BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Application of Bell Atlantic Corporation and GTE Corporation for Consent and Approval of a Change in Control.	)	Case No. 98-1398-TP-AMT

MEMORANDUM OF THE JOINT APPLICANTS
IN OPPOSITION TO MOTION TO COMPEL AND
REQUEST FOR EXPEDITED RULING OF SEPTEMBER 13, 1999

On September 13, 1999, AT&T Communications of Ohio, Inc. filed its Motion to Compel and Request for Expedited Ruling ("AT&T's Motion"). With this Memorandum, GTE Corporation and Bell Atlantic Corporation, Joint Applicants herein, respond to AT&T's Motion.

Summary of Argument

1. AT&T's Data Requests involve GTE operations in Texas, Florida, California, and Washington, and are unrelated to any Ohio-specific aspect of the proposed merger. Moreover, they seek information about operations that cannot be lawfully duplicated in Ohio. Accordingly, AT&T's requests have no arguable relevance to this proceeding.

2. AT&T's Data Requests are outside the scope of permissible supplemental discovery. Neither issue that AT&T argues to justify the relevance of these requests -- Joint Applicants' commitment to compete in two new markets or AT&T's own monopoly leveraging theory -- was impacted by the Joint Applicants' amendment of their Application.

3. AT&T's Data Requests are clearly irrelevant to the Joint Applicants' commitment to compete out of franchise. AT&T seeks information from other states regarding GTE Communications Corporation's ("GTECC") *in franchise* competition with each state's GTE ILEC. The Joint Applicants' commitment in this case is to compete *out of franchise* in two new Ohio markets. Further, because Joint Applicants are prohibited by Commission rule from setting up an affiliate to compete with GTE North in Ohio, AT&T's requests are completely irrelevant to any analogy that AT&T might wish to draw.

4. AT&T's Data Requests are also irrelevant to AT&T's "monopoly leveraging" theory. The disputed Data Requests relate only to the number of business and residential lines that GTE ILECs resell to GTECC in states where such resale is permitted. Such requests, therefore, have no nexus to AT&T's monopoly leveraging theory, which relates either to

Bell Atlantic large business *customers* or to the bundling of GTE North's "monopoly services" with an ILEC's competitive services.

5. The information sought by AT&T, in addition to being utterly irrelevant to this proceeding, is also highly proprietary and commercially sensitive. AT&T has not presented any legitimate basis, and Joint Applicants cannot conceive any legitimate basis, under which this information should be produced.

Background

This discovery dispute, like those previously presented in this case, involves AT&T's attempts to obtain highly competitive and commercially sensitive information.[1] Yet, up to and through the filing of this response, AT&T has provided no reason why this information is even arguably relevant to this merger proceeding, much less to the narrow scope of this discovery on the Amended Joint Application. Accordingly, AT&T should be denied access to the proprietary and commercially sensitive information sought through its motion to compel.

Argument

A. AT&T's Discovery Requests Seek Information Beyond the Scope Established For Supplemental Discovery

The information requested by AT&T in its Data Requests numbered 133, 135, 141, and 142 is outside the permissible scope of supplemental discovery. The Commission's August 12, 1999 Entry, which sets forth the procedure to follow the Joint Applicants' amendment of their Application, limited further discovery by stating that it should be conducted "on the amended application." Such a limitation is consistent with the hearing examiner's stated expectation that expanded discovery would not retread old ground, as evidenced by the following colloquy between GTE's counsel and the hearing examiner at the August 2, 1999 hearing:

> MR. LODGE: Only, your Honor, one aspect of the schedule that we proposed was to make it clear that the discovery to be undertaken in this - at this point would be discovery of the additional material and not discovery

[1] In this round, AT&T has asked for the number of resold lines obtained by GTE Communications Corporation from GTE ILECs in Texas, Florida, California and Washington. See Data Requests 133 and 135, attached to AT&T's motion as Exhibit C. Data Requets 141 and 142 attempt to obtain this information by arithmetic. The competitively-sensitive nature of this information is undisputed. Joint Applicants have objected to those Data Requests on the grounds of relevance and have refused to provide the requested information to AT&T, either directly or indirectly.

retreading ground that had already been addressed before. I assume that's what we're talking about, but I feel it's appropriate to say so on the record.

THE EXAMINER: That would be my expectation.

MR. LODGE: Thank you.

Transcript of August 2, 1999 hearing at 16-17.

AT&T now contends that its Data Requests are relevant to the Joint Applicants' commitment to compete in two new markets – Cleveland and Cincinnati – and to its own theory of monopoly leveraging. Neither issue, however, is raised by the recent amendment of the Joint Applicants' Application. In their original application, in the original discovery, and in the original direct testimony, the "new market" commitment was addressed at length and in detail; the Amended Joint Application simply memorializes that testimony. See, *e.g.*, Bellamy Direct Testimony at 17; Jacobi Direct Testimony at 12; Sievers Direct Testimony at 2-4.[2] Additionally, AT&T has already presented its monopoly leveraging theory, (Gillan Direct Testimony at 6-29, Transcript Vol. IV, April 16, 1999 at 46, 82-83, 86-89, 138-142, 144-147, 149) and has had ample opportunity to conduct discovery to support that theory. As further discussed below, AT&T's attempt to bootstrap further discovery on that issue through the Joint Applicants' amended application is pure opportunism. AT&T's Motion should be overruled.

B. AT&T's Discovery Requests Relate to Issues That Are Beyond the Commission's Jurisdiction, As the Commission Has Already So Found.

The information requested by AT&T in its Data Requests numbered 133, 135, 141, and 142 involves GTE's operations in Texas, Florida, California, and Washington. It is unrelated to any Ohio-specific aspect of the proposed merger, including the commitments expressed in the Amended Application. As it did in its previous motion to compel, AT&T attempts to pin the relevance of this out-of-state information on the Joint Applicants' promise to offer out of

[2] See also AT&T's Motion to Compel Discovery and Request for an Expedited Ruling, filed March 8, 1999. Six months ago, AT&T sought and failed to obtain other information allegedly relevant to this very topic. Nothing in the amended application grants another bite at the apple.

franchise competition in Cleveland and Cincinnati. Yet, in connection with AT&T's earlier motion to compel, the Commission found that the testimony of the Joint Applicants concerning out of franchise competition in the two new markets did "not appear to justify AT&T's desire to seek discovery beyond Ohio-related activities." (April 8, 1999 Entry at Paragraph 7.) AT&T has added nothing new here, and the same conclusion holds -- AT&T has pointed to nothing that ties its request to an Ohio-specific aspect of this merger.[3]

R.C. 4905.402 permits the Ohio Commission to review the merger to determine whether it will promote the public convenience *within the state of Ohio*.[4] Accordingly, information relating to conditions in existence wholly outside of Ohio are irrelevant to any issue over which the Ohio Commission has jurisdiction. This is especially the case here, where the out-of-state condition at issue cannot be replicated in Ohio. As a result, AT&T's Data Requests have no arguable relevance to this proceeding, and AT&T's Motion should be overruled.

C. AT&T's Data Requests Do Not Relate To The Joint Applicants' Commitment To Compete Out Of Franchise In Ohio

The information requested by AT&T in its Data Requests numbered 133, 135, 141, and 142 is clearly irrelevant to this proceeding. The Joint Applicants' commitment in this case is to compete *out of franchise* in two new markets. See Exhibit 9 to the Amended Joint Application, Part III. The Joint Applicants do not intend, and are in fact prohibited by Rule II.A.4 of the Local Service Guidelines (PUCO Case No. 95-845-TP-COI, February 20, 1997), from setting up an affiliate to compete with GTE North in Ohio. Accordingly, the only information requested by AT&T with respect to GTECC's operations in Texas, Florida, California, and Washington that is even arguably relevant to the Joint Applicants' out of franchise commitment involves the number of lines that GTECC obtains from ILECs other than the GTE ILEC in those states. While

[3] AT&T's attempt to obtain California information is particularly poignant, as the Attorney General of California recently concluded that the merger of GTE and Bell Atlantic would not adversely affect competition. See Opinion of the Attorney General on Competitive Effects of Proposed Merger Between GTE Corporation and Bell Atlantic Corporation (the "California AG Opinion"), attached as Exhibit A hereto.

[4] R.C. 4905.49 permits the same standard of review, and is likewise limited to intrastate concerns.

preserving their objections, Joint Applicants provided that information to AT&T in its responses to Data Requests 137 and 139.

If AT&T truly wishes to speculate how successful an affiliate of the Joint Applicants is likely to be in competing out of franchise in Ohio by gauging GTECC's success in Texas, Florida, California, and Washington, it already has been given the only information requested that is relevant to such a comparison. The information sought by AT&T in its motion to compel adds nothing. Moreover, the information sought involves a relationship between affiliates that is not lawfully possible in the state of Ohio and therefore incapable of replication. In fact, AT&T's own witness, Mr. Gillan acknowledged this fact in response to questioning by the Attorney Examiner. Transcript Vol. IV, April 16, 1999 at 145. Accordingly, there is no set of facts, either actual or hypothetical, under which the information sought by AT&T is relevant to the Ohio merger proceedings. AT&T's Motion should be overruled.

D. AT&T's Data Requests Are Irrelevant, Even When Considering Its Own "Monopoly Leveraging" Theory As Presented In This Case

AT&T has already presented its "monopoly leveraging" theory, and the amended application of the Joint Applicants adds nothing to it. As a result, further discovery to bolster that theory is impermissible.[5] Yet, even if AT&T did have license to embellish its "monopoly leveraging" theory though discovery, the information requested by AT&T in its Data Requests numbered 133, 135, 141, and 142 is still irrelevant. As presented by AT&T witnesses, that theory rests on the assumption that the merged company will take advantage of Bell Atlantic's service to allegedly "captive" large business customers in Bell Atlantic's service territory by (1) gaining and retaining such customers in GTE North's franchise territory, or (2) marketing bundled services to such Bell Atlantic customers in out of franchise markets. See Gillan Direct Testimony at 16-19. The Data Requests in dispute, however, relate only to the number of

[5] AT&T may wish to bolster the theory in Ohio because it was recently rejected, indeed resoundingly rejected, by the California AG Opinion attached as Exhibit A hereto.

business and residential lines that GTE ILECs resell to GTECC in states where such resale is permitted. Thus, the requested discovery is not even relevant to the theory advanced by AT&T.

A second aspect of the "monopoly leveraging" theory apparently relates to GTE North's ability, through an affiliate, to leverage its "exchange monopoly" by bundling "monopoly services" with competitive services either in or out of franchise. (Gillan Direct Testimony at 21-25.) Yet, AT&T's discovery is irrelevant to this feature as well. If AT&T is concerned that GTE North will leverage its own incumbency in franchise by using an affiliate to bundle monopoly services and competitive services, such a concern (1) in no way relates to any commitment found in the Joint Applicants' Amended Application, and (2) has already been addressed through a Commission rule preventing in-franchise competition by an affiliate. On the other hand, if AT&T is concerned that GTE will leverage its incumbency out of franchise by using an affiliate to bundle monopoly and competitive services, AT&T has not asked the right questions -- the information sought by AT&T's Motion relates only to in franchise activity.

In fact, AT&T's renewed reliance on its "monopoly leveraging" theory, if not merely pretextual, is unsupportable. AT&T's Motion should be denied.

E. The Information Sought by AT&T Is Proprietary And Commercially Sensitive, And Need Not Be Provided.

The information sought by AT&T, in addition to being utterly irrelevant to this proceeding, is also highly proprietary and commercially sensitive. Throughout discovery, Joint Applicants have, under reservation of objection, liberally produced information that is of questionable relevance to avoid disputes. In this round of discovery alone, the Joint Applicants have responded to a dozen requests on that basis. However, AT&T has not presented any legitimate basis, and Joint Applicants cannot conceive any legitimate basis, under which this information should be produced. At this point, a line must be drawn -- the Joint Applicants should not be compelled to share proprietary, commercially sensitive information with direct competitors when it is so utterly irrelevant to the object of these proceedings.

Conclusion

For the foregoing reasons, GTE Corporation and Bell Atlantic Corporation pray that AT&T's Motion be denied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing has been served upon all parties listed on the attached Service List, by hand delivery or regular U.S. mail, postage prepaid, this 20th day of September, 1999.

Todd A. Mazzola

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BEFORE THE PUBLIC UTILITIES COMMISSION

OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of GTE Corporation ("GTE") and Bell Atlantic Corporation ("Bell Atlantic") to Transfer Control of GTE's California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE's Merger with Bell Atlantic	**A. 98-12-005** **OPINION OF THE ATTORNEY GENERAL ON COMPETITIVE EFFECTS OF PROPOSED MERGER BETWEEN GTE CORPORATION AND BELL ATLANTIC CORPORATION**

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EXHIBIT A

September 1999

ATTORNEY GENERAL'S OPINION
September 10, 1999

Requested by: **PUBLIC UTILITIES COMMISSION**

Opinion by: BILL LOCKYER, Attorney General
Richard Frank, Chief Deputy Attorney General
Peter Siggins, Chief Deputy, Legal Affairs
Thomas Greene, Senior Assistant Attorney General
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THE PUBLIC UTILITIES COMMISSION has requested an advisory opinion, pursuant to Public Utilities Code section 854, subdivision (b)(3), on the following questions:

(1) Will the proposed merger between GTE Corporation and Bell Atlantic Corporation adversely affect competition?

(2) What mitigation measures could be adopted to avoid any adverse effects on competition that do result?

CONCLUSIONS

(1) The proposed acquisition should not adversely affect competition in the markets for telephone, wireless, or internet services.

(2) Mitigation measures are not required, but we recommend that the Commission share cost information with regulatory agencies in Bell Atlantic states that are strongly "affiliated" with California.

Accordingly, we have concluded that the acquisition will not adversely affect competition within the meaning of section 854(b)(3).

OUTLINE OF ANALYSIS

INTRODUCTION

This proposed merger would combine two of the largest local telephone companies in the United States into one of the two largest telecommunications firms in the world.[1] In their Joint Application, GTE and Bell Atlantic request that the California Public Utilities Commission approve the proposed consolidation. Pursuant to Public Utilities Code 854, the Attorney General of California submits this opinion on the competitive effects of this merger upon California telecommunications markets.

We find, for reasons virtually identical to those set forth in our review of the Pacific Telesis-SBC transaction, that this merger will not adversely affect competition within California markets. Although the applicants offer local and wireless services in more than 20 states, they do not compete within California. Bell Atlantic is not even a "potential competitor" in this state. The two companies operate, in fact, in distinct parts of the country, and the United States Department of Justice has announced that it will not oppose the merger on antitrust grounds.

Several parties, nonetheless, have intervened and opposed the merger or sought conditions upon its approval. AT&T, MCIWorldCom, Sprint, and the Office of Ratepayer Advocates allege that the merger "may" eliminate Bell Atlantic as a potential competitor in California markets The intervenors also claim that the merger will distort incentives in access, local, long distance,[2] and alleged national business markets.[3]

We conclude that these intervenors have failed to meet the burden required to successfully challenge this merger, a burden that is particularly heavy here, where one of the parties has less than 500 customers[4] in this state. The intervenors cite no evidence that Bell Atlantic "would" enter those markets in the "near future."[5] Other hypothesized effects are, at worst, de minimis, or inconsistent with empirical evidence.

All other protests alleging adverse competitive effects[6] have been resolved. Thus, on

[1]Joint Application at 28; DiTirro Direct Test. at 10.

[2]Baldwin Direct Test. at 52 (the increased percentage of in-region calls providing both originating and terminating access revenues may reduce competition in local, long distance, and "bundled service" markets); Brenner Direct Test. at 8 and 37-45 ("spillover" effects between local markets), and 55-56); DiTirro Direct Test. at 23.

[3]Gillan Direct Test. at 3, 4, 33 (referring to a "national business market").

[4]Joint Application at 1.

[5]Baldwin Direct Test. at 40; Brenner Direct Test. at 57-58; Gillan Direct Test. at 34-36;

[6]Northpoint Communications, Inc. does not allege that the merger will adversely affect competition in California, although it does request that the Commission impose certain conditions on the merged entity to "forestall anticompetitive or adverse consequences of the merger." Northpoint Communications Opening Brief, at 6.

June 21, 1999, the applicants announced the creation of a "Community Collaborative" with the Greenlining Institute, Latino Issues Forum, and Public Advocates. Under the Collaborative, the applicants agreed to: provide $25 million of merger savings to community based organizations, increase charitable contributions by at least $1 million for at least four years; and establish 98 percent as the goal for universal service penetration rates.

I. PRIOR PROCEEDINGS AND THE NATURE OF THIS OPINION

A. Section 854(b)

This transaction is to be accomplished by merging Beta Gamma Corporation, a wholly-owned subsidiary of Bell Atlantic, with and into GTE. Upon completion of the merger, GTE will continue as the surviving corporation and become a wholly-owned subsidiary of Bell Atlantic. Applicants do not dispute prior rulings that Section 854 applies to a merger of parent holding companies of California public utilities.[7]

B. This Advisory Opinion

This is the fifth opinion letter submitted by this office under the 1989 amendments to Section 854.[8] Public Utility Code section 854 refers to the opinion as advisory.[9] Consequently

[7]Joint Application at 3 n.3.

[8]See Opinion of the Attorney General on Competitive Effects of Proposed Merger between Pacific Enterprises and Enova Corporation, 81 Cal.Ops.Atty.Gen 1 (1998); Opinion of the Attorney General on Competitive Effects of Proposed Merger between Pacific Telesis Group and SBC Communications, Inc. 79 Cal.Ops. Atty.Gen 301 (1996)("AG Telesis-SBC Opinion"); Opinion of the Attorney General on Competitive Effects of Proposed Merger of American Telephone & Telegraph Company and McCaw Cellular Communications, Inc., 77 Cal.Ops.Atty.Gen. 50 (1994); Opinion of the Attorney General on Competitive Effects of Proposed Merger of GTE and Contel Corporations, Submitted Pursuant to PU Code Section 854(b)(2); Opinion of the Attorney General on the Proposed Acquisition of San Diego Gas and Electric Company by SCEcorp, the Parent of Southern California Edison Co., 73 Cal.Ops.Atty.Gen. 366 (1990).

[9]Section 854(b) provides in pertinent part:

> Before authorizing the merger, acquisition or control of any electric, gas, or telephone utility organized and doing business in this state . . ., the commission shall find that the proposal does all of the following:
>
> (1) Provide short-term and long-term benefits to ratepayers.
>
> (2) Equitably allocates, where the commission has ratemaking authority, the total short-term and long-term forecasted economic benefits, as determined by the commission, of the proposed merger, acquisition, or control, between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits.
>
> (3) Not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely

this document does not control the PUC's finding under section 854, subdivision (b)(3). However, the Attorney General's advice is entitled to the weight commonly accorded an Attorney General's opinion (see, e.g., Moore v. Panish (1982) 32 Cal.3d 535, 544 ("Attorney General opinions are generally accorded great weight"); Farron v. City and County of San Francisco, (1989) 216 Cal.App.3d 1071).

C. Evidentiary Basis of This Opinion

During the course of our review, we held numerous discussions with the parties and obtained substantial materials from them pertaining to the issues discussed. We also reviewed testimony filed in these proceedings, along with the transcripts of witnesses who testified on the competitive effects of this transaction. Additional information was obtained from other members of the industry and from staff of other governmental agencies. We have also relied upon Stanford Economics Professor Frank Wolak to obtain further background information and a better understanding of the industry.

II. THE MERGER

Both GTE and Bell Atlantic generate most of their revenues from local, access, wireless and toll services. The pro forma financial statements for the applicants indicate that the combined entity will have assets of approximately $96 billion, annual revenues of $53 billion, and annual net income of $6.9 billion.[10]

GTE is a New York corporation with headquarters in Irving, Texas. Its local companies serve over 23 million access lines in 28 states.[11] Through 11 subsidiaries, GTE serves approximately 4.5 million access lines in California,[12] where it generates annual revenues of about $5 billion.[13]

Bell Atlantic is a Delaware corporation based in New York, providing local telephone services through operating companies in Connecticut, Delaware, Maine, Maryland, Massachusetts, New Jersey, New Hampshire, New York, Pennsylvania, Rhode Island, Vermont, Virginia, West Virginia, and the District of Columbia. The company acquired many of these operating companies through its 1997 merger with NYNEX. Bell Atlantic also serves six million wireless customers in 25 states and another million customers in other countries. Bell

affected and what mitigation measures could be adopted to avoid this result.

[10]Joint Application, at 28.

[11]GTE has recently sold 40,000 access lines in California, and has agreed to sell lines in Iowa, Arkansas, and possibly other states. Atwood Direct Test. at 69-72.

[12]Atwood Trans. at 90.

[13]Id. at 73.

Atlantic provides neither local nor wireless services in California and its total sales in this state are negligible.[14]

A. The Purpose of this Merger

The applicants describe this merger as a joint attempt to meet changes in consumer demand that are accompanying technological advances and deregulatory forces within the telecommunications industry. Thus, as barriers erode between local and long distance and between wireline and wireless,[15] firms are competing to provide an increasingly broad array of services on an integrated ("one-stop shopping"[16]) and price competitive basis.[17] GTE concluded that its previous efforts to compete for these services through resale were not successful because it failed to appreciate that at least some out-of-region services must be facilities-based; that the (substantial) investment in facilities must be made at or prior to entry; and brand awareness must be created.[18] Bell Atlantic's existing relationships with large businesses ("anchor customers"),[19] GTE's new national fiber network[20] ("Global Network Infrastructure" or "GNI"), and the merged company's larger scale would significantly enhance the ability of the combined company to successfully compete out of its franchise areas. Combining these strengths, the applicants plan to compete in the national long distance market and, within 18 months of the consummation of the merger, to enter 21 out-of-franchise markets, including Los Angeles, San Francisco, and San Diego residential markets.[21]

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[14]Two subsidiaries, Bell Atlantic Communications Inc. and NYNEX Long distance Company, serve its California customers, which number approximately 400. Joint Application at 1, Chapter 1 at 4; Atwood Direct Test. at 34-36.

[15]"[W]ireless operations can be a viable alternative to a landline service." Kissell Trans. at 412.

[16]See Whelan Trans. at 377.

[17]See Huber, Kellog & Thorne, The Geodesic Network: 1993 Report on Competition in the Telephone Industry ("Geodesic Network II"). In 1987, Peter Huber prepared The Geodesic Network: 1987 Report on Competition in the Telephone Industry ("Geodesic Network I") for the Justice Department's "First Triennial Review" of the MFJ.

[18]Applicants' FCC Joint Reply Brief, at 23. GTE Communications Corporation ("GTECC") was created in May 1997 "to offer a full line of bundled telecommunication services to customers -- including local, long distance, wireless, and Internet -- both in and out of GTE's franchise territories." Kissell FCC Decl., at 1. GTECC serves approximately 80,000 customers in the Los Angeles area. Atwood Direct Test. at 43.

[19]See FCC Joint Reply Brief, at 19-22 ("Bell Atlantic serves the headquarters of 175 of the Fortune 500 companies; GTE's ILEC franchise covers only 20"); Kissell Rebuttal Testimony, at 9.

[20]See Atwood Direct Test. at 40.

[21]See Joint Application at 19; Atwood Direct Test. at 40-44.

B. GTE and Bell Atlantic Telecommunication Services

Both of the applicants offer local, access and toll services within their service regions.[22] In California, competition is increasingly intense for dedicated access, business switched access, and intraLATA toll.

1. Local Network Services

Local exchange carriers ("LECs"),[23] such as GTE and Bell Atlantic, provide the wires or the "local loops" that physically connect users to each other and to long distance carriers ("interexchange carriers" or "IECs"). Local exchange carriers also provide the local switching facilities that direct calls to a local party or the long distance carrier, depending upon the number dialed. A call is "local" if it is placed within the area in which flat-rate subscribers may call at no extra charge.[24]

The Telecommunications Act of 1996 ("TA 96")[25] and recent PUC rulings[26] eliminated

[22]GTE reported its 1997 revenues as follows: local services, $6,607 million; network access, $4,923 million; toll services, $2,429 million; cellular services, $2,817 million; directory services, $1507 million; other services, $4,977 million. 1997 Annual Report, at 29, attached as Exhibit C to Joint Application. Revenues from GTE operations in California constitute approximately 20 percent of those figures. See Atwood Test. at 73. During the nine month period ending September 30, 1998, Bell Atlantic reported revenues, as follows: local services, $10,303 million; network access, $5,742 million; toll services, $1,468 million; wireless services, $1,699 million; directory services, $1649 million; other services, 1,498 million. Bell Atlantic Corporation, Form 10-Q, 3rd Quarter, attached as Exhibit J to Joint Application.

[23]The LEC nomenclature is somewhat confusing because of the AT&T consent decree, which completely redrew the areas in which different types of telephone companies were allowed to operate. The traditionally exclusive right of local telephone companies to provide service for calls which originate and end within their service territories was unchanged. However, the LECs owned by the Bell Operating Companies ("BOCs") were prohibited from carrying telephone traffic out of judicially-defined "exchange" areas, or LATAs ["LATA" is an acronym for "Local Access and Transport Area." U.S. v. Western Electric Co., Inc., 569 F.Supp. 990, 993 n.9 (D.D.C.1983)(the "LATA Decision")], which subsumed local companies' service areas.

[24]In California, this area usually includes the exchange to which the subscriber's line is directly connected (the "end office"), contiguous exchanges, and other exchanges within 12 miles of the subscriber's end office. All remaining calls – both intra- and interLATA – between exchanges, except for Zone Usage Measurement ("ZUM") and Extended Area Services ("EAS"), are "toll" services. California Public Utilities Commission Division of Ratepayer Advocates, Report on Policy and Technical Issues in I. 87-11-033, Phase III, at 3-4 (Feb. 8, 1991) ("1991 DRA Policy Report").

[25]Section 253(a) of the Act provides that "[n]o State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service."

[26]The PUC opened California local markets to facilities-based suppliers on January 1, 1996. Resale markets were opened on March 31, 1996. D.95-07-054 (July 1995). In addition, D.95-12-058 lifted the prohibition on competition between LECs. Other PUC decisions have authorized GTE and Pacific Bell to enter each other's

entry barriers into local exchanges, which had been exclusive franchises for incumbent local exchange carriers "ILECs"). As a result, suppliers are now aggressively entering many local markets.[27] TA 96 permits entrants ("competitive local exchange carriers" or "CLECs") to resell[28] services the ILEC offers on a retail basis or to sell combinations of specific elements "picked and chosen" from the ILEC network. TA 96 also requires that, in selling these two types of services, ILECs price "finished services" at a discount from retail levels[29] and that "network elements"[30] be priced based on cost.

As competitive access providers have demonstrated, CLECs can most easily provide "facilities-based" services in urban markets, where traffic and routing economies reduce unit costs.[31] For that reason, GTECC, MCIMetro and other CLECs initially attempted to "resell"

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service areas as CLECs. See Joint Application, Chapter IV, at 5.

[27]According to a recent Merrill Lynch report, the number of business lines provided by CLECs across the country exceeded the number of business lines added by the RBOCs. See Whelan Trans. at 312.

[28]Section 251(c) of the Act requires local carriers to (a) provide "interconnection" to their networks at reasonable rates and (b) to "offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers."

[29]Earlier this year, the Supreme Court reversed the Eighth Circuit and upheld FCC rules that set wholesale prices at retail rates less avoided retail costs. AT&T Corp. v. Iowa Utilities Board, 76 ATTR 84 (No. 1894, 1999). The appropriate wholesale rates for local services had been intensely debated. In its First Report and Order, the FCC set forth an allowed range of "default" discounts from LECs' estimated avoided costs. First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, at ¶¶865-877 (CC Docket No. 96-98, Aug. 8, 1996). The FCC rejected the ECPR method as inconsistent with total service long run incremental cost methodology. Id. at ¶¶708-711. The Eighth Circuit, however, stayed the FCC order, which would have established "default" discount rates of between 17.5 and 25 percent. Iowa Utilities Board v. Federal Communications Commission, 1996 U.S. App. LEXIS (8th Cir. 1996).

In 1996 PUC proceedings, AT&T and MCIWorldCom advocated a rule which would set wholesale prices at retail rates less avoided retail costs, such as billing and collection, sales and marketing, and processing end-user service orders. D.96-03-020 at 11. The PUC adopted the long distance company model, but not its calculations. Id. at 31-32.

[30]The Supreme Court has defined the term broadly to include both physical facilities and equipment used to provide local phone service, as well as operator service and directory assistance, operational support systems (OSS), and vertical switching functions. AT&T Corp. v. Iowa Utility Board, supra, at 90.

[31]See Kissell Rebuttal Test. at 13. According to applicant witness Daniel Whelan, "CLECs largely go after large- to medium-sized business in the first instance." Whelan Trans. at 310. Similarly, MCIWorldCom expert DiTirro reports, "MCI, MFS, and Brooks . . . individually [financed facilities-based entry] into . . . 21 [urban] markets [targeted by the applicants] before their merger to form MCI WorldCom." DiTirro Direct Test. at 11.

ILEC services in residential markets.[32] AT&T, in contrast, apparently plans to aggressively enter residential local markets as a facilities-based supplier with the broadband fiber network it recently acquired from TCI.[33]

2. Toll Services

a. InterLATA

Interexchange services are telecommunications between a point in one Local Access and Transport Area ("LATA" or "exchange area") and a point located in another exchange area.[34] The MFJ prohibited all the BOCs, including Bell Atlantic, from providing interexchange services. Under Section 271 of the Telecommunications Act of 1996, however, BOCs can now provide both "out-of-region" interLATA communications[35] and, with Federal Communications Commission approval, "in-region" services.[36]

Both of the applicants provide the vast majority of their interLATA services as resellers. Bell Atlantic has not yet received Section 271 authorization to provide such services within its local service areas. GTE, which is not subject to the restrictions of Section 271,[37] provides only 0.36 percent of its California-originated interLATA services through its own facilities.[38]

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[32]GTECC's initial attempt to enter out-of-franchise areas by offering resale services (primarily those of Pacific Telesis) to residential and small business customers was not "as effective as planned" because "the cost of taking an order, processing an order, staging that order, billing for that order and providing customer care was higher than expected." Kissell Trans. at 423-425. GTE now views that wholesale market as "unprofitable." Id. at 428.

[33]See Kissell Rebuttal Test., at 18. That merger provides AT&T with "first mile access to 33 million homes throughout the United States." Kissell Trans. at 403. TCI "passes" 33 million homes and actually provides services to 15 million of those customers. Id. at 413.

[34]See 47 U.S.C. 153 (a)(42).

[35]Subject to certain restrictions on 800 service and private line service, Sections 271(b)(2) and 271(j) of the Act allowed the BOCs to "provide interLATA services originating outside its in-region States after the date of enactment of the Telecommunications Act of 1996."

[36]See Atwood Trans. at 78. Section 271(d) provides that the BOC must apply to the FCC for authority to provide in-region originating interLATA services for a particular state. The FCC, which must render a "determination" within 90 days, cannot approve the application unless the BOC has "fully implemented the competitive checklist." Section 271(d)(3).

[37]See Atwood Trans. at 78.

[38]Letter from Hojoon Hwang to Lindsay Bower (September 7, 1999). At the national level, GTE provides 99.95 percent of the interLATA traffic it sells as a reseller (equivalently, 0.05 percent of its long distance traffic is facilities-based). Letter from Hojoon Hwang to Lindsay Bower (September 9, 1999).

In this state, GTE resells long distance services to approximately 600,000 customers.[39] Bell Atlantic has about 400 long distance California customers.[40]

To enable future entry into the long distance market, GTE purchased in 1997 a national fiber optic network from Qwest.[41] Following the merger, the surviving entity and its subsidiaries (including GTE operating companies) will be "affiliates" of Bell Atlantic for purposes of Section 271. Accordingly, none of those subsidiaries can provide originating interLATA services within the Bell Atlantic states until the relevant operating company receives FCC authorization.[42] Moreover, under Section 272, the surviving entity must offer long distances services through a "separate" affiliate and conduct all transactions (such as determination of access charges) with Bell Atlantic operating companies "on an arm's length basis."

b. IntraLATA

In most instances, toll calls within the same area code require intraLATA toll services. Both GTE and Bell Atlantic generate significant revenues as suppliers of intraLATA services to their local exchange customers. Until 1995, LECs were the only carriers in California explicitly permitted to complete all types of intraLATA calls. InterLATA and intraLATA services are functionally equivalent,[43] though, so long distance carriers faced relatively insignificant barriers[44] when they entered ILEC toll markets. Accordingly, GTE California's share of intraLATA toll calls placed in-region has declined to less than 50 percent since that company converted its switches to 1+ equal access capability[45] in 1997.[46]

[39]Atwood Trans. at 91.

[40]Joint Application at 1.

[41]Atwood Trans. at 109.

[42]Section 271(b)(1) provides that "A Bell operating company, or any affiliate of that Bell operating company, may provide interLATA services originating in any of its in-region States . . . if the Commission approves the application . . . ."

[43]Geodesic Network I, supra, at 3.1.

[44]"Barriers to entry into this market are low." IRD, D.94-09-065, at 22 (Sept. 15, 1994).

[45]Until recently, it was necessary to dial an access code ("10XXX") if a subscriber wished to place an intraLATA call through a competitor. By "presubscribing" to an intraLATA competitor, users can now access an IEC by dialing "1 plus" the area code of the receiving area exchange.

[46]Kissell Rebuttal Test., at 26. GTE's share of intraLATA toll traffic originating in its Florida service areas fell from 82 percent in December 1996 to less than 37 percent in December 1998. Declaration of Robert W. Crandall and J. Gregory Sidak, at 14, attached as Exhibit H to FCC Joint Reply.

3. Access Services

Like other local exchange carriers, GTE and Bell Atlantic charge interexchange carriers for making available their facilities in the placement, transport and termination of toll calls.[47] These fees represent a substantial portion of the revenues generated by both companies.[48]

Competitive forces and PUC mandates, however, have significantly reduced access rates. Historically, per minute switched access[49] rates in urban areas are significantly greater than the average cost to the LEC of providing those services. Responding to these margins,[50] competitive access providers offer business customers direct access to a long distance company "point of presence" at fixed monthly rates. The resulting competition reduced California rates for dedicated access, which ILECs also offer, by 50% between 1985 and 1991.[51] California interstate, interLATA origination and termination charges are now among the lowest in the country.[52]

C. Wireless Services

GTE has 4.8 million wireless customers in the United States.[53] Bell Atlantic is the

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[47]See Dingwall, Imputation of Access Charges – A Prerequisite for Effective IntraLATA Toll Competition, 40 Administrative Law Review 433, 435 (1988) at 434 n.4. Access services may be switched or dedicated. "Switched access is accomplished in two steps: first, the customer is connected to the LEC end office using lines in common with other LEC long distance and local customers; second, the LEC end office is connected to the [long distance carrier]." See Competitive Telecommunications Assn. v. FCC and United States, 87 F.3d 522, 524 (D.C. Cir. 1996). Dedicated, or "special," access is provided on large capacity DS3 lines or smaller capacity DS1 lines that run directly from the customer to the IEC. Id. It is "dedicated" because only traffic of the individual customer is carried over the line. D.94-09-065, at 81 (Sept. 15, 1995).

[48]GTE reported that, in 1997, it earned $4,923 million, or 21 percent of its overall revenues, for providing network access services. 1997 Annual Report, at 29, supra. The corresponding figures for Bell Atlantic were $5,742 million and 26 percent. Bell Atlantic Corporation, Form 10-Q, 3rd Quarter, supra.

[49]"Switched access is the switching transmission service provided by the LECs to connect end-users with IECs and vice versa." D.94-09-065 at 114.

[50]MCI concluded that access services generate an operating cash flow margin of 71% for the BOCs. Operating Cash Flow is a company's Earning Before Interest Expense, Taxes, Depreciation and Amortization (EBITDA). In 1993, MCI reports, the BOCs generated Operating Cash Flows of $14.7 billion on net revenues of $20.8 billion. MCI, The Bell Operating Companies' Cash Flow: A Case Study in Overearnings, at 5 (March 1995). These figures, however, may fail to account for capital and other associated costs.

[51]California Public Utilities Commission Division of Ratepayer Advocates, Report on IntraLATA Competition in California and Program Proposals, Exhibit 559, at 2-4 (Sept. 23, 1991).

[52]Federal Communications Commission, Trends in Telephone Service, at Table 1.4 (1999).

[53]Kissell Trans. at 412.

nation's fourth largest wireless provider, with about 6.6 million subscribers nationwide. Bell Atlantic provides cellular service in its local exchange service region and in parts of Arizona, Georgia, North Carolina, New Mexico, South Carolina and Texas. Through its PrimeCo partnership with Airtouch, which the partners recently agreed to dissolve, Bell Atlantic has provided PCS service in parts of 18 states. As a result of a recent consent decree with the United States Department of Justice, the applicants have agreed to sell one of their two interests in the 65 markets (located in nine states) in which their wireless systems overlapped. Bell Atlantic has no wireless operations in California, so none of those overlapping systems were in this state.

III. THE COMPETITIVE EFFECTS

The issues raised by this merger are very similar to those we addressed in our 1996 review of the Pacific Telesis-SBC transaction. As there, both firms offer local, access, intraLATA toll, and wireless services, but they do not compete in California. Furthermore, there is no evidence that Bell Atlantic has any current effect upon GTE operations within California, or that Bell Atlantic would enter any California market served by GTE in the absence of the merger. Accordingly, Bell Atlantic is neither an "actual" nor a "perceived" potential competitor within this state. Like Telesis-SBC, it is also necessary to determine whether the consolidation could enhance the ability of the merged firm to anticompetitively cross-subsidize its competitive operations.

A. The Standard of Review

Traditionally, the competitive effects of a proposed merger are analyzed by a well-developed model that seeks to measure effects of the consolidation within some "relevant market." This model predicts competitive effects for those consolidations where market forces determine price and output levels. A merger necessarily has no effects upon competition, however, in markets where the regulatory scheme has already "displaced" competition.[54]

The traditional model for assessing effects within unregulated markets begins with the characterization of each relevant product market affected by the merger. This model is embodied in the analytically similar horizontal merger guidelines developed by the Department of Justice and Federal Trade Commission[55] and the National Association of Attorneys General.[56] The product market refers to the range of products or services that are or could[57]

[54] City of Lafayette v. Louisiana Power & Light Co., 435 U.S. 389 (1978).

[55] U.S. Department of Justice and Federal Trade Commission Horizontal Merger Guidelines, reprinted in 4 Trade Reg. Rep. (CCH) ¶13,104 (April 2, 1992)("Merger Guidelines").

[56] Horizontal Merger Guidelines of the National Association of Attorneys General, reprinted in 4 Trade Reg. Rep. (CCH) ¶13,406 (March 30, 1993)

easily be made relatively interchangeable, so that pricing decisions by one firm are influenced by the range of alternative suppliers available to the purchaser. The analysis then proceeds to a determination of the relevant geographic market, which is defined as the area in which the sellers compete and in which buyers can practicably turn for supply.[58]

The competitive effects of a merger between suppliers operating within the same relevant markets depend upon several related factors, including changes in concentration levels,[59] entry conditions,[60] and efficiency enhancements.[61] Where the acquiring firm is a potential supplier to a concentrated relevant market, the competitive effects depend upon whether the acquiring firm is or is likely to be a destabilizing force within that market.

B. The Relevant Product and Geographic Markets

To avoid speculation, we limit the product markets that we consider here to the range of

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[57] The Justice Department and the courts apply slightly different standards to determine the range of supply substitutes to be included within the relevant market. The courts generally include supply substitutes within the relevant market but they sometimes "include the products to which firms selling the particular product could substitute in supply, rather than, or in addition to, the products produced by firms that do not currently sell the particular product but that could begin doing so by substituting in supply." Werden, Market Delineation under the Merger Guidelines: a Tenth Anniversary Retrospective, 38 Antitrust Bull. 517, 525-26 (1993). The DOJ/FTC Merger Guidelines distinguish between "uncommitted entrants" and other types of "supply responses." Thus, the Guidelines include within the relevant market those "potential competitors" which could shift their facilities "easily and economically" to sell in the relevant market within one year in response to a hypothetical price increase. DOJ/FTC Merger Guidelines, supra, at §§1.3, 3.0 n.25.

[58] U.S. v. Connecticut National Bank, supra, 418 U.S. 656, 668 (1974).

[59] Market share statistics for regulated industries must be applied with particular care: "Market share is but one determinant of market power. . . . . A 'high' market share in a regulated industry undergoing a transition to competition may mean nothing in terms of market power, since it may be but an artifact of the past, devoid of information concerning a regulated firm's actual ability to control current prices." Larson, An Economic Guide to Competitive Standards in Telecommunications Regulation, 1 CommLaw Conspectus 31, 43 (1993). See Metro Mobile CTS, Inc. v. New Vector Communications, Inc., 892 F.2d 62, 63 (9th Cir. 1989); Entergy Services Inc., 64 F.E.R.C. 61,001 (1993). See also Watson & Brunner, Monopolization by Regulated "Monopolies": The Search for Substantive Standards, 22 Antitrust Bull. 559 (1977).

For example, entry conditions for long distance companies, not market share figures, most accurately represented competitive conditions in the business intraLATA toll market immediately after the Commission opened that market to competition. As noted above, entry by long distance firms forced rapid price reductions and ended GTE's previously overwhelming dominance in the market.

[60] See McCaw Personal Communications, Inc. v. Pacific Telesis Group, 645 F.Supp. 1166, 1174 (N.D. 1986).

[61] See FTC v. University Health, Inc., 938 F.2d 1206, 1222 (11th Cir. 1991); Broadcast Music, Inc. v. CBS, 441 U.S. 1 (1979) (joint venture).

competitive services currently offered[62] by both of the merging parties.[63] Because this is a "conglomerate" merger between non-competitors, we accept California as the relevant geographic market. We reject, however, suggestions that local services provided outside California are part of any market relevant to this merger analysis.[64]

C. Potential Competition

Even though GTE and Bell Atlantic do not compete in any California telecommunications market, it is still possible that the merger will reduce competition by eliminating Bell Atlantic as a potential supplier within local service[65] or other relevant markets. The record, however, contains no significant evidence that Bell Atlantic will actually enter any California market if this merger is not approved. Moreover, AT&T, MCIWorldCom, Sprint and other major firms now compete with GTE in markets where entry is viable and they are all planning to aggressively

[62]See Pitofsky, supra, at 1835 (advocating focus upon "currently available products"). We are not aware of any litigated Section 7 action in which the merger would have allegedly restrained trade in a product market that did not exist prior to the merger.

[63]Likewise, we refrain from attempting to forecast effects upon competition in markets for services that are not now available. "No one currently knows which system or systems will be technologically and financially viable in the foreseeable future. Although it is regularly reported in the business press that a 'convergence' of telecommunications technologies is occurring, it may actually be the case that a divergence of such architectures may simultaneously evolve for the delivery of various combinations of narrowband and interactive broadband services." Crandall & Sidak, Competition and Regulatory Policies for Interactive Broadband Networks, 68 So. Cal. L.Rev. 1203, 1204 (1995).

[64]Relying upon expert Susan Baldwin, ORA suggests that the merger will adversely affect competition in a "national market of integrated telecommunications services." ORA Opening Brief at 32. Within this market, ORA claims, are the seven largest ILECs in the country. Id. at 33, citing Baldwin Direct Test. at 24-26, 30-32. Moreover, concentration within this market can be measured from the number of access lines provided by each LEC. See Baldwin Direct Test. at 31.

Ms. Baldwin, however, fails to adequately describe this market, or even provide evidence that such a market exists. As we indicate above, relevant markets are delineated by assessing alternative supply sources available to an identifiable group of consumers. The purpose of this exercise is to "establish a geographic boundary that roughly separates firms that are important factors in the competitive analysis of a merger from those that are not." 1984 Merger Guidelines, at §2.31. Even assuming that the seven major ILECs are in the hypothetical national market, however, Ms. Baldwin does not provide any basis for concluding that their sales in that market are meaningfully related to the number of access lines they provide in their franchise areas. We conclude that the record contains no probative evidence of a national market of bundled services or any basis for determining concentration within that assumed market.

[65]See Brenner Direct Test., at 57, 63 (referring to "the loss of Bell Atlantic as a potential competing supplier of local service" and to the question of whether "Bell Atlantic had no plans to provide local service as an entrant in California")

expand the range of that competition.[66]

1. The Actual Potential Competitor Doctrine

A merger between two firms that offer the same products in different geographic markets can have two types of anticompetitive effects. First, the presence of the acquiring firm on the "fringe" of a target firm's insufficiently competitive market may "temper" pricing behavior there. The "perceived potential competition" doctrine views such mergers as illegal because they have adverse effects upon current prices within the target market. In this case, there is no evidence that Bell Atlantic affects current pricing or output levels within California's "target" telecommunications markets. Accordingly, none of the intervenors has challenged the merger under that theory.

Nonetheless, the merger may still have adverse competitive effects if Bell Atlantic would have otherwise entered California markets in the foreseeable future and if that entry would have had "procompetitive" effects within those markets. The Supreme Court has never endorsed this theory,[67] which is sometimes referred to as the "actual potential competition" doctrine, but the lower courts have specified three conditions to its application. First, the target market must be concentrated, thus establishing a prima facie case of noncompetitive behavior by the existing competitors.[68] Second, the acquiring firm must be a probable market entrant. Third, the

[66]ORA expert Baldwin contends that the potential competition doctrine (as described in the Merger Guidelines) may not "deal adequately with mergers between firms which have "only recently emerged from a condition of near-absolute monopoly and market dominance arising from specific government action." Baldwin Direct Test. at 21-22. We disagree. The courts successfully applied the potential competition doctrine to several bank mergers, for example, during the deregulation of that industry. As in this case, the merging banks offered similar services but branching and other regulations limited their ability to compete in the same geographic market. In the leading potential competition case, U.S. v. Marine Bancorporation, 418 U.S. 602 (1973), the Supreme Court applied the doctrine while branching restrictions were "stringent." Id. at 609-10. In U.S. v. First Nat. State Bancorporation, 499 F.Supp. 793 (D.C.N.J. 1980), decided seven years later, another court considered potential competition claims in New Jersey bank markets, where the Legislature had increased competition "significantly" by liberalizing state branching laws. Id. at 798. Neither court suggested that industry deregulation should affect the scope of the doctrine.

[67]Tenneco, Inc. v. F.T.C., 689 F.2d 346, 352 (2d Cir. 1982). In fact, "the government has been unable to sustain its burden of proof in any actual potential competition case." Brodley, Potential Competition in the Merger Guidelines, 71 Cal.L.Rev. 376, 378 (1983). One observer has thus rejected the doctrine as unworkable. See Carter, Actual Potential Entry under Section 7 of the Clayton Act, 66 VA L.Rev. 1485 (1980). Areeda, likewise, questions whether the doctrine provides a basis for a Section 7 violation. Areeda and Hovenkamp, Antitrust Law ¶1118' (Supp. 1996)("Where the outside firm is relevant only because it might otherwise enter in the future and thereby increase competition at that time, the merger does not reduce competition but only eliminates a future opportunity to increase it.").

[68]Marine Bancorporation, supra, at 630-32.

hypothesized future entry must have significant procompetitive effects.[69]

2. Bell Atlantic Entry into California Markets.

The probable entry requirement is particularly difficult to establish. To avoid speculation,[70] the courts consistently require proof that the acquiring firm "would"[71]--not "could"[72]--have entered the target market de novo or through a "toehold" acquisition, absent the merger.[73] Moreover, entry must occur, not in the "reasonably foreseeable" future, but in the "near" future.[74] The showing must be supported with "substantial evidence"[75] that includes a "reasonable temporal estimate"[76] of probable entry and subjective evidence[77] of an intent to enter.

The record in this matter contains no such evidence. The intervenors concede they have no documentary evidence that Bell Atlantic intended to enter GTE markets in California,[78] and they cite no direct proof of specific intent. Instead, Sprint suggests that the requisite intent be

[69]See Pitofsky, Proposals for Revised United States Merger Enforcement in a Global Economy, 81 Georgetown L.J. 195, 203 (1992).

[70]The Supreme Court limits the analysis to "probabilities," not "ephemeral possibilities." Marine Bancorporation, supra, 418 U.S. at 622-23. See also BOC Int'l Ltd. v. FTC, 557 F.2d 24, 29 (2d Cir. 1977)(rejecting a finding of "eventual" entry as "uncabined speculation").

[71]BOC Int'l, supra, 557 F.2d at 27-28.

[72]Mercantile Texas Corp., v. Board of Governors of the Fed. Reserve Sys., 638 F.2d 1255, 1268 (5th Cir. 1981).

[73]In Tenneco, the absence of evidence of a subjective intent to enter the relevant market was dispositive. Tenneco v. F.T.C., 689 F.2d 346 (2d Cir. 1982).

[74]Republic of Texas Corp. v. Board of Governors of the Fed. Reserve Sys., 649 F.2d 1026, 1047 (5th cir. 1981) (demonstrating entry in the "reasonably foreseeable future" was insufficient); BOC Int'l, supra, 557 F.2d at 29. The long distance intervenors themselves cite the "near future" standard. See Protest of AT&T et al., at 17. The Merger Guidelines consider "timely only those committed to entry alternatives that can be achieved within two years from initial planning to significant market impact."

[75]BOC Int'l Ltd. v. FTC, 557 F.2d 24, at 29 (2d Cir. 1977).

[76]Id.

[77]See Tenneco, supra; B.A.T. Indus., 104 F.T.C. 852 (1984) (the Federal Trade Commission concluding that the "best evidence concerning the incentives of the acquiring firm to enter independently . . . is likely to be subjective").

[78]Gillan Trans. at 1266; Brenner Trans. at 1214.

inferred from statements of the applicants that "each company wants a national presence."[79] AT&T/MCIWorldCom, similarly, introduce opinion testimony that "it is unlikely that Bell Atlantic would forever ignore (at least the most attractive) of GTE's markets."[80]

In contrast, the FTC's unsuccessful challenge in Tenneco established with "abundant evidence" that one of the respondents had both the interest and the incentive to enter the shock absorber market. The evidence included proof that Tenneco was "actively considering entry" and was "pursuing all leads to that end."[81] The Commission, however, failed to show that Tenneco would be willing to incur the substantial up-front costs associated with de novo entry or that continued negotiations with small manufacturers for "toehold" entry would ultimately be successful. The intervenors in this case have shown neither such "interests" nor such "incentives;" they have not demonstrated specific intent; and they have certainly not provided a "reasonable temporal estimate" of probable entry. Following the Second Circuit's Tenneco opinion, we conclude that allegations that Bell Atlantic "would have entered the market . . . absent its acquisition [of GTE] is based on the kind of unsupported speculation that the Supreme Court condemned when it warned that . . . '§7 deals in 'probabilities' not 'ephemeral possibilities.'"

3. Competitive Effects of Independent Bell Atlantic Entry.

For the actual potential competition theory to apply, entry must also have a deconcentrating or other significant procompetitive effect.[82] This predicate effect will not exist "if there are numerous potential competitors," because the elimination of one of many "would not be significant."[83]

If Bell Atlantic entered California telecommunications markets, it would face strong competitors in the markets for intraLATA toll, dedicated access, and some facilities-based[84] basic business services. AT&T, Sprint, MCIWorldCom, SBC and perhaps other major firms

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[79] Brenner Direct Test. at 60.

[80] Gillan Direct Test. at 35. See Teece Rebuttal Test. at 25.

[81] Tenneco, supra, at 353.

[82] Brodley, supra, at 379; Republic of Tex. Corp., supra, 649 F.2d at 1047.

[83] Mercantile Texas Corp., 638 F.2d at 1267. See also U.S. v. First National State Bancorporation, 499 F.Supp. 793, 814 (D.N.J. 1980)

[84] Local services represent combinations of "building blocks" or "unbundled elements." The Telecommunications Act of 1996 attempts to promote competition by allowing new entrants to construct new facilities, use unbundled elements, or employ resale. First Report and Order, supra, ¶¶12-13. Thus, long distance carriers can offer switched access services by combining ILEC "loops" with their own switching and transport facilities. In California, GTE has over 142 collocation arrangements. Kissell Rebuttal Test. at 17. "UNE loop sales increased from zero on April 1, 1997 to 5569 by the end of 1998." Id.

have existing plans to enter profitable markets currently served by GTE.[85] There is no basis for concluding that future Bell Atlantic entry would substantially increase the level of competition beyond that provided by these other entrants.

D. Competitive Objections of the Long Distance Companies

Although the traditional analysis indicates that this consolidation will not adversely affect competition in California, the long distance intervenors contend that the merger will be anticompetitive. Thus, Sprint expert Dr. Brenner claims that the merger may increase alleged incentives to prevent or deter entry by firms operating in both GTE and Bell Atlantic regions. Recommending that the Commission prohibit the applicants from packaging, bundling, or jointly marketing their services in any way,[86] AT&T/MCIWorldCom expert Gillan similarly asserts that the merger will reduce competition in an alleged national business market. AT&T/MCIWorldCom also claim that the merger will increase the likelihood of "price squeezes," and reduce competition for certain Internet services. These claims, however, lack merit. The intervenors also fail to demonstrate that the Brenner and Gillan theories would affect a significant part of any relevant market or that the effects they allege have ever actually occurred in the telecommunications industry.

1. "Spillover" Effects

Following Katz and Salop,[87] Sprint expert Dr. Brenner claims that the merger will exacerbate existing incentives of the applicants to deter entry.[88] In their model, Katz and Salop hypothesize that, even in the absence of a merger, ILECs facing price regulation may discriminate against CLECs seeking access to the ILEC network to enhance sales in downstream (e.g., long distance) markets.[89] More particularly, under certain conditions,[90] the ILEC will effectively sacrifice "upstream" or "wholesale" access revenues from the CLEC for a portion

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[85] See Brenner Trans. at 1219. Dr. Brenner also testified that U.S. West, Bell South, ICG, Nextlink, and Electric Lightwave are "in the list of firms [relatively well positioned to enter and compete in California], but [not] quite on the same level. Id. at 1217-1219. Moreover, "IXCs, CLECs, and cable companies have facilities, customer relationships, and brand recognition that Bell Atlantic cannot match out-of-region. These firms have already sunk significant investments into facilities in GTE's region and would benefit from expanding their bundle of services into local exchange services." Teece Rebuttal Test. at 29.

[86] Gillan Direct Test., at 37.

[87] Declaration of Dr. Michael L. Katz and Dr. Steven C. Salop, Using a Big Footprint to Step on Competition: Exclusionary Behavior and the SBC-Ameritech Merger (Oct. 14, 1998).

[88] In their Opening Brief, AT&T and MCIWorldCom do not allege spillover effects.

[89] See Katz & Salop, supra, at ¶34 (ILECs facing access price caps will have "the incentive to raise competitors' costs by denying, delaying, or degrading access").

[90] Id. at ¶¶36-42.

(the "diversion ratio"[91]) of the "downstream" or "retail" sales made by the CLEC to end users.[92] The merger exacerbates these incentives, they argue, because "one ILEC's exclusion of competitors from efficient access will create anticompetitive benefits for other ILECs."[93] As independent entities, the ILECs will not take into account these "spillover" effects.[94] By merging, however, the applicants can "internalize" these spillovers, thereby reducing entry and, ultimately, competition below pre-merger levels.[95]

As Professor Teece and other experts for the applicants note, however, Katz and Salop present no empirical evidence supporting the existence of their rather elaborate hypothesis. Specifically, Katz and Salop present no evidence that ILECs can selectively discriminate in the quality of access services they provide to competitors;[96] and, if they could, why such discrimination could not be readily detectable by CLECs or their customers. It can also be shown that, under a broad set of circumstances,[97] the spillovers Katz and Salop predict would be captured by the merging ILECs, regardless of whether they merge. Accordingly, a merger may not exacerbate the incentive to discriminate, even if spillover effects do occur. Finally, the Katz and Salop model assumes that the entry deterring behavior of one LEC would benefit other LECs, but plausible models producing the opposite result can also be constructed.[98]

Although we take no position on the general question of whether spillover effects deter or even induce multi-market entry, any additional externalities which result from this merger, between GTE operations in California and Bell Atlantic franchises in the Northeast, appear minimal. As the applicants and intervenors both recognize, spillover effects will not arise unless CLECs must "sink" common costs in both markets prior to entry. In other words, an ILEC can impose costs on CLECs contemplating entry elsewhere only by reducing the value of sunk

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[91] Id. at ¶39.

[92] Id. at ¶36.

[93] Id. at ¶62.

[94] Brenner Direct Test., at 39.

[95] Brenner Direct Test., at 39.

[96] Teece Rebuttal Test., at 17.

[97] See Declaration of Jacques Cremer and Jean-Jacques Laffont on behalf of GTE Corporation and Bell Atlantic Corporation and Bell Atlantic Corporation, at 16-24 (Dec. 15, 1998), attached as Exhibit I to Joint Reply of Bell Atlantic Corporation and GTE Corporation to Petitions to Deny and Comments, in re GTE Corporation and Bell Atlantic Corp., No. 98-184 (FCC Dec. 23, 1998)("Applicants' FCC Reply Brief"); Declaration of Kenneth Arrow, at Appendix 3, attached as Exhibit F to Applicants' FCC Reply Brief.

[98] Applicants' expert Dr. Teece notes, for example, that ILECs may cause spillovers "to develop a reputation of being a tough competitor and encourage [CLECs] to enter somebody else's territory instead." Teece Rebuttal Test. at 19.

investments to provide local services that are common to both markets. Katz and Salop generally categorize the common costs for a CLEC entrant as "research, product development, supporting software development and promotional costs."[99]

These types of costs are substantial, but they are not a significant addition (i.e., "incremental") to costs already sunk by most viable entrants in local exchange markets. Long distance companies, cable operations, and wireless firms and other likely CLECs have already made the types of investments Katz and Salop describe in their existing operations. For those carriers, the additional common costs that must be incurred to enter local exchange markets are relatively small. For example, the vast majority of the costs of providing the ION service described by Sprint in its Opening Brief, such as in the purchase or installation[100] of unbundled network elements ("UNEs"),[101] are specific to California,[102] and would not be jeopardized by any incentives resulting from this merger.

2. The "National Business" Market

AT&T/MCI expert Gillan apparently contends that the merger will adversely affect competition within an alleged "national business market."[103] The relevant market he alleges includes "packaged services [offered] on a nationwide scale to . . . [large business] customers who have operations and communications needs all across the country."[104] AT&T/MCIWorldCom fails to provide, however, any evidence supporting either Gillan's underlying theory or consumer injury within this hypothesized market.

Gillan stresses that the merger will broaden the applicants' product line and the

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[99]Katz and Salop, supra, at ¶70. Similarly, Dr. Brenner discusses ILEC actions directed at the Sprint ION plan. See Brenner Direct Test., at 41-42 ("some costs that CLECs and CSCs will incur to offer service will be independent of the number of markets that they intend to serve"), 44-45.

[100]I.e., through the "denying, delaying or degrading the provision of access or interconnection inputs." Id. at 35.

[101]See Sprint Opening Brief, at 34.

[102]Sprint notes that it has "made initial investment to cover the fixed cost to develop the sophisticated software and back office systems and to deploy the equipment that will make ION service possible, but it anticipates further investment of this sort to develop further service capabilities and support entry. Such investments are not specific to the areas entered or the number of customers that actually subscribe." Sprint Opening Brief, at 38. Those common costs, however, that are incremental to the provision of Sprint services will be a small percentage of the overall cost of providing ION service. It is, therefore, unlikely that the merger will affect Sprint's decision to provide ION service given the rapid growth in the demand for bundled telecommunications services.

[103]Gillan Direct Test., at 5, 6. In its Opening Brief, Sprint does not claim anticompetitive effects within this alleged market.

[104]Gillan Direct Test, at 6, quoting Joint Application at 13.

geographical scope of their customer base. In particular, the merger will expand the region in which Bell Atlantic and GTE multi-state customers receive local exchange services[105] from a single supplier.[106] In addition, Bell Atlantic customers will gain access to GNI. Gillan seems to claim that this broader customer base and service region will enhance the market power the merged entity can "leverage" -- as an incumbent[107] -- into (a) new service offerings[108] or (b) out-of-region service areas.[109]

This theory is "extremely vague,"[110] but Gillan apparently contends that the market power of an ILEC is related to the number of exchanges it serves.[111] Thus, bigger "footprints" supposedly increase the "leverage" of an ILEC over "competitive" product or geographic markets. Gillan, however, provides no theoretical basis or empirical evidence for a supposed relationship between footprint size and market power.

Equally important, Gillan fails to demonstrate consumer injury in any of the relevant markets identified above. Gillan attempts to calculate HHI figures in his hypothesized national business market using the number of multi-line business access lines sold by each firm. As Professor Teece notes, however, the number of "multi-line business lines" served by an ILEC are a wholly inadequate measure of the number of ILEC customers requiring national telecommunications services.[112] Accordingly, Gillan's HHI calculations do not reflect concentration within the alleged market and they are not helpful to this analysis.

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[105]See Gillan Direct Test., at 12 ("[T]he larger the footprint, the more of the customer's locations that fall within it. When an incumbent expands its footprint by acquiring other incumbents, it is able to leverage its advantages of incumbency across a much larger geographic area.").

[106]See Gillan Direct Test., at 12 (referring to "the convenience of a single provider across multiple locations").

[107]See Gillan Direct Test., at 13 (referring to "the incumbent's inherent advantage").

[108]See Gillan Direct Test., at 4 (referring to "the Joint Applicants' desire to leverage the market power that each enjoys within its existing franchise area, thereby making their franchise position stronger and extending that market power to an even broader array of geographic and product markets."); Gillan Trans. at 1244.

[109]Gillan Direct Test. at 14-15; Gillan Trans. at 1245 ("the merger will increase their ability to leverage their monopoly power if they do expand into out-of-region markets").

[110]Teece Reply Test., at 7.

[111]See also DiTirro Direct Test., at 18 ("The more locations of a multi-location customer a LEC can serve over its own facilities, the greater its competitive advantage.").

[112]Teece Direct Test., at 24.

In fact, neither GTE nor Bell Atlantic offers "truly nationwide services"[113] within the alleged market, and this merger may actually have the effect of reducing concentration there. Bell Atlantic sales in this state -- the largest in the country -- are de minimis. Bell Atlantic is even prohibited from selling long distance services within any of the 13 states it serves as an ILEC. In contrast, the three major long distance carriers already provide the packaged services Gillan describes. Even assuming that national business services are a relevant market for this analysis, competition for those sales is intense and the entry of the combined entity will only increase the intensity of that rivalry. Moreover, the object of the leveraging tactics alleged by Gillan, sophisticated multi-state business customers, can easily respond to price increases or output/quality restrictions by substituting between carriers or even leasing or purchasing their own lines.[114]

3. "Price Squeezes" in the Long Distance Market

Citing Town of Concord,[115] the intervenors contended in their Protest that the vertically integrated merged entity will be able to more "efficiently" squeeze rival long distance rivals because the consolidation will increase the percentages of calls originating and terminating within the same service area (from 16 to 29 percent).[116] "A price squeeze occurs when the integrated firm's price at the [upstream] level is too high, or its price at the [downstream] level is too low, for the independent to cover its costs and stay in business."[117] Here, AT&T/MCIWorldCom claim that the merged entity will manipulate the price of access, the upstream product, to squeeze rivals and eliminate competition in the downstream long distance markets.[118] As in other merger proceedings between LECs, however, AT&T/MCIWorldCom have failed to show

[113] Teece Rebuttal Test., at 24. As Teece also notes, the business access line statistics Gillan presents are "meaningless" because they do not indicate "the share each competitor has of those customers requiring national coverage." Id.

[114] See Teece Rebuttal Test. at 8-9 ("[T]here is enormous competition for these high volume customers from numerous ILECs, CLECs and IXCs across the country, some of whom today can provide services more closely approximating one-stop shopping, meeting all of their telecommunications needs, a handicap that, until it is granted 271 authorization, will not be possible for Bell Atlantic. Of all local exchange customers, these are the least likely for an ILEC to be able to exploit by leveraging its 'monopoly' with these customers.").

[115] Town of Concord, Mass. v. Boston Edison Co., 915 F.2d 17 (1st Cir. 1990).

[116] Protest of AT&T Communications of California, Inc. et al., at 21-22 (Jan. 15, 1999). GTE apparently provides terminating access services for 16% of the calls originating within its region. Protest of AT&T Communications, Inc. et al., at 22 (Jan. 15, 1999). Protestants claims that, "[i]f the merger were approved, 29% of the traffic originating in the current GTE territories will terminate in the combined territories of the merged entities, almost double the extent of pre-merged control." Id. at 22.

[117] Town of Concord, supra, at 18.

[118] See DiTirro Direct Test., at 26. Sprint takes no position on the price squeeze issue. See Opening Brief of Sprint Corporation L.P., at 19.

that such tactics are profitable or even feasible against long distance firms. Moreover, in this case, neither GTE nor Bell Atlantic is significantly integrated into interLATA services.

In Town of Concord, then Judge Breyer rejected a claim that the defendant utility squeezed the plaintiff municipality in the wholesale electricity market by raising the (regulated) prices of generation and transmission input services. In that particular case, the court held that price regulation at both levels of production eliminated the possibility of antitrust injury.[119] The court also noted, however, that for unregulated industries, "the extension of monopoly power from one to two levels does not necessarily, nor in an obvious way, give a firm added power to raise prices . . . [because] . . . there is but one maximum monopoly profit to be gained from the sale of an endproduct."[120]

The Commission and the FCC have reached similar conclusions about the ability of LECs to squeeze long distance carriers by manipulating access prices. Such tactics are not profitable in the short run because a fully integrated LEC incurs opportunity costs equal to the price of access on every call it gains from a long distance carrier.[121] This opportunity cost is multiplied for calls where the LEC provides both originating and terminating access.

Moreover, as a form of predation,[122] price squeeze tactics do not become profitable in the long run until after rivals have withdrawn from the market, at which time the LEC can recoup its lost earnings, provided that the long distance carriers cannot reenter the market. The cost of forcing enterprises like AT&T, MCIWorldCom, and Sprint from the market would, of course, be prohibitive. At the same time, reentry by the excluded firm or its successor would be a near certainty.[123] Compounding these overwhelming difficulties, "competitive access providers" (CAPs) and the long distance companies themselves can and do bypass the LEC and

[119] Town of Concord, supra, at 25 ("Full price regulation . . . significantly diminishes the likelihood of major antitrust harm.").

[120] Id. at 23.

[121] "Lost access charges represent the opportunity cost of any price squeeze. . . . If . . . the contribution from access were greater than the contribution from retail long distance, total ILEC profits would fall even though the ILEC long distance affiliate attracted business from a competitor." Teece Rebuttal Test., at 13.

[122] See Teece Rebuttal Test., at 13.

[123] See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rule Making, CC Dkt. No. 96-308, at ¶137 (July 18, 1996) ("Even in the unlikely event that a [BOC affiliate] could drive one of the three large interexchange carriers into bankruptcy, the fiber-optic transmission capacity of that carrier would remain intact, ready for another firm to buy at a distress sale and immediately undercut the noncompetitive prices.").

provide direct access to IEC "points of presence."[124]

Price squeeze allegations are particularly farfetched in this proceeding because neither GTE nor Bell Atlantic are significant sellers of facilities-based interLATA services. GTE provides 2.6 percent of the residential interLATA calls sold in the United States, but it sells 99.95 percent of those calls as a reseller.[125] Bell Atlantic's share of the facilities-based interLATA market is also extremely small. Thus, the only meaningful result of a successful price squeeze by the merged entity would be to replace one firm in the wholesale long distance market for another (because the merged entity will at least initially require facilities-based IECs to complete most of its calls). The merged entity has no conceivable incentive to achieve such results.

Finally, we are not aware of evidence that any integrated LEC has price squeezed its long distance rivals in any market. In another proceeding, the FCC also concluded that such an outcome was "unlikely."[126] We conclude that AT&T/MCIWorldCom have not presented any probative evidence that the merged entity would have the requisite incentive or ability to engage in a price squeeze against long distance suppliers.

4. Internet Service Providers and Access

AT&T/MCIWorldCom claim that the merger will "endanger" competition among Internet service providers (ISPs) and distort Internet access. GTE, with 900,000 internet customers nationally,[127] may be numerically a "very large ISP,"[128] but AOL's customers number over 15 million.[129] In market share terms, AOL has over 44%,[130] while GTE has only 2.6%[131]

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[124] As we noted in our review of the merger between Pacific Telesis and SBC, "AT&T reports that approximately 31.5% of its intraLATA traffic in North Carolina originates on special access facilities." AG Telesis-SBC Opinion, supra, at 11 n.57.

[125] Letter from Hojoon Hwang to Lindsay Bower, at 2 (Sept. 9, 1999).

[126] "At least three IXCs – AT&T, MCI, and Sprint – have nationwide or near-nationwide facilities. These are large well-established companies with customers throughout the nation. It may be unlikely, therefore, that a BOC affiliate . . . could drive one or more of these companies from the market." See Teece Rebuttal, at 14 n.16 (quoting Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, Notice of Proposed Rule Making, CC Dkt. No. 96-308, at par. 137 (July 18, 1996).

[127] Kissel Direct Test., at 29.

[128] AT&T/MCI Opening Brief, at 25.

[129] Kissell Direct Test., at 30.

[130] Kissell Direct Test., at 30.

and Bell Atlantic is "much smaller."[132] The Merger Guidelines provide no basis for concluding that the merger will "endanger" competition among ISPs. Furthermore, geographic markets for Internet access are local, and "there is no reason why adding together two non-competing ILECs in different geographic markets would change that situation."[133] MCIWorldCom witness DiTirro concedes that the Internet is "highly competitive,"[134] even though most users now obtain access through their ILECs. Given its local nature, we find that the merger will not exacerbate any (currently unidentified) anticompetitive incentive of the applicants to distort access.

E. Cross-Subsidization

This merger will not by itself increase the potential for cross-subsidization between California telecommunication markets, but the sheer size of the merged entity may present regulatory monitoring problems. The merged entity may have an incentive to shift common and other costs between regulated and competitive operations in different states to take advantage of these differences. We find, however, that the types of cross-subsidization AT&T/MCIWorldCom allege would not in any way be exacerbated by this merger.

1. Cross-Subsidization and Price Caps in Telecommunications Markets

Cross-subsidization occurs when a firm with a common capital facility uses revenues from one service to finance a portion of the cost of producing a second service.[135] A firm regulated to "break even" employs cross-subsidies if the revenues generated by either of two services exceeds the "stand-alone" cost[136] of providing that service. Conversely, the firm is free of cross-subsidies if the revenues generated by each service cover the incremental cost of providing that service.[137] For example, to promote universal service objectives, the Commission requires GTE and other LECs to cross-subsidize high cost with low cost service

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[131] Id. at 28.

[132] Id. at 29.

[133] Teece Rebuttal Test. at 21.

[134] DiTirro Direct Test., at 25 n.15.

[135] Larson, Monson, and Nobles, Competitive Necessity and Pricing in Telecommunications Regulation, 42 Fed. Comm. L.J. 1, 12 (1989).

[136] The stand-alone cost of a service is the cost to an efficient independent entrant of providing that service alone. Larson, Monson, and Nobles, supra, at 13 n.38.

[137] For discussions of these criteria, see Temin & Peters, Cross-Subsidization in the Telephone Network, 21 Willamette L.Rev. 199, 205-10 (1985); Larson, Monson and Nobles, supra, at 18-20.

areas.[138]

Cross subsidies can be anticompetitive under cost-based regulation if a firm with market power uses them to drive rivals out of a market.[139] A firm can price a competitive service below cost to the extent it is allowed to treat the cost of providing that service as a recoverable expense of the regulated sector. Suppliers which sell only the competitive service may be unable to match this cross-subsidized price and may, therefore, be forced to leave the market.[140] Like predatory pricing, the practice does not have adverse competitive effects unless the firm can reasonably expect to prevent future competitive reentry while it "recoups" profits lost during the predation stage.[141] For that reason, LECs could not profitably use cross-subsidies to monopolize long distance markets.

Even so, there may be other services which can be anticompetitively cross-subsidized. Telecommunications services are highly interdependent and the networks that provide them are almost infinitely complex. Accordingly, it is extremely difficult to ascertain the economic (long run incremental) cost of providing any single service.[142] Likewise, LECs can shift costs to

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[138]D.94-09-065, at 35-36 (Sept. 15, 1994).

[139]"Cross-subsidization is relevant . . . insofar as it may used to price below cost in the competitive market, and thereby unfairly acquire power and impede competition in that market." U.S. v. Western Electric Co., 900 F.2d 283, 297 (D.C. Cir. 1990).

[140]Thus, some observers contend that cross-subsidization is not a feasible practice in the telecommunications industry because (1) telephone companies are generally not allowed to earn rates of return that exceed the market cost of capital and (2) telephone companies' rates of return do not always stay at even the allowed rate of return. Larson, Monson, and Nobles, supra, at 15.

This analysis is incomplete. "[P]redation cannot be a successful strategy under price caps in the short run. . . . Price caps can, however, reduce the cost of predation. Thus predation is more likely under price caps than in an unregulated private market, but it is less likely than under standard [cost-based] regulation. For this reason, it is important to segregate competitive and monopoly services under a price-caps regime, keeping competitive services out of the regulatory regime altogether." Crandall & Waverman, Talk is Cheap: The Promise of Regulatory Reform in North American Telecommunications, at 113 (Brookings Institution, 1995).

[141]Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209, 224 (1993) ("Recoupment is the ultimate object of an unlawful predatory pricing scheme; it is the means by which a predator profits from predation.")

[142]The proper attribution of many network costs is not clear. For example, some observers contend that the costs of providing customers with access to the network are not "common" to all telecommunications services. See Kahn & Shew, Current Issues in Telecommunications Regulation: Pricing, 4 Yale J.Reg. 191 (1987); Parsons, Seven Years after Kahn and Shew: Lingering Myths on Costs and Pricing Telephone Service, 11 Yale J.Reg. 149, 152 (1994). Instead, they argue, these costs should be directly attributable to a network access service, which is a service in its own right. Parsons, supra, at 152. By treating "loop costs" as common, however, "the marginal cost of subscriber access will be very low (or perhaps zero) and the common costs to be recovered by all services will be relatively high. In contrast, if loop costs are accepted as directly attributable to subscriber access, then marginal costs for access will be high and common costs relatively low." Id. at 163. Moreover, the treatment of

underprice rivals in many telecommunications markets.[143]

2. Recommended Data Sharing Measures

Many states other than California employ price caps, but the majority continue to use cost-based systems. Moreover, significant differences arise among the inflation rates and productivity factors calculated by the various price cap states. The merged entity may have an incentive to shift common and other costs between regulated and competitive operations in different states to take advantage of differences in regulatory price-setting policies. To minimize these opportunities, we recommend that the Commission share detailed data with states that are strongly "affiliated" with GTE's California operations.

3. The AT&T/MCIWorldCom Cross-Subsidy Allegations

Relying on expert Gillan, AT&T/MCIWorldCom alleges that the merged entity will provide two types of cross-subsidies to its competitive operations in California.[144] Neither of the alleged tactics, however, are merger-related and the hypothesized "in-region" compensation is not even a cross-subsidy.

Like his discussion of an alleged national business market, Gillan's theories of cross-subsidies are "extremely vague." In his analysis of "in-region" effects, he seems to allege that GTEC is currently subsidizing, as opposed to cross-subsidizing, GTECC. He begins with the claim that neither GTECC nor any other CLEC is operating profitably. GTECC, moreover, continues to provide services within GTEC service areas. Gillan infers from the fact of its continued operation that GTECC is operating at a loss, and that GTEC is making up the difference; i.e., that GTECC "is willing to 'cross-subsidize' its service packages through its affiliate relationship with its incumbent affiliate, GTEC."[145] Gillan, however, provides no evidence and does not even allege that the payments from GTEC are transfers between regulated and competitive operations. In any event, GTECC and GTEC are presumably selling the same types of retail services at the same rate, so the transactions between affiliates are a "wash" from the parent company perspective with no adverse competitive effects. Moreover, Gillan fails to demonstrate how the merger would alter the nature of these transactions.

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these costs will also affect the circumstances under which cross-subsidization will be inferred. Id. at 164-65.

[143]The New York Public Service Commission found, for example, that an unregulated NYNEX subsidiary, Materials Enterprises Company (MECO), overcharged the parent for purchasing, supply, and other services provided to New York Telephone Company. The Public Service Commission did not find that the practices were anticompetitive, but the overcharges presumably would have been reflected in the regulated rates of New York Telephone. See Schwartz and Hoagg, Vertical Divestiture: Structural Reform of an RHC, 44 Fed. Com. L.J. 285, 297 (1992).

[144]See AT&T/MCIWorldCom Opening Brief, at 16-19.

[145]AT&T/MCIWorldCom Opening Brief, at 18; Gillan Direct Test., at 22.

The "out-of-region" effects alleged by Gillan are also obscure and, in fact, may enhance competition. In its discussion of the Gillan theory, AT&T/MCI refers to Bell Atlantic offering "its existing large business customers" local services "outside Bell Atlantic's existing service area."[146] This "outside" area apparently refers to GTE California service areas, particularly because Gillan refers to the planned use of "GTE's local exchange facilities."[147] The cross-subsidy here is apparently between profits generated in access and other regulated services provided by Bell Atlantic and competitive services offered by GTE (either in GTE or other service areas). Gillan, however, fails to identify any types of regulated revenues that are not currently available to GTE, or to describe GTE's current inability to engage in the hypothesized behavior of the merged entity.

Gillan also fails to demonstrate that any tying or "leveraging" outside the GTE service area would be anticompetitive. He implicitly claims that the merged entity will sell in-region services over which it has market power on the condition that its national business customers also purchase competitive services in out-of-region areas. As a public utility, however, the merged entity cannot refuse to sell regulated services offered within its franchise area. Accordingly, the merged entity cannot "tie" the two services. In any event, prospective customers will purchase the package of in-region and out-of-region services to which Gillan objects from the supplier offering the most favorable price/quality mix. Competition is enhanced to the extent that the merged entity can provide this mix on more favorable terms than any existing supplier. We conclude that the merger will not exacerbate any current incentive of GTE alleged by AT&T/MCIWorldCom to cross-subsidize its California operations.

IV. CONCLUSION

We conclude that this merger will not adversely affect competition within California telecommunications markets. The record contains no evidence that Bell Atlantic would have entered California markets in the absence of this merger. Moreover, AT&T, MCIWorldCom, Sprint, and other well-financed companies do plan to provide service in major markets where entry is at least theoretically profitable. Entry by these and other firms has already reduced both prices and concentration levels within the intraLATA toll and direct access markets.

We also conclude that the merger by itself will not enhance anticompetitive cross-subsidization opportunities. To promote competition in the markets served by the applicants, however, we recommend that the Commission share state-level accounting cost information with regulatory agencies in Bell Atlantic states that are strongly "affiliated" with California.

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[146] AT&T/MCIWorldCom Opening Brief, at 18.

[147] AT&T/MCIWorldCom Opening Brief, at 19.

DECLARATION OF SERVICE

Case Name: In the Matter of Joint Application of GTE Corporation & Bell Atlantic Corporation, et al. No.: A.98-12-005

I declare:

I am employed in the County of San Francisco, California. I am 18 years of age or older and not a party to the within entitled cause; my business address is 455 Golden Gate Avenue, Suite 11000, San Francisco, California 94102.

On September 15, 1999, I served the attached

OPINION OF THE ATTORNEY GENERAL ON COMPETITIVE EFFECTS OF PROPOSED MERGER BETWEEN GTE CORPORATION AND BELL ATLANTIC CORPORATION

by placing a true copy thereof enclosed in a sealed envelope with postage thereon fully prepaid, in the United States mail at San Francisco, California, addressed as follows:

SEE ATTACHED LIST

I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on September 15, 1999, at San Francisco, California.

Michelle Quach

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