charges of around 5 cents that would otherwise place an absolute floor on long-distance prices.

47. Here is a list of some of the deals that long-distance carriers currently offer for interstate calling for residential customers.

Carrier	Name of plan	Terms
AT&T	One Rate Plan	10 cents per minute at any time. $4.95 per month
MCI	MCI One Savings	10 cents per minute evenings and Saturdays. 5 cents on Sundays. 25 cents per minute daytime. $5 minimum.
Sprint	Sprint Sense Day Plan	15 cents per minute at any time. no fee. no minimum purchase
WorldCom	Home Advantage Easy Plan	13.9 cents per minute at any time.
Qwest		7.5 cents per minute. 24 hours. using Internet-like transmission. Requires access code and limited to a few cities.
Unidial		8.9 cents per minute at any time
Telco Communications	Great Rate Plan	10 cents per minute off-peak. 15 cents per minute peak. no minimum
	Just Ten Plan	10 cents per minute all times. $3 minimum
VarTec Telecom	Dime Line Plan	10 cents per minute all times. 3 minute minimum. 5 cents a minute on every other call under 10 minutes. $5 minimum
Frontier	HomeSaver	10 cents per minute off-peak. 25 cents per minute on-peak. no fee. no minimum

Source: Carriers and John Keller, "Qwest Communications to Offer Calls for 7.5 Cents a Minute Around the Clock." *The Wall Street Journal*, December 17, 1997.

These rates are substantially lower than rates available even a year ago

48. Almost 80 percent of MCI's customers use plans other than the standard rate.[11] Many of the advantageous plans described above are available to all users, regardless of their level of usage. Moreover, the availability of these plans is a frequent discussion point in the media. Some of the lowest rates are available without presubscription—you can take advantage of

[11] Based on MCI data. See elaboration in the next section.

the 10 cents per minute off-peak rate and 15 cents per minute peak rate from Telco Choice 10297 by dialing their access code, 10297, without any preliminary arrangement.

F. Prices Paid by Low-Volume Long-Distance Customers

49. The Bells have argued that the existence of low-price plans creates an incorrect impression of competition because most customers do not receive the benefits from some of these plans. The flat-rate bargain plans that provide the most attractive residential prices today are not volume based. Some are open to all users. Others have relatively low fixed costs of $3 to $5 or similar minimum purchase requirements. The breakeven point for a family that makes half its calls at nights and on Saturdays, and the other half on Sundays, under the MCI One Savings plan, relative to paying 25 cents per minute, is only 20 minutes of calling per month.

50. Most residential customers take advantage of flat-rate low-price plans. I have studied data from MCI on the distribution of customers and revenue across pricing plans, for residential customers. About 22 percent of MCI's residential customers pay the standard rates—the remaining 78 percent use plans with lower rates. Not surprisingly, those using the standard rate tend to spend little on long distance. In the month I examined, 12 percent of MCI's residential revenue came from customers using the standard rate. The remaining 88 percent of MCI's residential business was with customers using more advantageous price plans. Of those that pay standard rates, 46 percent have bills less than $1.50 per month in an average month—corresponding to about 6 minutes of long-distance conversation.

51. The Bells' experts often cite contrary data from PNR and Associates that 65 percent of residential customers pay standard prices rather than using lower-price plans.[12] First, a substantial number of these customers, perhaps as many as one-fourth, do not subscribe to a low-price plan because they have no toll usage.[13] More importantly, the PNR sample is badly biased, through its construction, in favor of smaller users.

52. PNR wrote to 25,000 households requesting copies of their local telephone bills, long-distance bills, cable TV bills, and cellular bills. PNR paid $5 to each responding household. PNR received telephone bills from 8,731 households, for a response rate of about 35

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[12] *Declaration on Behalf of BellSouth by Richard L. Schmalensee*, "BellSouth's Prospects for Success in the InterLATA Market," filed in CC Docket No. 97-208, at 7, August 18, 1997.

[13] PNR and Associates provided MCI with promotional documents for a program known as Bill Harvest II. The discussion in this paragraph and the next are based on these documents.

percent.[14] Whenever a survey is performed, an analysis of non-respondents must be done to insure that the respondents are not biased, particularly when the response rate is this low. No such study has been done to validate the PNR sample, to my knowledge. There is a presumption that the response rate will be highest in lower-income households, to whom the $5 payment is more significant. No conclusion about long-distance customers in general can possibly be drawn in view of the bias.

53. The bias from selective response appears to be serious. MCI has carried out a comparison of data from PNR on purchases from MCI with similar data on purchases by all of MCI's customers. According to PNR, about 54 percent of MCI residential customers spent $10 or less on long distance. In the MCI data, the corresponding fraction is only 32. Plainly, the highest usage customers were under-represented in the sample.

G. Issues in the Measurement of Cost

54. Economists generally agree that the relation between price and marginal cost is useful for understanding issues about competition and performance. But making valid inferences about industry performance from the relation of price to marginal cost is a challenge. Although the textbook perfectly competitive seller sets its marginal cost equal to price, it is difficult to relate departures from that equality into a suitable measure of performance. An industry could have marginal cost below price but still be workably competitive. In such an industry, the potential entrant would not perceive profit. The hardware costs of the network or the prices paid to bulk capacity suppliers can be measured, but appear to be a small part of the total cost. Access charges are the single largest component of cost and are easy to measure. The remaining 5 cents or so of cost are in areas such as customer service, billing, and other office-based activities that are hard to measure on a marginal basis.

55. One approach to measuring cost is to look at the very best prices charged for different long-distance services. Long-distance transport sells for about 1.5 cents per minute, which is in line with estimates of network costs. It appears that the best available price for switched long-distance for offices or homes is a little below 10 cents per incremental minute, about 4 cents above access charges.

56. Despite the difficulties in measuring marginal cost accurately, I believe that the price-cost margin has declined substantially in the long-distance industry in the past decade. This

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[14] *Ibid.*, PNR information about Bill Harvesting II.

decline is consistent with increasing competition. The decline has reached the point that the industry today is not far from the limit where price just covers marginal cost.

H. Cost Differentials among Customers and Corresponding Price Differentials

57. It is well known that customers with higher volumes pay less per minute for long-distance service. Some economists have been concerned that these price differences arise from the type of price discrimination that occurs when sellers have market power. Alternatively, the price differences could reflect cost differences. Pure price discrimination, not based on cost differentials, will not exist in a textbook perfectly competitive market. Price differences based on cost differences will occur even in perfect competition. In the long-distance industry, there is good evidence that favorable prices promoted mainly to high-volume customers (a common form of price differential in the industry) are the result of cost differences rather than pure price discrimination.

58. The costs that a long-distance carrier incurs to serve an additional customer for an additional month are substantial. A major component is the cost of billing. According to MCI, the cost of billing a customer with a single long-distance call is about $.48 per month (based on MCI's contracts with local carriers). Another major component of the cost during the period under study of an additional customer is the PICC of $.53 per line per month. Thus, just on account of these two categories, an additional customer adds over a dollar per month to a long-distance carrier's costs.

59. As I have noted earlier, there has recently been a shift toward simplified flat-rate long-distance plans and away from explicit quantity discounts, though some flat-rate plans have minimum charges. Higher-usage customers are more likely to take the trouble to seek out the best flat-rate plans. Long-distance carriers are likely to target known large users for their flat-rate promotions, because it is not worth the effort of contacting the low-usage customer.

60. If the higher rates per minute paid by the smallest customers are the result of pure price discrimination and do not reflect differences in costs, including the promotional costs of signing up the customers, then there would be an important arbitrage opportunity for resellers. Because a reseller can buy service cheaply at high-volume low prices and resell the services at higher prices to small customers, the reseller makes substantial profits when prices depart from costs. As I have discussed, there is an active market for resold service—there are hundreds of resellers of long-distance service and many more entering every week. I find it unlikely that there are large profits available to resellers that they have

failed to pursue, despite the vitality of the reselling business. A more reasonable explanation is that there is an additional cost to recruit and serve each customer. As a result, carriers offer low prices to large customers, as would be expected under competition, to reflect the recruiting cost and the fixed monthly cost of serving a customer.

I. Structure and Competition

61. The data reviewed earlier in this section effectively demonstrate the benefits that consumers have received from the development of a competitive long-distance market. In addition, the structural factors often considered by economists in judging the likelihood of the existence and continuation of competition support the conclusion that vigorous competition is serving the interests of the long-distance consumer. These factors include the concentration of sellers, trends in market shares, the ability of rivals to observe prices, barriers to entry, profitability, and returns to scale.

1. Concentration

62. The domestic long-distance industry in the United States has the following competitive structure: There are four carriers with national networks (AT&T, MCI, Sprint, and WorldCom). Their current market shares are roughly 51 percent, 17 percent, 9 percent, and 7 percent, respectively.[15] There are at least 20 other carriers with annual revenues over $100 million and a half-dozen near $1 billion, including Cable & Wireless, Excel, Frontier, and LCI. In addition, numerous other carriers have smaller roles in the industry, based on their own facilities, capacity leased from other owners, and on reselling network services from other carriers. The FCC reports that there are 482 firms identifying themselves as long-distance carriers or resellers of interstate services.[16] The sellers other than the top four now account for 16 percent of the market.

63. AT&T's market share of just over half does not necessarily indicate a serious deficiency in competition. In any industry, but particularly in an industry where one seller has had an historical head start, one must examine a broader set of information than market share to

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[15] *Long Distance Market Share, Third Quarter 1997*, Table 3.1, Total Operating Revenues and Table 3.4, Quarterly Toll Revenues Reported to Shareholders, Industrial Analysis Division, Common Carrier Bureau, Federal Communications Commission, January 1998.

[16] *Telecommunications Industry Revenue: TRS Fund Worksheet Data*, Table 1, Industrial Analysis Division, Common Carrier Bureau, Federal Communications Commission, November 1997.

reach conclusions about the state of competition in a market. In particular, such an examination should consider trends in market shares, barriers to entry, and the prospective profits of a new entrant. It should also consider direct evidence on price-cost margins, as I discussed earlier.

64. WorldCom is now the fourth largest long-distance carrier with nearly 4.1 million customers as of 1995. It has grown both by building its own facilities and by acquisition of other carriers. In January 1995 WorldCom's predecessor, LDDS, acquired WilTel, the sixth largest carrier. Recently, WorldCom acquired Brooks Fiber, a company that provides access services to businesses in several cities. Currently, WorldCom has about a 7 percent share of the long-distance market. Allnet is the fifth largest carrier with 1.5 million customers as of 1995. Allnet has achieved its growth as a reseller. In 1995 Frontier Communications acquired Allnet's parent. Their combined market share is about two percent of the market. These two firms are just two of the many players who are aggressively challenging AT&T, MCI, and Sprint. At present, there are 130 facilities-based long-distance carriers and 260 resellers who are actively recruiting customers.

65. The market contains many aggressive, successful carriers who have every intention of taking as much business as they can away from the larger carriers. Executives in the industry who are constantly fighting to retain customers solicited by WorldCom, Allnet, and other aggressive sellers would be surprised at a portrayal of their industry as a comfortable club with just three members who have agreed not to poach on each other's territories. These other carriers could expand rapidly if competition among the larger carriers were inadequate and left prices above competitive levels. Further, the smaller carriers are increasing competition in the market through consolidations that result in a number of highly successful entities such as Frontier Communications, the fifth-largest carrier. A recent example is the merger announced on June 6, 1997, between Excel and Telco Communications Group, Inc., to create what will be the sixth-largest carrier. The smaller carriers thrive on the availability of fiber capacity in the bulk transmission market.

2. Trends in Market Shares

66. The changes in and current levels of market share of the long-distance carriers reveal a vigorously competitive market. Thirteen years have passed since divestiture opened the long-distance market. AT&T still has a majority share, but it continues to lose share—from 65 percent in 1980 to 51 percent in 1997—to all of its rivals, especially the smaller carriers whose collective share has grown rapidly. What market share AT&T still has, it retained only by competitive response to the aggressive attempts of its rivals to lure away its business. The rise in MCI's and Sprint's market shares accounts for about a third of AT&T's loss of share.

The remainder—two-thirds—of AT&T's loss was the gain of smaller, but fast-growing and successful, carriers.

67. Measured by the economist's favored index of market concentration, the Herfindahl-Hirschman Index (HHI), long-distance service has become ever more competitive with the passage of time. The HHI for 1996 was at a level only half of what it was in 1987. With a continuation of the downward trend observed continuously since divestiture, the long-distance industry will enter the range of a relatively unconcentrated industry within the next 10 years or so.

3. Communication of Prices among Rivals

68. Economic analysis of the relation between competition and rivals' observation of price has stressed that the central question is whether a firm can take its rivals by surprise by offering terms to prospective customers that the rivals cannot match immediately. If a smaller firm can attract a significant number of customers before its rivals respond, competition is more effective in lowering prices because the firm can expand relative to its larger rival or rivals. Even a one-day advantage can be crucial—in the airline business, one carrier can run a media blitz for a special low-price offer for a single day and book a large amount of business, even if the other carriers respond with their own blitzes the next day. In the residential long-distance business, one important tool is the signup bonus. The larger carriers target their rivals periodically with mass mailings offering bonuses—the rivals learn about the tactic only after it occurs. Promotional bargain offerings come at such a fast and furious pace that rivals cannot respond quickly enough to erase the temporary advantage that each offer provides to the carrier making the offer.

69. The observability of prices by rivals is a significant issue in markets with high barriers to entry and small numbers of firms. But in the long-distance market, with hundreds of sellers, a smaller seller need not fear that its larger rivals will respond to the prices it sets. The small firm can publicize its prices as widely as it chooses. Smaller firms find viable niches in the market, knowing that larger rivals would sacrifice too much profit from their existing customers if they matched the terms that were being offered by the smaller firms to a few of its customers. The combined effect of the hundred or so smaller carriers, each nibbling at the shares of the larger carriers, is to enforce a high level of competition in the market in general.

4. Barriers to Entry in Long Distance Service

70. The role of barriers to entry is prominent in all discussions of structural determinants of competition. If a small number of sellers are isolated from further competition by high

barriers to entry, the likelihood of implicit collusion is higher. In my opinion, however, the barriers to entry in the long-distance business are relatively low, so actual and prospective entry keeps the market competitive.

71. Barriers to entry in the long-distance industry are low because of the competitive bulk capacity market. If uncompetitive behavior among the existing carriers created excessive prices, the resulting profit opportunity would be seized by operators who assemble effective national service from components available today in the bulk capacity and switching markets.

72. Analyses of barriers to entry have stressed the importance of sunk costs. A sunk cost is one that cannot be recovered if entry is not successful. Few of the costs of transmission capacity in the long-distance business are sunk, because there is an active market where an unsuccessful entrant in retail long distance could sell or lease facilities to other retail sellers. In this respect, the long-distance market is quite different from the local market—in that market, the investment of an unsuccessful entrant may have little resale value, so sunk costs are a more important barrier to entry in local service than in long distance.

The fluid, substantially competitive market for long-haul fiber capacity, where transmission service can be bought and sold at prices close to cost, thus creates the environment for a highly competitive long-distance market.

5. Returns to Scale

73. Competition cannot flourish in an industry where the technology has important returns to scale. When large scale brings lower cost, one firm will dominate and its cost advantage will prevent effective competition from smaller rivals. All the evidence suggests the absence of increasing returns in the long-distance market. AT&T is approximately three times as large as MCI. Under returns to scale, AT&T should have substantially lower costs per minute of service and thus higher profits. But, in fact, AT&T and MCI are about equally profitable. Further, many carriers exist in the market that are much smaller than MCI, and these small carriers are not only viable, but profitable and growing.

J. Conclusion on Competition and Collusion

74. The United States has a vibrant, successful long-distance industry. Since competition was introduced to the long-distance market, there has been a large and continuing flow of technological innovations. The performance of the industry in the past decade has been a clear success, with substantial declines in prices relative to other products and the rapid

development and dissemination of advanced technologies by the competitive long-distance carriers. The price-cost margin has declined to close to its competitive minimum.

75. The force of competition among the four major long-distance carriers (AT&T, MCI, Sprint, and WorldCom) and dozens of other significant carriers has pushed prices down to the level where only an efficient firm with perceptive management can make a profit. But competition in long distance does not take the precise form of textbook perfect competition. For example, AT&T's brand name and consumer inertia dating back to the time when the company was a monopoly gives a continuing, though declining, advantage to AT&T.

76. After divestiture provided the opportunity for full competition in the long-distance market in the United States, competition acted quickly to lower prices. Increasing competition and rising productivity were driving forces, along with declining access charges, in lowering long-distance prices. The decline in the price of long distance was most rapid just after divestiture, but has continued since 1987. The economic analysis of the benefits of competition teaches that competition will drive prices toward the level of cost. During the transition from noncompetitive prices to competitive prices, large price reductions will occur. After the benefits of competition are achieved, the economy continues to enjoy low prices but cannot expect prices to continue falling at their earlier rate. Future declines in long-distance prices will come from continuing improvements in productivity and from any further declines in access charges that are granted by regulators or that result from structural changes in local telephone service.

77. In my opinion, the performance of the industry suggests vigorous competition with large consumer benefits even though AT&T still has about half of the U.S. long-distance market. There are neither natural barriers to entry nor barriers created by law in the market. If competition were inadequate, new firms would enter and those currently on the periphery would move into the core.

78. The Bells' economists have argued that the long-distance industry is distinctly non-competitive. The particular form of non-competitive organization that they diagnose is tacit collusion. In this view, each long-distance carrier is willing to stick to high prices because there is an understanding that the others will keep their prices high as well. However, the Bells' economists cite no evidence of actual collusion. The diagnosis of tacit collusion makes little sense for an industry with numerous sellers, many of whom are small enough to avoid any strategic response from the four major sellers, but collectively large enough to exploit any gap between price and cost. These sellers—currently ranked number 5 and smaller—have grown collectively in recent years and now account for an important share of the total market.

79. Sellers of long-distance pursue every conceivable strategy to capture profit opportunities in niches in the market. There is even a carrier, T-NETIX, that specializes in providing long-distance service to prisoners! As a result of the vigorous pursuit of profit opportunities, they have been largely extinguished. One of the most persuasive indications of the lack of remaining profit in long distance is the failure of the Bells to offer significant long-distance service outside their own regions—a right they have had since the passage of the Telecommunications Act of 1996 two years ago.

K. Effects of Entry by the Bells in Their Own Regions

80. The Telecommunications Act of 1996 provides a mechanism for the Bells to sell long-distance services to their local customers. When the Bells begin to qualify for this opportunity by opening their local markets to effective competition, long-distance markets will be affected in certain ways that are predictable.[17]

81. The local telephone company serving Connecticut, Southern New England Telephone (SNET), began selling long-distance services in 1994. At the same time, the local toll market was opened to competition. Experience since then is helpful in understanding what will happen when other local telephone companies offer long-distance service to their own customers.

82. SNET has a huge competitive advantage in the Connecticut market for interstate long-distance calls because the Telecommunications Act prohibits responses by its national rivals that apply only to Connecticut. The national long-distance carriers would have to lower their prices nationally in order to respond to SNET's pricing. SNET has done little to take advantage of this perverse feature of the law. SNET's interstate rates are 13 cents per minute off-peak, with small discounts for high volumes. By contrast, the MCI One Savings interstate rate is 10 cents per minute off-peak and 5 cents on Sunday. The AT&T's One Rate Plus rate is 10 cents per minute at any time with a charge of $4.95 per month. The Connecticut long-distance customer has gained no meaningful advantage from SNET's control of a long-distance subsidiary in the market. And the customer has suffered the disadvantage that SNET has withdrawn its earlier policy of cooperating with long-distance carriers.

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[17] For a full analysis, see *Declaration of Robert E. Hall*, in Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision In-Region, InterLATA Services in South Carolina, FCC Docket 97-208, October 1997

83. SNET is also the high-price seller in the local toll market. In this respect it is no different from the other local telephone companies, such as BellSouth and Ameritech, who have placed themselves toward the top of the distribution of prices in local toll markets, as these markets have been opened to competition. If you subscribe to SNET's intraLATA service, you pay 18 cents per minute during the day and 10 cents at night and on the weekend. It is an astonishing fact that I, a part-time resident of Connecticut, pay half again as much per minute to call from Guilford to Hartford using SNET as I pay to call to California. By contrast, AT&T's local toll rate in Connecticut is 5 cents per minute for One Rate and One Rate Plus, MCI's is 10 cents per minute, and Sprint's is 10 cents per minute off-peak and 15 cents during peak hours.

84. Although SNET does not offer meaningful price advantages in long-distance, it has been successful in attracting around a third of Connecticut's long-distance customers. It appears that these are mostly low-volume customers and that SNET's share of the market in dollars is smaller. SNET appeals to customers who seek simple lives with only a single telephone supplier and are willing to pay for that convenience in higher long-distance rates than they could get by shopping among carriers. It also is likely that SNET has attracted most of its long-distance customers away from AT&T.

85. Thus the pattern of market shares—especially measured by counting customers rather than revenue—is likely to be quite different in markets where the dominant local carrier becomes affiliated with a long-distance carrier. AT&T's customer count is likely to be reduced substantially. The change will have little economic substance, however. In particular, WorldCom's primary focus in long distance is the business customer, so the migration of passive low-volume residential customers from AT&T to their local phone company hardly interacts at all with the issues relevant to the merger.

L. Effects of the Merger

1. Effects on Competition

86. MCI's share of the long-distance services market based on revenue is about 17 percent and WorldCom's is about 7 percent. The immediate effect of the merger would be to raise the HHI by about 240 points. Again, according to the Merger Guidelines, this amount of increased concentration calls for a full analysis of the competitive effect.

87. Currently, WorldCom and MCI compete against each other actively only for business customers. Although WorldCom serves many residential customers, the company has not perceived that it would be profitable to invest heavily in attracting more of them, and there is

no reason to expect that this view would have changed absent the merger. If there were competitive harm from the merger, it would occur among the business customers who previously were able to shop for bargains from MCI and WorldCom and the many other sellers of business long-distance services.

88. For larger businesses, the process of purchasing long-distance service has the same character I discussed earlier for transactions in the bulk capacity market. A business has the incentive to shop carefully and to extract the best possible deal from alternative sellers. Again, auction theory is helpful in understanding the outcome, even if its predictions do not apply literally. The theory suggests the overwhelming value to purchasers of adding a second seller when there has been a monopoly in the past. Buyers then have a chance at pushing the price all the way down from the monopoly level to the level of cost. When MCI began competing with AT&T, businesses were the early beneficiaries of this process.

89. Today, dozens of long-distance carriers offer bargains to businesses. When the larger carriers such as AT&T succeed in retaining a business customer, it is because the overall value of AT&T's offering (benefits less the price charged) exceeds the value of competing proposals. In this environment, a merger of two players out of dozens cannot have a measurable effect. Moreover, if there were even a small effect, it would induce the entry or expansion of other sellers, who would push prices back to the level that would have prevailed without the merger.

90. The residential customer with a long-distance bill at the typical level of $20 per month does not have the same incentive to create an informal auction for it purchases as does a business spending vastly more. As I have mentioned earlier, many residential customers are completely passive, sticking with AT&T at its standard rates despite potential gains from signing up for a better plan from AT&T or switching to a good plan on another carrier. When the dominant local phone companies offer long-distance service under their own brands, they will capture a large fraction of these passive customers, as experience in Connecticut has shown. This event will have no significance for the merger and will not convey any benefits to the passive customers or to other long-distance customers. As I have pointed out elsewhere, consumers will suffer harm in other ways from the change in incentives for cooperation that occurs when a dominant local carrier controls a long-distance carrier in its own market.[18]

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[18] *Ibid.*

91. The two merging companies have distinctive strategies for residential customers. WorldCom offers residential service plans, but makes only modest efforts to sign up residential customers. The company does not believe it has a comparative advantage in attracting these customers and prefers to focus primarily on business customers, who can be reached through direct sales techniques. As I have stressed earlier, the higher prices that many residential customers are willing to pay is not an indication of failed competition or major profit opportunities for companies like WorldCom. It is expensive to sign up the passive customers—precisely because they are passive—and it is expensive to serve them because of their low volume.

92. MCI is an important player in residential service, with a well developed strategy based on intensive promotion. MCI sets low prices for off-peak residential service and relatively high prices for on-peak service. MCI One charges 5 cents per minute on Sunday, 10 cents at other off-peak times, and 25 cents during the daytime on weekdays.

93. Thus, in my opinion, the merger of WorldCom and MCI would have almost no effect on residential customers. Because of the major differences in the way the two companies have competed for residential customers, those customers will not be harmed by the coordination of MCI's and WorldCom's residential businesses that would occur as a result of the merger.

94. MCI's residential business has built a stock of valuable reputational capital as a result of MCI's promotional efforts, low off-peak prices, and high-quality service. It would be economically irrational for the merged entity not to capture the value of that reputational capital by failing to continue the business. Even a spin-off is economically unlikely, given the profitability and value of residential service, because it would involve substantial transaction costs to accomplish and would sacrifice transactional efficiencies from the existing vertical integration of MCI.

2. Efficiencies Resulting from the Merger

95. The efficiencies that WorldCom and MCI could enjoy from combining the two companies—and would pass on in part to their customers—are primarily reductions in transactions costs and in costs associated with the market power of their suppliers. In the provision of local service and long-distance access, the companies also would benefit from cost reductions associated with sharp increasing returns to scale.

96. MCI's ability to use WorldCom's local network without incurring transactions costs should enable MCI to avoid more of the use of overpriced access provided by dominant local telephone companies.

97. Similarly, WorldCom should be able to reduce its international termination costs by taking advantage--without important transactions costs—of MCI's existing settlement agreements.

98. Because the two companies' product lines are complementary in a number of ways, the merged company would enjoy lower selling costs, as the sales force is able to sell a broader product line to each potential customer.

99. The stock market shows evidence of the efficiencies. The combined value of WorldCom and MCI rose when WorldCom made its offer on October 1, 1997, rose again the morning after GTE made its offer on October 15, and rose a third time when the merger was announced on November 10. The total increase in the combined value of the two companies was less than 5 percent likely to have occurred from random variation in stock market values. As I show below, none of the increase can be attributed to the market's belief that markets would become less competitive as a result of the merger—a portfolio of rivals to WorldCom and MCI showed close to no change over the three merger events. Hence the increase in value of the two companies reflects Wall Street's belief that the merger would create efficiencies.

V. Discussion of Analyses in the Bells' Petitions

A. BellSouth's Prediction that the Merged Company Will Exit Residential

100. BellSouth's petition makes the prediction that the merged company would have the incentive to exit the residential market.[19] On the other hand, BellSouth believes that the residential market is currently non-competitive and will become more so after the merger. Logically, this would make residential highly profitable. Why would the merged company exit?

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[19] *Petition for Conditional Approval of the Applications of WorldCom, Inc. for Transfer of Control of MCI Communications Corporation* BellSouth Corporation, January 5, 1998, p. 11.

101. Separately, BellSouth predicts that the merged entity will spin off residential service.[20] As I discussed in Part IV, a spinoff is a neutral event for consumers. No harm will occur to consumers if the merged company decides to spin off its residential assets. In the same discussion, BellSouth presumes that MCI's existing residential business will go to the incumbents, primarily AT&T, raising the concentration of the long-distance market. In effect, BellSouth is forecasting the immediate demise of the spun-off company. there is no economic basis for that forecast, given the success of MCI's residential business to date.

B. Long-Distance Prices

102. BellSouth states that long-distance carriers have raised their prices despite declining access charges.[21] The detailed factual material I reviewed in Part IV of this declaration shows conclusively that this statement is incorrect. The best measure of the price of long-distance service—revenue per minute—has fallen substantially more than have access charges. Although it is true that AT&T, MCI, and Sprint raised their standard rates through 1996, the authors of the BellSouth petition appear to be unaware of reductions in those rates that occurred in 1997 when the FCC lowered access charges.

103. BellSouth states: "The major carriers have, moreover, raised their discounted rates along with the basic rates off of which discounts are taken."[22] Again, the authors are completely out of touch with current practices in the long-distance market. Carriers do not state their lower-priced plans in terms of percentages off basic rates. Rather, as the table in Part IV shows, they state the rates as cents per minute. And those rates have *declined* uniformly.

104. BellSouth makes the remarkable charge that "... mid-volume callers are denied discounts."[23] This is completely preposterous. To take one of hundreds of examples to the contrary, MCI charges 5 cents per minute on Sunday and 10 cents per minute at other off-peak times, with a monthly minimum of only $5. Surely a mid-volume caller saves a great deal with this plan relative to standard rates. And a mid-volume caller who calls frequently during peak hours can sign up for AT&T's One Rate Plus plan, which charges 10 cents per minute at all times with a $4.95 per month base charge.

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[20] *Ibid.*, p. 18.

[21] *Ibid.*, p. 13.

[22] *Ibid.*, p. 13, emphasis in original.

[23] *Ibid.*, p. 14.

105. BellSouth cites the 1995 and 1996 increase in the Consumer Price Index for long distance as support for the claim that long-distance prices are rising.[24] Over a longer period, the CPI shows a sharp decline in long-distance prices, but they do not present a complete picture. The evidence suggests that the CPI understates recent declines in those prices. Construction of price indices for products such as long-distance service presents a serious challenge. For the CPI, the Bureau of Labor Statistics prices a fixed basket of calls placed by households. Until last year, the CPI used the standard rates, without considering the more favorable pricing plans that most consumers use. The long-distance component of the CPI understated price declines that occurred when more favorable plans were introduced. In addition, the CPI's procedure for the introduction of new sellers and new products understates price declines.[25] In light of the extensive use of pricing plans that are far more attractive than the standard rates in the long-distance market since divestiture, the omission of these factors from the CPI has led to a substantial understatement of price decreases. An FCC document warned users that the CPI (and the PPI) were unreliable measures for long-distance prices: "Price indexes are less reliable when industries are changing rapidly." The FCC document further states that "Because of these sorts of difficulties, measures of average revenues are sometimes used as alternatives to price indexes."[26] Although the new CPI may be a more reliable measure of changes in long-distance prices from 1997 onward, the historical CPI, including 1995 and 1996, is seriously biased.

C. Defects in the PNR Bill Harvesting Data

106. BellSouth relies on data from PNR and Associates to measure shares of residential long-distance revenue.[27] In Part IV, Section F, I demonstrated that these data are not representative of residential long-distance customers. They disagree significantly with highly reliable internal data from MCI. I do not believe that the PNR data should be used for the purposes that BellSouth proposes.

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[24] *Ibid.*, p. 13

[25] A good example is the following: Prior to 1987, the CPI included only AT&T calls. When other carriers were added to the index in 1987, the new index was adjusted so that it had the same value as the old index in 1987. Although the cost of a basket of calls was lower if some of the calls were made on other carriers, the effect was eliminated by a multiplicative adjustment. Hence the consumer benefit from the lower prices of other carriers before 1987 never was recorded in the CPI.

[26] Section 5, *Price Index Limitations for Telephone Service*, FCC Trendline Report, Industry Analysis Group, Common Carrier Bureau, Federal Communications Commission, May 7, 1996.

[27] BellSouth *Petition*, p. 10

D. Direct Effect of the Merger on MCI's and WorldCom's Prices

107. BellSouth suggests that "...funding the deal premium will require WorldCom to improve residential margins, either by jettisoning residential customers or by raising residential prices."[28] That suggestion contains a major error of economic analysis. If MCI is currently maximizing profit, raising prices or shedding customers would lower, not raise profit.

E. Reselling Issues

108. BellSouth suggests that WorldCom now cooperates as a bulk capacity supplier to residential resellers, but would withdraw that cooperation if it owned MCI.[29] (p. 17) Bell Atlantic complains about MCI's unwillingness to enter into a reselling arrangement that would enable Bell Atlantic to bid away MCI's customers.[30] I believe that these are insignificant issues from the consumer's perspective.

109. First, pure reselling of long-distance service is a less efficient form of competition than the creation of a long-distance carrier by leasing or building capacity. In the pure reselling arrangement, one firm provides the brand name and sales effort, and a second firm provides the switching and transport. The transactions costs in managing this type of relationship have proven to be substantial. The most vigorous competition in long distance comes from sellers who are responsible for managing their own long-distance operations—even where they lease the transport capacity. Thus Bell Atlantic will have less to offer the consumer during the period when they are just rebranding MCI or other service, in comparison to the time when they control more of their long-distance operations. This point has been made frequently in connection with local service, where competition based on reselling the services of the local carrier is widely seen as less effective than competition based on leasing or owning local capacity. It applies in long distance as well.

110. Second, the high level of competition in both the long-haul fiber capacity market and in the long-distance market mean that Bell Atlantic and other would-be resellers have many other sellers of whatever inputs they wish to purchase for their long-distance operations. The

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[28] *Ibid.*, p. 17.

[29] *Ibid.*, p. 17.

[30] Bell Atlantic, *Petition to Deny the Application of WorldCom or, in the Alternative, to Impose Conditions*, January 5, 1998, p. 14

analysis in Parts III and IV of this declaration explains why the merger will have little effect on the outcome of the deals made in those markets.

F. BellSouth's Analysis of the Effect of the Merger Announcement on the Stock Market

111. BellSouth states that AT&T and Sprint have enjoyed higher prices in the stock market as a result of the announcement of the merger.[31] They do not present a real event study to support this conclusion. Apparently, BellSouth is referring to general changes from all sources, including the overall movement of the stock market during the fall of 1997, and has made no effort to separate the effects of the merger.

112. BellSouth is correct to look to the stock market for information about the potential effects of the proposed merger. The stock market reflects the judgments of the investors who follow and assimilate information about the firms traded there. It is well established that the stock market helps evaluate the competitive effect of a merger. Upon the news arrives of an anticompetitive merger, the prices of the rivals of the merging companies will rise, because the rivals will enjoy the benefits of the increased price.

113. Table 2 shows the standardized price changes of four rivals of MCI and WorldCom on the days when the market recorded the effects of three events related to the merger.

Table 2. Evidence from the Stock Market

Event	*AT&T*	*Sprint*	*IXC*	*LCI*	*Portfolio*
10/1/97 WorldCom's offer	-1.2	2.4	1.8	-.5	-0.2
10/15/97 GTE's offer	-1.7	-2.5	0.0	0.2	-2.0
11/10/97 MCI and WorldCom announce merger agreement	2.4	0.8	-0.1	0.8	2.0
Sum of three price changes	0.3	0.6	1.0	0.3	-0.1

Explanation: Each entry is the percentage change in the stock price less the percentage change forecasted from the Capital Asset Pricing Model, divided by the standard deviation. The portfolio is the four stocks weighted by the market values of the companies.

[31] BellSouth *Petition*, p. 18

A standardized price change is not statistically remarkable unless it is greater than 2 in magnitude. The general pattern of changes gives no support to the hypothesis that Wall Street viewed the merger as anticompetitive. AT&T and LCI fell a little when WorldCom announced its offer but Sprint and IXC rose. Sprint lost what it gained, though, when GTE made its offer. Then except for Sprint, stock prices moved in opposite directions when the merger agreement was announced from the direction when the offer was made. The net effect, measured by the sum of the three price changes, is close to zero for each company separately and almost precisely zero for the four companies considered together, as shown in the last column of the table.

114. AT&T and Sprint are vertically integrated rivals of WorldCom and MCI. There is no indication that the merger created expectations of higher prices in their markets—long distance service or fiber capacity. IXC and LCI are rivals mainly in the capacity market. Again, Wall Street did not see higher prices in that market creating opportunities for these rivals.

VI. Discussion of Analyses Performed by the Bells' Experts

A. Professor Jerry Hausman

115. Professor Hausman analyzes the list prices of the major long-distance carriers in a framework similar to the one used by other economists engaged by the Bells. As I showed in Part IV, list prices have as little to do with the prices paid for most purchases in this industry as in many others. AT&T may put a list price of 27 cents on its product, but it gets about 12 cents on the average and customers with any significant long-distance volume have only themselves to blame if they pay more than about 10 cents.

116. Professor Hausman makes the statement, "Furthermore, AT&T did not pass on the recent (July 1997) access rate decreases to its one-rate plan customers or indeed, to any of their residential discount plan customers." (p. 23) It is true that AT&T's bargain One Rate Plus plan remained at 10 cents per minute at all times of the day. But recently, AT&T moved this plan from a status where it was provided only to customers who demanded it to a status where it is actively promoted through $100 switchover checks. Surely one of the reasons that AT&T finds it profitable to promote such a low rate is that its costs have fallen. Further, as Section IV showed, revenue per minute has been declining dramatically, faster than the

decline in access charges. AT&T customers are continuing to enjoy rapidly declining prices, and one of the forces contributing to the rapid decline is diminishing access charges.

B. Professor Richard Schmalensee

117. Professor Schmalensee concludes that there is inadequate competition in long distance.[32] The evidence he cites of inadequate competition is first, that the rising market shares of smaller carriers is a sign of high profit margins; second, that AT&T's list prices have risen rather than fallen since 1993, and that this is true even after incorporating flat-rate plans into the analysis; and, third, that prices for residential service exceed cost.

118. Professor Schmalensee observes that AT&T's market share has fallen steadily, Sprint's and MCI's have been steady, and that smaller carriers have expanded. He reaches the carefully hedged conclusion that this pattern is "consistent with tacit price coordination among the Big Three carriers, or at least with a tight-knit oligopoly" (p. 6). I believe that Professor Schmalensee would agree that any pattern of trends in market shares could be consistent with any type of oligopoly model. For example, in a Cournot model, market shares are controlled by cost differences. Perhaps the smaller carriers have more favorable cost trends than do the established firms. I do not disagree with Professor Schmalensee's use of the word "consistent" but do point out that the trends in market shares are also consistent with a workably competitive market where muscular and active smaller companies are squeezing their way into the market by taking advantage of small cost differentials. The dogs are eating the dogs, and the smaller dogs are gaining weight. My analysis of the long-distance industry in Part IV uses the kinds of data that most economists would rely upon to reach conclusions about the factors explaining changes in market shares, and, in my opinion, strongly supports the competitive model for that purpose.

119. Professor Schmalensee bases his conclusions about residential long-distance prices on the PNR "Bill Harvesting" data. In response to earlier section 271 filings by SBC and Ameritech, and as discussed above in Part IV, Section D, I have shown that these data are badly biased. Professor Schmalensee continues to rely on the biased PNR data without responding to this evidence of bias. I do not believe that the PNR data are usable to measure actual residential prices. Instead, I believe that the best way to measure those prices is by revenue per minute. As I showed in Section IV, revenue per minute has fallen every year

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[32] "BellSouth's Prospects for Success in the InterLATA Market," Declaration of Richard L. Schmalensee, August 18, 1997.

since 1985. It has fallen much faster than access charges and its level is far below theoretical calculations based on price plans and hypothetical distributions of customers among plans.

120. Professor Schmalensee's discussion of AT&T's One Rate plan has been rendered completely obsolete by the One Rate Plus plan, which prices all long-distance calls at 10 cents per minute. This plan was in existence when Professor Schmalensee wrote, but he ignored it. It cannot be ignored today, as AT&T is actively promoting the plan by mailing $100 checks to prospective customers. One Rate Plus is a sure bargain for any of the subscribers considered by Professor Schmalensee on pages 9 and 10 of his affidavit.

121. Professor Schmalensee observes that AT&T earns profits on its sales of long distance—its price is above its cost. Although he does not mention the fact, it is reasonably well known that MCI makes profits as well. Although the long-distance market is workably competitive and delivers substantial and rising benefits to the consumer, it is not perfectly competitive, the standard Professor Schmalensee applies. No industry with intellectual property, brand-name capital, and the other intrinsic features of long distance could ever be expected to have marginal cost equal to price, no matter how much rivalry there is. Professor Schmalensee's findings of marginal cost somewhat below price do not have any implications for policy analysis in general or for the evaluation of the proposed merger.

122. Professor Schmalensee considers low-usage customers, who are well known to pay higher rates per minute for long distance than do other customers. His reliance on the biased PNR data to estimate the fraction of AT&T customers who pay list price probably results in a serious overstatement of this fraction. I believe it is not in dispute that AT&T has retained a substantial fraction of low-usage customers and that the carriers that have expanded since 1984 have done so in part by attracting higher-usage customers. Moreover, as Professor Schmalensee discusses, it is understandable that low-usage customers pay more per minute, because there are important fixed costs of serving a customer. In a competitive industry, prices to each class of customers will reflect the costs of serving the class, including the costs associated with adding a customer, even if those costs do not vary over the customer's usage.

VII. Conclusions

123. I have studied both the level of competition in the long-distance market and the change in competition that would result from the proposed merger of WorldCom and MCI. I believe that the merger would be economically beneficial to the consumers of long distance.

The market is currently substantially competitive. In particular, the evidence suggests that every potentially profitable niche in the market has been pursued vigorously by the hundreds of sellers in the market. Even if the merger created some opportunities for profit—which I do not believe it will—new sellers would enter and existing rivals would expand to eliminate that profit in short order.

124. The merger would be positively beneficial for the consumer because the merged company would achieve lower costs, which would make it an even more vigorous competitor in long distance and in other telecommunications markets. Some of the most important benefits would come from avoiding the use of access services of dominant local phone companies, which are still grossly overpriced.

125. One of the reasons that entry and expansion are easy in long distance is the fluid and competitive market for long-haul fiber capacity, one of the important inputs to long distance. As a result of the smooth operation of that market, the sunk costs facing a potential entrant to long distance are low. A firm can enter long distance easily by purchasing capacity in the market, and, if a disappointment follows, the firm can recover the investment by selling in the market.

126. Although WorldCom and MCI are both operators of long-haul fiber networks today, I do not believe that their merger would have any measurable effect on the price of fiber capacity. The rapid pace of entry today shows not only that there are no important barriers to entry and no important returns to scale, but also that the concentration of the fiber capacity market will fall rapidly in just the next two years. Because the new entrants bring the most advanced low-cost technology, their costs will determine prices starting in the near future. Even if the merger had the potential to raise today's price of fiber capacity—which I do not believe it has—that would only accelerate entry of new sellers in the market.

VIII. About the Author

127. I serve as Professor of Economics at Stanford University and also Senior Fellow at Stanford's Hoover Institution. I received a Ph.D. in economics from the Massachusetts Institute of Technology in 1967. I have been elected a fellow of the American Academy of Arts and Sciences and a fellow of the Econometric Society. I have published 7 books and numerous articles in several areas of applied economics. I have extensive experience in the

economics of telecommunications, computers, and software. Recently I served as an expert for the Department of Justice in its case against Microsoft and in its opposition to Microsoft's proposed merger with Intuit. Further information about my professional activities is in my *curriculum vitae*, which is appended to this declaration.

I, Robert E. Hall, declare under penalty of perjury that the foregoing is true and correct.

Robert E. Hall

Executed January 26, 1998.

US OFFICE PRODUCTS

Attachment D: Route Entries Methodology

Bell Atlantic's Analysis is Flawed. MCI and WorldCom believe the data used in the Bell Atlantic analysis is incomplete and the analytical method very likely yields distorted and incorrect results. MCI and WorldCom believe that Bell Atlantic only counted routes originating from MCI and WorldCom networks and not routes that belong to customers of MCI and Worldcom. The results, therefore, can be significantly skewed for networks with a high percentage of such customers whose routes were excluded. Some of the data is incorrect, as networks can be counted multiple times. An example can be found by choosing the "Total Number of Routes from AS" report, and entering "AS1673" as the network of interest. This shows several networks listed multiple times. It is unclear from the methodology which networks were included in the Bell Atlantic formula and which networks were used to consider the total number of networks being announced by any specific network. More critically, the simplistic counting of route entries in the database, given the route "aggregation" associated with current Internet routing tables, produces very distorted results. The total number of apparent routes is understated, leading to an overstatement of the percentage of routes announced that are attributable to MCI and WorldCom networks. Accordingly, the conclusion that 58% of customer routes on the Internet would be owned by the merged WorldCom and MCI is a significant exaggeration.

WorldCom and MCI Analysis of Route Entries. In the WorldCom and MCI analysis, the number of unique preferred paths in the internet choosing WorldCom or MCI was tabulated. Because of the connectivity of the Internet, a given ISP may appear on many paths linking a source network to a destination network. Accurate information on the number of ASs (Autonomous Systems) to which each North American network is connected is not available. An AS is a collection of routers under one administrative authority. Each Autonomous System is assigned an identifier, an Autonomous System Number (ASN) by the Internet Assigned Numbers Authority (IANA). Most ISPs have at least one, but may have more than one ASN. WorldCom and MCI used the U.S. network registry database RADB (Routing Arbiter Database) data showing connections among Autonomous Systems to guide their analysis. RADB is not yet fully populated and accordingly, data generated for the North American Internet backbone providers is understated. Thus, even in this analysis, the resulting fraction of routes attributable to MCI and WorldCom is, in all probability, overstated. In their analysis, all route entries showing WorldCom or MCI as lying on the preferred path, were attributed to WorldCom or MCI. WorldCom and MCI each separately obtained the route entry information from two different routers on the East Coast of the United States and as a consequence (because routers have a preponderance of localized information) North American route and therefore, path, information is over-emphasized.

Performing the measurements using different routers in North America would yield somewhat different measurements. There may also be some duplication of route entries in the WorldCom and MCI aggregate tabulations. Nevertheless, WorldCom's analysis yielded aggregate route entries of 20.47% for WorldCom and MCI, and MCI's analysis yielded aggregate route entries of 22.43% for WorldCom and MCI, each using unique preferred paths for each network prefix evaluated (for example, 208.192/16) as a route entry.

Counting Route Entries is Not an Appropriate Measure of ISP Market Position. To appreciate why simplistically counting the number of route entries in routing tables is not a reliable indicator of the market position of a given ISP, it is necessary to understand the way in which the routing table functions. In order for the interconnected networks of the Internet to guide traffic properly from source to destination, the routers of all networks need to maintain tables which determine where an Internet packet bearing a given destination IP address is to be forwarded (the so-called "next hop"). The Internet community has arrived at certain procedures to minimize the number of routing table entries required to maximize efficiency of maintaining and exchanging routing information. Counting routing table entries does not give a very good indicator of the size of an ISP's network or the size of the customer base served because each routing table entry may represent a different sized network. Accordingly, a single entry might represent anywhere between 256 and 16 million addresses depending on the size of the network referenced by that route entry. In addition, the measurements represent a snapshot of a specific point in time. For the foregoing reasons, these measurements are almost impossible to duplicate. If the measurements were taken from routers in widely different locations, they are likely to vary, perhaps significantly. However, if the measurements were taken from the same router repeatedly over the course of several days, or routers in relatively close geographic proximity, the measurements are likely to vary only slightly. Given the inability to identify accurately the whole and the technical limitations inherent in measuring the units, WorldCom and MCI believe counting route entries is an inappropriate measure of market position.

US OFFICE PRODUCTS

Attachment E: A Brief History of Internet Addressing Policies

The Internet grew out of the development of the ARPANET which came into being in 1969. A central authority for keeping track of the assignment of addresses and other identifiers was created for ARPANET and, as the Internet emerged in 1983 from its research roots, the responsibility for maintaining the records of address and identifier assignment fell to an entity now called the Internet Assigned Numbers Authority (IANA). This very small organization kept track of Internet Protocol addresses (IP addresses) assigned to the networks of the Internet, as well as domain names (e.g. www.mci.com, www.uu.net).

From the period from 1973 to 1990, the availability and size of the Internet address space was not an issue. As the Internet's geometric growth became apparent, the technical community, principally in the Internet Engineering Task Force (IETF) began to worry about the size of the routing tables needed to determine how to guide traffic from source to destination in the rapidly growing global network.

The routers available have not been well-suited to handling extremely large tables, both because of memory space limitations and also because of the limited processing power available to process large routing table updates from the network. Moreover, large tables imply large update and this consumes transmission capacity which might be better put to work servicing customer traffic.

It was with these limitations in mind that the IETF developed a set of procedures to reduce the effective size of the routing tables, conserving memory and also reducing the capacity needed to move routing table updates around the Internet. These procedures are referenced as Classless Inter-Domain Routing (CIDR) guidelines and their application helps to trim the actual sizes of the routing tables and speed their processing in routers of the Internet.

IANA promulgated recommendations for the assignment of address space by the organizations charged with this responsibility to ISPs and their customers. In essence, the three bodies,[1] which perform address allocation under the oversight of IANA follow the CIDR guidelines as do ISPs, including backbone service providers, making subsidiary assignments to customers.

These guidelines essentially confine ISPs to assign what are called "non-portable" IP address space to customers. This restriction, which requires that address space be returned if a customer changes ISPs helps to keep the routing tables small and compact.

There are exceptions for ISPs and for large customers withbona fide requirement to interconnect with more than one service provider concurrently. Portable address space must be obtained from one of the three Internet Address registries or, in some circumstances, from IANA

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[1]ARIN - American Registry for Internet Numbers in the Americas; RIPE NCC - Reseaux IP Europeenne Network Control Center; APNIC - Asia Pacific Network Information Center.

directly.

MCI and Worldcom/UUNET follow the CIDR guidelines for the benefit of the worldwide Internet community.

Attachment F: A Brief History of Peering, Network Access Points (NAPs) and Internet Exchanges

The earliest Internet had a single backbone, the ARPANET, to which most other Internet networks were connected. Local Nets connected to ARPANET or to the Packet Radio Net(s) or the Atlantic SATNET, which formed the original triumvirate of the primary networks of the Internet. As various U.S. Government agencies built their own networks, these needed to be interconnected and, eventually, rather than using the ARPANET as the primary interconnecting medium, two Federal Internet eXchange points (FIX-East and FIX-West) were established to link the ARPANET with the National Science Foundation Network (NSFNET), Department of Energy's ESNET, and the National Air and Space Administration's NASA Science Internet. These FIX sites were precursors to today's Network Access Points (NAPs).

Protocols were developed which allowed networks that interfaced with each other to exchange routing information using what was called an Exterior Gateway Protocol (EGP) and the procedures for this exchange eventually came to be known as "peering" - as in the exchange of routing information between equals or peers.

As the Internet grew, connectivity among the non-Government networks in the US moved from the ARPANET, which was retired in 1990, to the NSFNET. Essentially, the costs of most of this interconnection was underwritten by the U.S. Government. The NSFNET instituted what it called an Appropriate Use Policy (AUP) to restrict use of the Government-provided interconnection.

By 1990, these restrictions began to interfere with the growing commercial interest in Internet services. To avoid the AUP limitations, a number of Internet Service Providers, notably UUNET and PSINet among others, formed the Commercial Internet eXchange (CIX). This non-profit organization provided facilities for the exchange of traffic among all its members at a site in the San Francisco Bay area. The terms and conditions were simple: all members would accept and send traffic to all other members without additional costs, and each member would underwrite its costs to reach the CIX location.

When the National Science Foundation concluded that it was no longer necessary to provide backbone connectivity, because of the rapid growth of commercial alternatives, it retired the NSFNET in April 1995. In its place, to assure that the Internet would remain "connected", NSF sponsored the formation of several Network Access Points (NAPs) which became neutral meeting points for any networks interested in exchanging traffic. Connection to a NAP did *not* require that all parties exchange traffic - this was left to the ISPs to work out on a bilateral basis at each NAP.

Parties exchanging routing information and traffic at NAPs were said "peer" with each other and the practice has historically not involved any exchange of payment, other than payments to the NAP operator for access to the facility and colocation of ISP equipment on the site.

Attachment G: Amendment No. 3 to Form S-4 of WorldCom, Inc., dated January 22, 1998

(Attached as separate bound document)

As filed with the Securities and Exchange Commission on January 22, 1998
Registration No. 333-36901

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Amendment No. 3 MARKED COPY
to
Form S-4
REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933

WorldCom, Inc.
(Exact name of registrant as specified in its charter)

Georgia	4813	58-1521612
(State or other jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification Number)

515 East Amite Street
Jackson, Mississippi 39201-2702
(601) 360-8600
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)

Bernard J. Ebbers
President and Chief Executive Officer
WorldCom, Inc.
515 East Amite Street
Jackson, Mississippi 39201-2702
(601) 360-8600
(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies To:

P. Bruce Borghardt, Esq.
General Counsel—
Corporate Development
WorldCom, Inc.
10777 Sunset Office Drive, Ste. 230
St. Louis, MO 63127
(314) 909-0990

Don G. Lentz, Esq.
R. Randall Wang, Esq.
Bryan Cave LLP
211 North Broadway, Suite 3600
St. Louis, MO 63102
(314) 259-2000

Allen Finkelson, Esq.
Robert A. Kindler, Esq.
Cravath, Swaine & Moore
Worldwide Plaza
825 Eighth Avenue
New York, NY 10019
(212) 474-1000

Michael H. Salsbury, Esq.
Executive Vice President and General Counsel
MCI Communications Corporation
3301 Pennsylvania Avenue, NW
Washington, DC 20006
(202) 872-1600

Richard I. Beattie, Esq.
Philip T. Ruegger III, Esq.
Simpson Thacher & Bartlett
425 Lexington Avenue
New York, NY 10017
(212) 455-2000

Approximate Date of Commencement of Proposed Sale to the Public: As soon as practicable after this Registration Statement is declared effective.

If the securities being registered on this form are being offered in connection with the formation of a holding company and there is compliance with General Instruction G, check the following box. ☐

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

In connection with authorizing Mr. Roberts to execute the MCI/WorldCom Merger Agreement and the BT Agreement and notwithstanding the oral fairness opinions delivered by MCI's financial advisors with respect to the $50.00 per share WorldCom offer, the MCI Board directed Mr. Roberts to make one final attempt to seek an increase in the consideration proposed by WorldCom in order to fully satisfy themselves that they were obtaining on behalf of MCI's stockholders the highest price reasonably available under the circumstances. The MCI Board meeting was adjourned while Mr. Roberts telephoned Mr. Ebbers and requested that the consideration to be received by MCI stockholders in the proposed MCI/WorldCom Merger be increased. During their conversation Mr. Ebbers agreed (subject to the approval of the WorldCom Subcommittee) to increase the consideration to $51.00 of WorldCom Common Stock (subject to adjustment based on the WorldCom Average Trading Price during the Measurement Period, as described herein).

Subsequently Mr. Roberts reported to the MCI Board on his conversations with Mr. Ebbers. After discussion and consideration, the MCI Board unanimously (with Sir Peter Bonfield, Sir Colin Marshall and Mr. J. Keith Oates not attending due to their relationship with BT) reconfirmed, based on the final pricing terms, its approval of the MCI/WorldCom Merger, the MCI/WorldCom Merger Agreement, the BT Agreement and the transactions contemplated thereby.

Later that evening, the WorldCom Subcommittee met to consider the final pricing terms of the MCI/WorldCom Merger. Salomon Smith Barney rendered an oral opinion (subsequently confirmed in writing) to the effect that, as of such date and based on certain matters stated in such opinion, the consideration to be paid pursuant to the MCI/WorldCom Merger Agreement to the holders of MCI Common Stock and MCI Class A Common Stock was fair to WorldCom from a financial point of view. Based upon the presentations and discussions at the full WorldCom Board meeting, the developments since the full WorldCom Board meeting and the opinion of Salomon Smith Barney rendered to the WorldCom Subcommittee, the WorldCom Subcommittee approved the final pricing terms set forth in the MCI/WorldCom Merger Agreement.

After the requisite approvals were obtained from the BT Board of Directors, on November 9, 1997, the BT Agreement was executed, the MCI/WorldCom Merger Agreement was executed and the BT/MCI Merger Agreement was terminated.

The execution of the MCI/WorldCom Merger Agreement and the BT Agreement, as well as the termination of the BT/MCI Merger Agreement, were publicly announced on November 10, 1997.

WorldCom's Reasons for the MCI/WorldCom Merger; Recommendation of the WorldCom Board

THE WORLDCOM BOARD HAS UNANIMOUSLY DETERMINED THAT THE MCI/WORLDCOM MERGER AND THE SHARE ISSUANCE ARE IN THE BEST INTERESTS OF WORLDCOM AND ITS SHAREHOLDERS AND HAS APPROVED THE MCI/WORLDCOM MERGER AGREEMENT. THE WORLDCOM BOARD UNANIMOUSLY RECOMMENDS THAT THE SHAREHOLDERS OF WORLDCOM VOTE IN FAVOR OF THE SHARE ISSUANCE AT THE WORLDCOM SPECIAL MEETING.

The WorldCom Board believes that the MCI/WorldCom Merger will create a fully integrated communications company that will be well positioned to take advantage of growth opportunities in global telecommunications. The combined company, MCI WorldCom, is expected to have over $30 billion in 1998 pro forma revenues and will provide a complete range of local, long distance, Internet and international communications services. In addition, the WorldCom Board has concluded that the MCI/WorldCom Merger presents significant opportunities for cost savings and operating efficiencies. WorldCom estimates that annual cash operating cost synergies of $2.5 billion are achievable in 1999, increasing to $5.6 billion by 2002. In addition, capital expenditure savings of $2 billion per year are expected in 1999 and beyond. There can, however, be no assurance that any specific level of cost savings or other synergies will be achieved or that such cost savings or other synergies will be achieved within the time periods contemplated.

Set forth below are the synergies originally estimated by WorldCom to be achievable as a result of the MCI/WorldCom Merger (the "Previous Synergy Estimates") and the revised synergy estimates prepared by

WorldCom following the exchange of information between MCI and WorldCom (the "Revised Synergy Estimates"). Both the Previous Synergy Estimates and the Revised Synergy Estimates are net of the expenses WorldCom estimates will be incurred to achieve such savings. WorldCom is in the process of developing its plan to integrate the operations of MCI which may include certain exit costs. As a result of this plan, a charge, which may be material but which cannot now be quantified, is expected to be recognized in the period in which such a restructuring occurs. As described below, the WorldCom Board, in reaching its conclusion, considered the synergies, cost reductions and operating efficiencies expected to be available to the combined enterprise as a result of the MCI/WorldCom Merger and concluded that the transaction presents significant opportunities in that regard. However, as described in the following paragraph and under "Risk Factors," achievement of the expected synergies cannot be assured, and the Board's recommendation was not predicated on the achievement of any specific level of synergies.

The information contained in this section "WorldCom's Reasons for the MCI/WorldCom Merger; Recommendation of the WorldCom Board" was not prepared with a view toward compliance with published guidelines of the SEC or the American Institute of Certified Public Accountants regarding forward-looking information or generally accepted accounting principles and was not examined, reviewed or compiled by independent public accountants and, accordingly, the independent public accountants do not express an opinion or any other form of assurance with respect thereto. The estimates of achievable cost synergies ("synergies") were based upon a variety of estimates and assumptions. The estimates and assumptions underlying the synergies involved judgments with respect to, among other things, future economic, competitive, regulatory and financial market conditions and future business decisions which may not be realized and are inherently subject to significant business, economic, competitive and regulatory uncertainties, all of which are difficult to predict and many of which are beyond the control of WorldCom and MCI and will be beyond the control of MCI WorldCom. There can be no assurance that the synergies will be realized, and actual results may vary materially from those shown. Additionally, the synergies do not reflect revised prospects for WorldCom's, MCI's or MCI WorldCom's businesses, changes in general business and economic conditions, or any other transaction or event that has occurred or that may occur and that was not anticipated at the time such information was prepared. None of the synergies was intended to be a forecast of profits by WorldCom, MCI and MCI WorldCom or any of their directors, and in deciding whether or not to approve the MCI/WorldCom Merger, shareholders of WorldCom and stockholders of MCI should not put undue reliance upon any such synergies. Neither WorldCom nor MCI has updated or supplemented this information or intends to do so. This section contains "forward looking statements" within the meaning of the PSLRA. See "Cautionary Statement Regarding Forward-Looking Statements" and "Risk Factors."

Estimates of Achievable Cost Synergies

Previous Synergy Estimates

	Fiscal Year Ended December 31,			
	1999	2000	2001	2002
	(Dollars in Billions)			
Network synergies and avoided local losses	$1.5	$2.0	$2.7	$3.2
Core SG&A	0.9	1.0	1.1	1.2
Total pre-tax cash operating synergies	$2.4	$3.0	$3.8	$4.4
As a % of combined revenues	6%	6%	7%	7%
As a % of combined operating expenses	8%	8%	9%	9%
Capital expenditure savings	$1.5	$1.6	$1.5	$1.5
As a % of combined revenues	4%	3%	3%	2%
As a % of combined capital expenditures	20%	21%	19%	18%

Revised Synergy Estimates

	Fiscal Year Ended December 31,			
	1999	2000	2001	2002
	(Dollars in Billions)			
Network synergies and avoided local losses	$1.6	$2.6	$3.5	$4.4
Core SG&A	0.9	1.0	1.1	1.2
Total pre-tax cash operating synergies	$2.5	$3.6	$4.6	$5.6
As a % of combined revenues	6%	8%	8%	8%
As a % of combined operating expenses	8%	10%	11%	12%
Capital expenditure savings	$2.0	$2.0	$2.0	$2.0
As a % of combined revenues	5%	4%	4%	3%
As a % of combined capital expenditures	26%	26%	24%	23%

The Previous Synergy Estimates were developed by WorldCom prior to October 1, 1997 based on publicly available information, WorldCom's general knowledge of the telecommunications industry and WorldCom's experience in prior merger and acquisition transactions. The Revised Synergy Estimates were developed subsequently by WorldCom following an exchange of information between MCI and WorldCom and discussions between the companies' respective management teams. As a result of the information obtained by WorldCom and the discussions with the MCI management team, the Revised Synergy Estimates include certain new categories of potential savings, such as cost savings relating to the elimination of duplicated information technology costs. In addition, categories of savings included in the Previous Synergy Estimates were revised by WorldCom in light of improved knowledge about MCI's business and prospects.

The Previous Synergy Estimates and the Revised Synergy Estimates are net of the expenses WorldCom believes will be incurred to achieve the estimated costs synergies.

Network Synergies and Avoided Local Losses. In both the Previous Synergy Estimates and the Revised Synergy Estimates, network synergies and avoided local losses were anticipated to be realized in three areas: reduced domestic network costs, reduced cost of terminating international traffic and avoided costs in MCI's local activities.

Reduced domestic network costs. As a result of WorldCom's existing extensive local network, the combined company will carry an increased proportion of its domestic traffic on its own local network facilities resulting in a reduction in leased line costs and access costs associated with switched traffic. By combining WorldCom's and MCI's traffic, a reduction in variable network costs such as In-WATS, Out-WATS and directory services are expected as a result of the combined company's greater purchasing power. Assumptions used by WorldCom to estimate the magnitude of potential cost savings in this area included: (i) the magnitude of MCI's and WorldCom's projected costs for terminating traffic domestically; (ii) the mix of these costs between different categories such as access, direct access lines and leased lines, Out-WATS and In-WATS, and entrance facilities; and (iii) the proportion of the projected costs that net of implementation costs could be eliminated as a result of combining MCI's and WorldCom's activities.

Reduced cost of terminating international traffic. MCI currently has more extensive settlement agreements for international traffic than does WorldCom. The combined company will benefit from these settlement agreements. In addition, as a result of construction of transatlantic facilities and network facilities in Europe, the combined company will be able to lower MCI's average costs of terminating certain traffic in Europe. Assumptions used by WorldCom to estimate the magnitude of potential costs savings in this area included: (i) the magnitude of MCI's and WorldCom's projected costs for terminating traffic overseas on a country-by-country basis; (ii) the magnitude of MCI's and WorldCom's projected international traffic on a country-by-country basis; and (iii) the proportion of MCI's international traffic that could be carried on WorldCom's facilities in Europe.

Avoided costs in MCI's local activities. As a result of WorldCom's existing extensive local network and operations, the combined company will be able to execute MCI's plans to expand in the local

market at a lower cost than MCI would be able to on a stand-alone basis. The combined company will avoid the need to duplicate certain sales, marketing and administrative functions and will have reduced network costs resulting from the more rapid transfer of traffic to the combined company's network facilities. Assumptions used by WorldCom to estimate the magnitude of potential cost savings in this area included: (i) the projected operating costs associated with MCI's plans to expand its presence in the local market; and (ii) the proportion of these costs that net of implementation costs could be avoided by combining MCI's and WorldCom's businesses.

Comparing the Previous Synergy Estimates and the Revised Synergy Estimates, network synergies and avoided local losses increased by $100 million in 1999 and by $1.2 billion in 2002. These changes occurred as a result of a substantial increase in estimated reduced costs of terminating international traffic and a modest increase in reduced domestic network costs offset by a modest reduction in avoided costs in MCI's local activities.

Core SG&A. The increased scale of activities in the combined company's operations will result in opportunities to reduce costs by avoiding expenditures on duplicative activities, greater purchasing power and the adoption of best practices in cost containment across the combined company resulting in a reduction in core sales, general and administrative expenses. Assumptions used by WorldCom to estimate the magnitude of potential cost savings in this area included: (i) the magnitude of MCI's and WorldCom's sales, general and administrative expense by category such as sales, accounting and finance and information services; and (ii) the proportion of the projected costs that net of implementation costs could be eliminated as a result of combining MCI's and WorldCom's activities, based in part on a comparison to other comparable companies' levels of sales, general and administrative expenses as a percentage of sales.

Core sales, general and administrative cost synergies did not change materially between the Previous Synergy Estimates and the Revised Synergy Estimates.

Capital Expenditure Savings. Capital expenditure savings are expected to be realized primarily in three areas: domestic long distance network activities, local network buildout and information technology. Capital expenditures relating to the combined company's long distance activities will be reduced primarily as a result of avoided duplicative fixed capital expenses and the cost benefits realized from greater purchasing efficiencies. Capital expenditures relating to the combined company's local and information technology activities will be reduced primarily as a result of avoided duplicative capital expenditures. Assumptions used by WorldCom to estimate the magnitude of potential cost savings in this category included: (i) the magnitude of MCI's and WorldCom's long distance, local and information technology related capital expenditures; and (ii) the proportion of the projected costs that net of implementation costs could be eliminated as a result of combining MCI's and WorldCom's activities.

Comparing the Previous Synergy Estimates and the Revised Synergy Estimates, capital expenditure savings increased by approximately $500 million per year primarily as a result of significant anticipated savings in the area of information technology that were not included in the Previous Synergy Estimates and a modest increase in anticipated long distance network savings. In the Revised Synergy Estimates, in 1999 approximately 45% of total capital expenditure savings relate to long distance, 35% to local and 20% to information technology. In 2002, approximately 65% of total capital expenditure savings relate to long distance, 15% to local and 20% to information technology.

Specific business strategies necessary to realize the anticipated cost synergies will include: (i) coordinating the purchasing activities of the combined company to ensure that potential purchasing efficiencies are achieved, (ii) coordinating network operations to ensure that to the extent economically attractive traffic is carried on the network of the combined company domestically and overseas, (iii) coordinating local activities of the combined company to eliminate unneeded duplication, (iv) adopting best practices in cost control throughout the combined company, and (v) coordinating capital expenditure programs of the combined company to eliminate unneeded duplication.

The combined company would be the second largest long distance carrier in the United States. The combined company would begin operations with one of the industry's strongest bases of business customers and more than 22 million small business and residential customers.

The WorldCom Board believes that the MCI/WorldCom Merger would create a company strongly positioned to fulfill the promise of the Telecom Act and accelerate the onset of competition in local telecommunications. WorldCom believes that the combined company can expand further and faster into local service areas now dominated by incumbent local exchange carriers than either company could on a stand-alone basis because of the efficiencies that WorldCom believes the combined company will achieve through, among other things as described above, reduced capital expenditures in the deployment of the same amount of, or more, network capacity than the total of what the two companies would deploy on a stand-alone basis. The new company would offer local service over its own facilities, including more than 9,000 route miles of local fiber, in more than 100 markets.

MCI WorldCom, with offices in 65 countries, would be the second largest carrier of international voice traffic in the world. The WorldCom Board believes that the combination of WorldCom and MCI will position MCI WorldCom as a powerful competitor in the $670 billion global telecom industry.

MCI WorldCom would bring together the Internet expertise of UUNET and MCI to create one of the world's largest providers of Internet services. The company's advanced portfolio of Internet/data services would include access, web hosting and development, intranet applications as well as high-speed virtual data services.

The WorldCom Board believes that MCI WorldCom would provide global customers with unparalleled networking strength and more than 20 years of experience in systems integration, superior outsourcing capabilities and technology support and implementation.

For the foregoing reasons, the WorldCom Board believes that the terms and conditions of the MCI/WorldCom Merger Agreement are in the best interests of WorldCom and its shareholders. In reaching its conclusion, the WorldCom Board considered, among other things, (i) the judgment, advice and analyses of its management, (ii) the judgment and advice of, and the analyses prepared by, Salomon Smith Barney, (iii) the financial condition, results of operations and cash flows of WorldCom and MCI, both on a historical and a prospective basis, (iv) the synergies, cost reductions and operating efficiencies that should be available to the combined enterprise as a result of the MCI/WorldCom Merger, (v) the many management challenges associated with successfully integrating the businesses of two major corporations (along with BFP, CompuServe and ANS), (vi) the strategic benefits of the MCI/WorldCom Merger and the current and anticipated environment in the telecommunications industry and the other strategic options available to WorldCom, (vii) the terms and conditions of the MCI/WorldCom Merger Agreement, (viii) historical market prices and trading information with respect to WorldCom Common Stock and MCI Common Stock, (ix) the terms and conditions of the BT Agreement, (x) the significant worldwide enhancement of the market position of the combined enterprise, (xi) the likelihood of receiving regulatory clearance for the MCI/WorldCom Merger, (xii) the business and financial information received by WorldCom from MCI following the execution of confidentiality agreements between the companies, (xiii) current industry, economic and market conditions, (xiv) the corporate governance arrangements set forth in the MCI/WorldCom Merger Agreement, including that WorldCom directors (including directors designated by WorldCom from among pending acquisitions by WorldCom) would constitute two-thirds of the Board of Directors of the combined company and that Mr. Roberts would serve as Chairman of the Board of the combined company and Mr. Ebbers would serve as Chief Executive Officer of the combined company, and (xv) the percentage ownership of the combined company to be owned by shareholders of WorldCom, and the potential variation in the Exchange Ratio based upon changes in the price of WorldCom Common Stock.

The foregoing discussion of the information and factors considered by the WorldCom Board is not intended to be exhaustive but is believed to include all material factors considered by the WorldCom Board. In view of the variety of factors considered in connection with its evaluation of the proposed MCI/WorldCom Merger, the WorldCom Board did not find it practicable to and did not quantify or otherwise assign relative weights to the specific factors considered in reaching its determination.

Attachment

Affidavit of Dennis W. Carlton and Hal S. Sider

AFFIDAVIT OF DENNIS W. CARLTON AND HAL S. SIDER

Before the Florida Public Service Commission
Docket No. 971604-TP

February 27, 1998

1. We are the authors of the declaration submitted to the Federal Communications Commission on January 25, 1997 on behalf of WorldCom and MCI. That declaration evaluates competitive conditions in the provision of local exchange service, long distance service and Internet services and assesses the likelihood that the proposed merger between WorldCom and MCI will adversely affect competition in the provision of these services. Based on our analysis, we concluded (at ¶4): (i) that the proposed transaction creates potentially large benefits to consumers; and (ii) that it is highly unlikely that the proposed transaction will adversely affect competition in light of the rapid entry, expansion and technological changes now taking place in the telecommunications industry.

2. We have been asked by counsel for WorldCom and MCI to evaluate and to respond to the Affidavit submitted by Robert G. Harris on behalf of GTE Corporation on February 10, 1997 to the Florida Public Service Commission. Prof. Harris claims that "the merger is likely to harm both GTE and Florida consumers." This declaration presents a preliminary response to several of the major claims made by Prof. Harris. While it is not possible to evaluate all such claims in the brief time available for a reply, our review indicates that Prof. Harris has misinterpreted and mischaracterized several key characteristics of the telecommunications industry that relate to the potential impact of the proposed transaction on competition.

3. Our FCC declaration addresses many of these issues in some detail. Other claims made by Prof. Harris, particularly those relating to interexchange pricing, are addressed in the Declaration of Robert Hall filed before the FCC on behalf of WorldCom and MCI on January 25, 1997 and are not addressed below. This affidavit, however, highlights only a few of the major problems in Prof. Harris' analysis, including his claims regarding: (i) barriers to entry and expansion; (ii) the competitive significance of new entrants; (iii) the provision of service in Florida by entrants; (iii) the significance of AT&T in the wholesale long

distance industry; (iv) competition in interexchange service; and (v) recent increases in the stock prices of telecommunications firms. As we explain below, even these few problems show that Prof. Harris' analysis does not support his conclusions. We also present some additional comments on other aspects of Prof. Harris' analysis.[1]

BARRIERS TO ENTRY AND EXPANSION

4. Prof. Harris claims (p. 11) that "[t]he supply of interexchange services is characterized by substantial barriers to entry. The first significant barrier to entry is the need for substantial capital and human resources outlay to provide the services and features that customers demand."

5. This statement reflects a misunderstanding of the concept of entry barriers and is contradicted by the massive entry and expansion in capacity now occurring throughout the telecommunications industry. Barriers to entry are usually defined as a cost that must be incurred by a new entrant that incumbents do not (or have not had to) bear. This widely-accepted definition, generally credited to George Stigler, means that barriers to entry do not necessarily exist just because entry is costly.[2] The fact that entry into an industry is "expensive" does not imply that it is likely that the industry suffers from competitive problems and above-competitive prices. Access to capital markets ensures that even high entry costs cannot prevent the entry that precludes supracompetitive pricing.

6. The massive entry now occurring into the provision of various telecommunication services is documented in our FCC declaration. This includes the construction of nationwide, high capacity fiber optic networks by Qwest, IXC, Williams Co., and Level 3 as

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1. Our failure to address below other claims made by Prof. Harris does not suggest that we agree with Prof. Harris' analysis or his interpretation of available data. Instead, it merely reflects our desire to focus on a few of the main shortcomings of Prof. Harris' analysis in the short time available to us to prepare a response.

2. See the discussion of entry barriers in Carlton's textbook (with J. Perloff), Modern Industrial Organization, p. 110. Stigler discusses this general definition in his book The Organization of Industry (1968).

well as more limited entry by others. These major entrants are all highly credible, are well-financed, and are managed by individuals with significant industry experience. These new networks generally contain more fiber capacity and more sophisticated electronics than the networks now in place. In addition, significant portions of the Qwest and IXC networks have been sold to major telecommunications firms such as GTE and Frontier that will independently own, operate and market the capacity they own. Thus, the count of new networks understates the increase in the number of new firms participating in the market.

7. News reports in the few weeks since our declaration has been filed provide additional examples of entry and expansion. AT&T, for example, recently announced that it will use new technology from Lucent to double the capacity of its network by the end of 1998[3] and to increase its capacity "by a factor of 10 over the next few years."[4] Williams Co., which previously announced an investment of $2.7 billion for construction of a 32,000 route-mile national fiber optic network, recently announced plans to accelerate the deployment of its network.[5]

THE COMPETITIVE EFFECTIVENESS OF ENTRANTS AND SMALLER NETWORKS

8. Prof. Harris' claim that the merger of WorldCom and MCI will adversely affect competition in the provision of wholesale long distance services rests on his view that "[c]arriers with regional or limited networks cannot provide adequate competition to check the anticompetitive effects of the proposed merger." (p. 10) To support this claim, Prof. Harris cites data on the geographic coverage for entrants into long distance services and the fact that they now have fewer points of presence (POPs) than the largest national networks, AT&T, MCI and Sprint.

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3. Wall St. Journal, January 27, 1998, p. B6.

4. New York Times, January 27, 1998, Section D, p. 1.

5. PR Newswire, Williams press release, February 11, 1998.

9. Prof. Harris' suggestion that networks smaller than AT&T, MCI and Sprint "cannot provide adequate competition" is at odds with his own analysis of the importance of the competitive significance of WorldCom. Prof. Harris notes that even today WorldCom has many fewer POPs than AT&T, MCI and Sprint, and that WorldCom served far fewer POPs as recently as 1996. For example, Exhibit 2 to Prof. Harris' affidavit shows that WorldCom has 162 POPs today, while Sprint has 399, MCI has 582 and AT&T has 715. Prof. Harris' Exhibit 17 shows that as recently as 1996, WorldCom had only about 110 POPs.

10. Nonetheless, Prof. Harris emphasizes throughout his report that WorldCom has played a significant role in promoting competition in the industry. For example, he claims that, "[a]cting as the industry 'maverick,' WorldCom has helped spur the growth of the interexchange resale segment and its concomitant check on anticompetitive behavior by the Big Three." (p. 7) Prof. Harris cannot have it both ways. Clearly, networks like WorldCom's that are smaller than those of AT&T, MCI, and Sprint can significantly affect competition. Thus, there is every reason to think that the large and sophisticated entrants now investing billions in deploying new networks also will be effective competitors.

11. Prof. Harris also emphasizes GTE's reliance on WorldCom in providing wholesale services and that other network providers cannot provide comparable service. He states that "GTE must be able to maintain a strong relationship with a national facilities-based interexchange carrier. WorldCom is exactly that carrier." (p. 22)

12. Again, this claim is inconsistent with Prof. Harris' assertion that networks without the geographic coverage of AT&T, MCI and Sprint cannot be effective competitors. Moreover, this claim is not supported by the experience of other resellers. For example, Excel, perhaps the nation's largest reseller, relies extensively on "second tier" providers of wholesale service. Until 1996, Excel purchased much of its transmission from Frontier. At that time, Excel entered into a contract with IXC, which now carries a substantial portion of

Excel's traffic, and uses other carriers as well.[6] This suggests, contrary to Prof. Harris' assertion, that resellers can be sophisticated buyers that can assemble the necessary geographic coverage by relying on smaller networks.

13. Finally, Prof. Harris mischaracterizes the scope and coverage of new networks and the speed with which they can expand. He claims, for example, that Qwest and IXC "have relatively few points-of-presence" and that "Qwest's own network reaches from San Francisco to Columbus, OH." (p. 7) The data he reports, however, indicate that Qwest already has more than 100 POPs and that IXC has in excess of 75. (As noted above, Prof. Harris' data indicate that WorldCom today has 162 and as recently as 1996 had only 110 or so.) Moreover, construction of the Qwest and IXC networks is not complete. Deployment of Qwest's nationwide network is expected to be completed in the second quarter of 1999 and deployment of IXC's nationwide network is expected to be completed by the end of next year. Thus, Prof. Harris' data suggest that these entrants already have a significant competitive presence and that their competitive significance will increase in the near future.

PROVISION OF SERVICE IN FLORIDA BY ENTRANTS

14. Prof Harris claims that new entrants, particularly Qwest and IXC, will not soon "provide adequate competition" for Florida consumers. (p. 9) For example, Prof. Harris claims that the Qwest and IXC networks "are quite far from being fully built" (p. 9) and that "these new networks . . . are designed to provide bulk transport between large metropolitan areas, with only limited capacity to serve other areas of the country." (p. 9) He also claims that "the interexchange carriers' coverage of Florida is simply a more extreme form of the national pattern."[7] (p. 10)

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6. Excel Communications, Form 10-K for December 31, 1996; IXC 10-K, December 31, 1996.

7. Prof. Harris' summary of interexchange carriers' POPs in Florida in Exhibit 7 to his affidavit identifies three IXC POPs and no Qwest POPs.

15. Prof. Harris, however, fails to adequately describe the entry now occurring Florida. For example, both Qwest and IXC have announced that they will begin providing service throughout Florida during 1998. Qwest has announced that service will begin on September 14, 1998 in Jacksonville, Daytona Beach, Melbourne, West Palm Beach, Fort Lauderdale and Miami. Service in Orlando and Tampa is scheduled to begin in November 1998.[8] Similarly, IXC is scheduled to begin service in Miami, Orlando, Tallahassee and Tampa in the fourth quarter of 1998.[9]

16. Prof. Harris' review of the competition among network providers in Florida also fails to mention Interstate FiberNet, which owns and operates fiber optic assets and manages and markets fiber optic assets owned by utility companies, including Florida Power and Light. Interstate Fibernet operates in Florida and other southeastern states, providing a variety of wholesale telecommunication services to other carriers.[10] The company currently provides service in Miami, Ft. Lauderdale, West Palm Beach, Ft. Myers, Jacksonville, Sarasota, Tampa, Orlando, Ocala, Gainesville and Tallahassee. Interstate Fibernet has announced that between now and September it will be deploying service in Daytona, Homestead, Hollywood, Vero Beach, Melbourne, Cocoa Beach, Port Charlotte, and St. Augustine.[11]

17. In sum, these examples indicate that, contrary to Prof. Harris' suggestion, large scale entry is now occurring in both major and secondary Florida cities.

AT&T'S ROLE IN THE PROVISION OF WHOLESALE SERVICE

18. Prof. Harris claims that "the proposed merger would have a disproportionate effect on the resale segment of the interexchange market. Importantly, AT&T does not

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8. Qwest, Planned POP Network, route map distributed at [cite industry trade show] dated February 2, 1998.

9. Conversation with D. Weymouth of IXC Communications.

10. http://www.itcdeltacom.com/ifn.html, http://www.itcdeltacom.com/dec9.html.

11. Interstate FiberNet Fiber Optic Network route map, February 1, 1998.

compete to a great extent in resale segments, which reduces effective supply for resellers from three carriers to two." (p. 19) Prof. Harris' claim (which he supports with Exhibits 27 and 28 to his affidavit) is based on data from a February 1996 study from Atlantic-ACM, a firm that publishes research on the telecommunications industry.

19. First, the 1996 data cited by Prof. Harris report AT&T had a 12 percent share of services sold to resellers that do not own switches. This figure was based on a survey of various resellers and was constructed using unweighted averages of the purchasing shares of the surveyed resellers that do not own switches. The more appropriate revenue-weighted share for AT&T was 37 percent.[12] Indeed, Atlantic-ACM noted in the report cited by Prof. Harris that a revenue-weighted figure, not an unweighted figure like that used by Prof. Harris, "more accurately depicts the wholesale usage . . ." Thus, the 1996 survey cited by Prof. Harris indicates that AT&T played a significant role in serving this group of customers.

20. Atlantic-ACM presented more recent estimates of AT&T's role in the wholesale marketplace in a 1997 report.[13] This survey reports AT&T's revenue-weighed share for (i) private line (e.g., transport-only) services; (ii) switched services (in which AT&T and others provide both transport and switching).[14] These more recent Atlantic-ACM data indicate that AT&T accounted for 38 percent of private line sales, indicating that, contrary to Prof. Harris'

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12. Consider a simple example in which Reseller 1 purchases all its wholesale capacity from AT&T, while the remaining 99 resellers each purchase all their capacity from MCI. Prof. Harris would calculate AT&T's share as the unweighted average of 1 percent (=100/100). Such an unweighted average will not accurately reflect AT&T's importance if all resellers are not equal in size. For example, suppose that Reseller 1 has $1 billion in sales while Resellers 2 through 100 sell virtually nothing. In such a case, AT&T's share should be based on the revenue-weighted average and would approach 100 percent.

13. Atlantic-ACM 1997-98 Interexchange Services Market Sizing and Share Analysis, July 1997.

14. These categories do not correspond precisely to those used in Atlantic-ACM's 1996 report. We understand that much of private line services are purchased by facilities-based resellers (that provide, at least in part, their own switching); switched wholesale services are purchased by resellers that do not perform any of their own switching and by facilities-based carriers for areas in which they do not have switches.

claim, AT&T plays a significant role in providing this type of wholesale capacity. With respect to the provision of switched services, the Atlantic-ACM data indicate that AT&T is among a large number of wholesale suppliers. These figures indicate that firms other than AT&T, Sprint, MCI and WorldCom account for nearly 40 percent of such sales. Again, Prof. Harris' claim that the proposed transaction "reduces effective supply for resellers from three carriers to two" is not supported by the data.

21. More fundamentally, however, Prof. Harris' claim that AT&T is not a significant participant in reselling wholesale capacity is inexplicable given the fact that MCI, Sprint, and WorldCom each grew up reselling AT&T capacity. Ironically, Prof. Harris emphasizes this precise history in another section of his affidavit, where he states that "[w]hen MCI and Sprint first entered, they supplemented their own facilities with resold AT&T service in order to offer national coverage. Similarly, WorldCom was first a reseller ..." (p. 12)

COMPETITION IN INTEREXCHANGE SERVICES

22. Prof. Harris claims that "the interexchange industry exhibits classic characteristics of oligopolistic competition." While he summarizes various arguments that have been presented to support this proposition, he fails to address the extensive and detailed responses to these arguments that have been presented. These issues have most recently been presented in the BOCs' applications to provide long distance service under Section 271 of the Telecommunications Act of 1996 and the responses to the applications filed by others.

23. More generally, however, simple analyses of market structure and performance in an industry fail to address the relevant question in merger analysis, which is: "Will the proposed transaction adversely affect competition?" None of the evidence presented by Prof. Harris directly addresses this question. While Prof. Harris acknowledges (p. 4) that he does "not believe that there is an automatic link from industry structure to firm conduct, and in turn from conduct to outcomes," he does not present the results of any economic study that suggests that the changes in concentration associated with this transaction will adversely

affect competition. Prof. Harris' use of HHIs is at best only a first step in any such analysis. An analysis of the effect of a merger on competition needs to address forward-looking considerations, including entry conditions and the growth of industry capacity. As described above, Prof. Harris has mischaracterized the extensive entry and expansion in capacity now occurring in the industry nationwide and in Florida.

STOCK MARKET PERFORMANCE

24. Prof. Harris notes (p. 24) that "[t]he stock market valuations of both the merging parties and their facilities-based competitors have rocketed between the time of the announcement and the present date . . . suggesting that [the merger] is highly anticompetitive." Such a conclusion cannot be based on the stock market evidence presented by Prof. Harris. It is simply impossible to attribute stock market performance over a period of several months to one event: here, the alleged anticompetitive effects of this transaction. A large number of factors contribute to stock market performance over such an extended period. Indeed, it is standard practice in the finance literature to look at much shorter time horizons (at most a few days) to isolate the effect of some event. (Such studies are called "event" studies.)

25. Our analysis of the history of stock price changes for AT&T on a daily basis over recent months illustrates the fallibility of Prof. Harris' analysis.[15] Using standard methods of analysis for event studies, our analysis shows that AT&T's stock price fell relative to the market on October 1-2, the two days following the announcement of the proposed WorldCom/MCI merger. This result is inconsistent with Prof. Harris' claim. Instead, other factors appear to account for the increase in AT&T's stock price over the last few months. For example, AT&T's stock price increased (on a net-of-market basis) by roughly 13 percent in the days surrounding its announcement of a new Chief Executive Officer on October 20.

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15. AT&T's market capitalization exceeds the sum of that for all other firms considered by Prof. Harris.

Similarly, AT&T's stock price rose 8 percent following reports on November 18 that a cost-cutting plan would be implemented. In sum, a closer examination of the stock market performance of industry leader AT&T fails to support Prof. Harris' claim that the alleged anticompetitive effects of the proposed transaction caused AT&T's share price to rise over this period.

FINAL COMMENTS

26. Three brief final points regarding Prof. Harris' analysis are worthy of note:

- Prof. Harris acknowledges that a merger between interexchange providers and entrants into local service can generate significant economies of scope. (p. 11) As emphasized in our prior declaration, these are precisely the type of efficiencies that are likely to be realized as the result of the combination of MCI's interexchange service with WorldCom's local services.
- Prof. Harris does not claim that the proposed transaction will adversely affect competition in the provision of local services.
- While Prof. Harris stresses GTE's role as a reseller (and its reliance on WorldCom as a supplier of wholesale capacity), he fails to discuss in any detail GTE's entry as a network operator through acquisition of a substantial portion of capacity throughout the Qwest Network. As noted in our earlier declaration, current GTE advertisements herald its new role as a national supplier of network services.

Dennis W. Carlton

Dennis W. Carlton

Hal S. Sider

Hal S. Sider

Subscribed and sword to me,
this 27th day of February, 1998

Margaret J. Funk

Notary Public

My Commission expires: 7-26-99

[redacted]

Attachment

GTE announcement of Qwest network acquisition

For media information contact:
Sharon Cohen-Hagar, 203/965-3188 (after 6 p.m. 203/849-8728), GTE
Bob Brand, 972/718-4945 (after 6 p.m. 972/317-0926)

For customer inquiries:
Please visit our Customer Care Page

GTE Announces Initiatives to Become a Leading National Provider of Telecommunications Services -- Will Acquire BBN In Transaction Valued At $616 Million -- Purchases Fiber-Optic Network From Qwest -- Creates A New National Sales Service and Marketing Company --

May 6, 1997

GTE today announced a series of steps to position itself as a market-leading, national provider of integrated telecommunications services, according to GTE Chairman and Chief Executive Officer Charles R. Lee, including a comprehensive plan to enter the $100 billion market for value-added data communications services -- the fastest-growing segment of the telecommunications industry.

The actions include the acquisition of BBN Corporation, a leading provider of end-to-end Internet solutions; a strategic alliance with Cisco Systems, Inc. to jointly develop enhanced data and Internet services for customers; and, the purchase of a national, state-of-the-art fiber-optic network from Qwest Communications. Also included is the creation of a new, deregulated unit to market integrated voice, video and data solutions both within and outside GTE's current markets.

"The actions announced today clearly position GTE to have the fastest, most reliable and most secure national network available, enabling end-to-end managed network solutions that we believe will be unmatched in the industry," said Lee.

In detailing its data plan, GTE said the moves announced today will enable it to:

- Develop innovative and value-added communications services to meet customer needs, especially in the fast-growing Internet-services market;
- Create a broadband, national backbone network based on SONET self-healing fiber rings; and
- Rapidly deploy "next generation" value-added services and Internet Protocol offerings.

"Simply put, GTE will become a leading national 'one-stop' provider of local, long distance, Internet and wireless services, and will establish an advanced data network that will be fully operational next year," said GTE President Kent B. Foster. "At that point, we will be in a position to reach virtually the entire U.S. population."

GTE/BBN

Under the terms of the transaction, which was approved by the Boards of Directors of both companies, GTE will shortly commence a cash tender offer to acquire all the outstanding

shares of BBN common stock at a price of $29 per share. Based on the number of shares of BBN stock currently outstanding, the equity portion of the transaction is valued at approximately $616 million. As soon as practicable following the conclusion of the tender offer, GTE will initiate a merger through which any remaining shares of BBN not owned by GTE will be converted into cash at the cash tender offer price in the merger.

Cambridge, Mass.-based BBN is a leading provider of high performance end-to-end Internet solutions such as World Wide Web site hosting, network security, consulting, systems integration, and dedicated and dial-up Internet access for government and commercial customers. Its 2,200 employees have extensive experience in leading-edge Internet and other telecommunications applications. Twenty-eight years ago, BBN created ARPANET, the forerunner of the Internet.

"GTE will jump-start its entry into the enhanced Internet services market for large businesses through the acquisition of BBN," said Foster.

George H. Conrades, chairman and chief executive officer of BBN said, "This business combination is a perfect strategic fit. The Internet opportunity, characterized by the convergence of computers and communications, is the fastest-growing economic endeavor in human history. GTE is today declaring its strategic intent to be a leading player in this important opportunity, backed up by plans for significant investment and alliances. BBN has been chosen to be the cornerstone of GTE's new strategy. We bring needed Internet skills, a suite of offerings and a business customer base.

"At the same time, we will be able to take advantage of GTE's strong brand image, distribution, network expansion plans and financial resources. Today, no one player in this industry has all the piece parts necessary for customer and competitive success. It's a game of scale and financial resources, as well as specialization and innovation. With this announcement, GTE, with BBN, is off to a great start," Conrades said.

GTE/Cisco

GTE and Cisco announce their intention to jointly develop enhanced internetworking capabilities to power GTE's network. Beyond the network infrastructure, the companies have committed to deliver targeted, turn-key, bundled solutions of applications, equipment installation, maintenance and telecommunication services.

"Cisco is the leading provider of Internet-related networking services. Its skill sets perfectly complement those of GTE, and we are pleased to enter into this long-term, mutually beneficial strategic relationship," said GTE's Foster.

"This combination will create a fundamentally new offering in the marketplace," said John Chambers, president and chief executive officer at Cisco Systems, Inc. "GTE will have leadership capabilities to provide integrated end-to-end services across all layers of the network such as multimedia, quality and security. The relationship will accelerate the deployment of these and other services through the alignment of our core competencies."

GTE/Qwest

Denver-based Qwest Communications Corp. is constructing a fiber-based national backbone network which will be equipped with state-of-the-art opto-electronics. The network will span 13,000 miles, connecting 92 metropolitan areas, including Atlanta, Chicago, Los Angeles, New York, San Francisco and Washington, D.C. In an agreement announced Monday, GTE will acquire 24 dark fibers, and certain associated facilities, in the new Qwest network.

"When completed in 1998, the network will provide the foundation for a myriad of

high-speed data communication services. GTE's network will greatly reduce the high upfront cost of today's private data networks, making advanced data communications more affordable for a greater segment of the population," Foster stated.

"We are extremely pleased with GTE's acquisition of dark fiber on the Qwest network route," said Joe Nacchio, president and chief executive officer of Qwest.

GTE Restructures Telephone Operations,

Creates New National Sales, Service and Marketing Company

As part of the company's plan to capture new growth, GTE restructured its Telephone Operations unit, Foster said.

To move with greater flexibility to capture growth opportunities in the telecommunications marketplace, GTE created an unregulated sales, service and marketing unit to offer an integrated package of local, long distance, Internet and wireless services nationwide, regardless of GTE's traditional market boundaries.

This new unit will operate as a competitive local exchange carrier (CLEC), offering targeted customers premium servicing capabilities and packaged products beyond what is currently available in the marketplace today.

Foster also announced the following realignment of key responsibilities: Thomas W. White, 51, has been named corporate executive vice president-market operations, reporting to Foster. He will assist the GTE president in coordinating the activities of the below-mentioned business units and also will be responsible for leading the company's overall data thrust. White has served as president of GTE Telephone Operations since July 1995.

Also reporting to Foster are the following newly appointed individuals:

- Lew Wilks, 43, has been named president of GTE's new national sales, service and marketing unit. This new retail business unit will offer a bundled package of premium telecommunications services to business and residential customers both within and outside GTE's current franchise areas. Wilks previously served as president, business markets, since July, 1996.
- John Appel, 48, has been named president of GTE's current regulated local exchange operations. Appel will continue work already underway to enhance quality and customer service and to preserve and grow GTE's current in-franchise, regulated business. Appel was appointed to his previous position, executive vice president-Network Operations, in January 1996.
- Jerry Dinsmore, 47, has been named president - Business Development and Integration, responsible for coordination and integration of all marketing, technology, finance, planning and business analysis, and regulatory for the above units. Dinsmore's principal responsibility will be to lead an integrated approach to the marketplace.

Now that these individuals have been named, they will begin to develop transition plans for their respective businesses and assume their new positions on June 1.

GTE's Wireless, Directories and Airfone units will continue to report directly to GTE President Kent Foster.

"The organizations and people now in place will drive our growth in the marketplace in a

powerful way," said Foster.

Background on BBN

BBN is one of the nation's leading providers of Internet access and value-added services for businesses, with annualized revenue of more than $380 million for BBN's third quarter, announced today. It offers Fortune 1000 companies a complete set of managed Internet services, including high-speed and dial-up access, systems development and electronic-commerce support, network security, and Web hosting services. BBN also provides network-related contract research and development for government and commercial customers. BBN's Internet customers include many of the world's top information technology, manufacturing and financial services companies. BBN's home page address is http://www.bbn.com.

Background on GTE

With revenues of more than $21 billion in 1996, GTE is one of the largest publicly held telecommunications companies in the world. In the United States, GTE offers local and wireless service in 29 states and long-distance service in all 50 states. GTE was the first among its peers to offer "one-stop shopping" for local, long-distance and Internet access services. Outside the United States, where GTE has operated for more than 40 years, the company serves over 6.5 million customers. GTE is also a leader in government and defense communications systems and equipment, directories and telecommunications-based information services, and aircraft-passenger telecommunications.

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Attachment

Letter dated January 26, 1998 to Honorable William Kennard from Bernard J. Ebbers and Bert C. Roberts, Jr.

WORLD COM

MCI

January 26, 1998

The Honorable William Kennard
Chairman
Federal Communications Commission
1919 M Street, N.W.
Room 814
Washington, D.C. 20554

Dear Chairman Kennard:

Today, WorldCom and MCI file their joint reply to comments concerning our merger. As those comments and our earlier submissions demonstrate, the MCI WorldCom merger is definitely in the public interest.

On one issue, however, we want to add our personal voices. Some have questioned MCI WorldCom's residential strategy.

MCI WorldCom intends to be the leading local service competitor for both residential and business customers of all sizes across the country. Indeed, local market entry is a driving force behind our merger.

Our investment has -- and will -- follow that intent. Each company has already invested billions of dollars to enter local telephone markets. Simple business logic explains why. MCI WorldCom will have an established base of residential and business customers, the marketing and product-development expertise to reach those customers, and the local facilities that will be used most efficiently by carrying residential night and weekend traffic along with business traffic.

But investment will flow and intent can be fulfilled only where real business opportunities exist. Thus far, achieving the goal of local competition has proven extremely painstaking and difficult because of delay, litigation and the obstructionist tactics of incumbents. Early approval of the MCI WorldCom merger -- and careful and vigilant enforcement of the Telecommunications Act -- are

vital steps to bringing competitive choice in local phone service to residential and business customers.

Sincerely.

Bernard J. Ebbers
President and CEO
WorldCom, Inc.

Bert C. Roberts, Jr.
Chairman
MCI Communications Corporation

cc: Commissioner Susan Ness
Commissioner Harold W. Furchgott-Roth
Commissioner Michael K. Powell
Commissioner Gloria Tristani

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