Exhibit ___ (ADK-T)
Docket No. UT-991991
Witness: A. Daniel Kelley

BEFORE THE WASHINGTON UTILITIES AND

TRANSPORTATION COMMISSION

In the Matter of the Petition of	)	
	)	
MCI WORLDCOM, INC.	)	
AND	)	Docket No. ____
SPRINT CORPORATION	)	
	)	
For an Order Disclaiming Jurisdiction, or in The Alternative, Approving the Transfer of Control of Sprint Corporation's Washington Operating Subsidiaries to MCI WorldCom, Inc.	)	

REPLY TESTIMONY OF A. DANIEL KELLEY

Dated: April 21, 2000

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Q. PLEASE STATE YOUR NAME.

A. My name is A. Daniel Kelley.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by MCI WorldCom and Sprint to reply to the testimony filed by staff witness Glenn Blackmon and SBC Communications, Inc. (“SBC”) witness Jerry A. Hausman.

Qualifications

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by HAI Consulting, Inc. of Boulder, Colorado as Senior Vice President.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE.

A. My professional experience began in 1972 at the Antitrust Division of the U.S. Department of Justice where I analyzed mergers, acquisitions and business practices in a number of industries, including telecommunications. While at the Department of Justice, I was a member of the economics staff of U.S. v. AT&T. In 1979, I moved to the Federal Communications Commission ("FCC") where I held positions as Senior Economist in the Common Carrier Bureau and the Office of Plans and Policy, and also served as Special Assistant to the Chairman. After leaving the FCC, I was a Project Manager and Senior Economist at ICF, Incorporated, a public policy consulting firm. From September 1984 through July of 1990, I was employed by MCI Communications Corporation as its Director of Regulatory Policy. At MCI, I was responsible for developing and implementing MCI's public policy positions. In August of 1990, I joined Hatfield Associates,

Inc. (the predecessor of HAI) as Senior Vice President. In my current position, I conduct economic and policy studies on a wide variety of telecommunications issues, including dominant firm regulation, local exchange competition, and the cost of local service. I have advised foreign government officials on telecommunications policy matters and have taught seminars in regulatory economics in a number of countries.

Q. PLEASE DESCRIBE YOUR EDUCATION.

A. I received a Bachelor of Arts degree in Economics from the University of Colorado in 1969, a Master of Arts degree in Economics from the University of Oregon in 1971 and a Ph.D. in Economics from the University of Oregon in 1976.

Q. HAVE YOU PUBLISHED RESEARCH IN ECONOMICS?

A. Yes, I have published articles in antitrust and telecommunications economics. A copy of my resume is attached as Attachment ADK-1.

Q. HAVE YOU TESTIFIED PREVIOUSLY?

A. Yes, I have testified on telecommunications issues before the California, Colorado, Connecticut, Florida, Georgia, Hawaii, Maryland, Massachusetts, Michigan, New Jersey, New York, Oregon, Pennsylvania and Utah Commissions, as well as the Federal Communications Commission and the State-Federal Joint Board investigating universal service reform.

Introduction and Summary

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

A. Contrary to the conclusions reached by Drs. Blackmon and Hausman, I conclude that the merger proposed between MCI WorldCom and Sprint is consistent with the

public interest because it will promote competition. The single largest public policy issue in telecommunications is, and always has been, the incumbent carrier monopoly over the last mile. As a result of this merger, Washington users of telecommunications services will benefit from a broader array of services in a more competitive environment, most particularly in local services. Consumers with a preference for one-stop shopping will benefit because the combined firm will offer a more extensive set of services in more geographic areas. At the same time, because of the increasingly important role of the emerging carriers, the merger will not adversely affect competition in the long distance market.

Q. HOW DO YOU BELIEVE THE MERGER WILL PROMOTE LOCAL COMPETITION?

A. There are three ways in which local competition will be promoted: through more rapid deployment of broadband wireless services using Multichannel Multipoint Distribution Service ("MMDS"), through more rapid deployment of UNE-loop and UNE-P services, and through more extensive deployment of WorldCom-owned local fiber facilities.

Q. PLEASE EXPLAIN WHY THE MERGER WILL NOT HAVE AN ADVERSE IMPACT ON COMPETITON IN THE LONG DISTANCE MARKET.

A. The long distance industry today is marked by robust competition. Given recent developments in long distance, the merger presents no serious risk to competition in that market. The long distance market in Washington and elsewhere is

experiencing significant entry and expansion by a number of carriers. This entry makes successful anti-competitive conduct by the combined firm highly unlikely.

Q. WHAT ARE THE BASES FOR YOUR CONCLUSIONS?

A. I base my conclusions on a review and analysis of the current telecommunications marketplace, as well as the rapidly emerging changes which will affect the telecommunications business in the near term, as the joint applicants describe in their application. In particular, my conclusion is supported by my review of the long distance industry, the state of local competition in the United States and Washington and other factors that I describe in my testimony.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Dr. Blackmon's testimony first performs a traditional antitrust analysis of the merger then considers the benefits that the merging parties have described. Finally, he addresses branding issues. I will discuss all of the long distance competition issues first and then will address the benefits issues. The testimony of Dr. Hausman raises many of the same issues raised in Dr. Blackmon's testimony. I address specific points raised by Dr. Hausman in the course of responding to Dr. Blackmon.

Long Distance Competition

Q. WHAT ARE DR. BLACKMON'S CONCLUSIONS?

A. Based on his analysis of the structure of the long distance industry, he concludes that the merger will reduce competition. Dr. Blackmon bases this conclusion on a traditional market concentration analysis.

Q. ARE THERE ISSUES ON WHICH YOU AND DR. BLACKMON AGREE?

A. Yes. He believes that "the long-distance market is, at this time, subject to effective competition" (p. 9) and I agree.

Q. THEN HOW DOES DR. BLACKMON ARRIVE AT HIS CONCLUSION THAT THE MERGER IS LIKELY TO REDUCE COMPETITION?

A. Dr. Blackmon uses a traditional antitrust analysis based on current market shares. For example, as explained in his testimony, he uses an HHI analysis along with the U.S. Department of Justice Merger Guidelines to support his conclusions.

Q. WHAT IS THE FRAMEWORK UNDER WHICH YOU BELIEVE THIS MERGER SHOULD BE EVALUATED?

A. The analysis must be forward-looking – informed by, but not restricted by current circumstances. An analysis premised on a relatively static business and technological environment is inapplicable to the telecommunications industry. An understanding of technological developments is critical for this merger review. By focusing on current market shares Dr. Blackmon underestimates the competitive forces present in this industry – forces that will not be adversely affected by the merger.

Q. WHY IS AN UNDERSTANDING OF TECHNOLOGICAL CHANGE IMPORTANT FOR THIS MERGER REVIEW?

A. There are two significant reasons. First, technological change is blurring the distinctions among traditional telecommunications markets. An analysis of the merger must take into account the ways that technological change is changing the markets in which the two firms are participating. Second, even in the context of traditional telecommunications markets, technological change affects the ability of

firms to engage in cooperative or anti-competitive behavior. The telecommunications industry is in a period of rapid technological change. It is impossible to draw reasonable conclusions about the public interest impact of the merger without taking these changes into account. (I will discuss technological change and local markets later in this testimony.)

Q. IS THE GROWTH OF THE INTERNET AFFECTING TELECOMMUNICATIONS MARKETS?

A. Yes. The Internet has stimulated the growth of broadband data service, which provides transmission capacity for sending data, video, and imaging information. The key point is that these networks involve the movement of increasingly large amounts of data, which in turn imposes the requirement for broadband data transport services. These developments are leading a host of large and small companies to compete to provide consumers with broadband connectivity. The capacity that is being built can carry both traditional voice calls and Internet data.

Q. IS THE TELECOMMUNICATIONS INDUSTRY ALSO UNDERGOING ORGANIZATIONAL CHANGE?

A. Yes. Other telecommunications industry consolidations are occurring, perhaps out of a belief that scale is required to be an effective provider of bundled services. As a result, the telecommunications industry is experiencing significant organizational change. SBC has acquired PacTel, SNET and Ameritech. Bell Atlantic acquired NYNEX, is proposing to acquire GTE, the second largest local carrier in Washington, and now is merging its wireless business with Vodafone. AT&T acquired McCaw, TCG and TCI and is proposing further cable mergers and joint

ventures. AT&T and BT have merged their international businesses. Williams and SBC have entered into joint ventures, including the transfer of major assets. While it is difficult to prove that technology is driving consolidation in the industry, it is clear that firms have decided to become larger as the industry evolves. Given the approval of several recent telecommunications mergers, policymakers have apparently considered large size to be acceptable. In addition, the telecommunications industry has rapidly begun to offer bundled services. In its advertising GTE reports that a 1999 survey by J.D. Power revealed that more than half of all consumers wanted to obtain their telecommunications services from one provider through a bundle. This leads to the compelling conclusion that consumers are leading the industry to put aside the historical distinctions among services. The MCI WorldCom-Sprint merger must be viewed, at least partially, as a response to consolidations that have already occurred.

Traditional Antitrust Analysis

Q. HOW DOES A TRADITIONAL ANTITRUST ANALYSIS OF THIS MERGER SUCH AS THE ONE CONDUCTED BY DR. BLACKMON PROCEED?

A. A traditional merger analysis focuses on whether the proposed combination will allow the combined firm, possibly in conjunction with other firms in the industry, to increase price (or, equivalently, to fail to lower price as much as would have occurred in the absence of the merger). Market definition takes into account the availability of identical services as well as substitutes and related products with varying degrees of substitution and is a tool used to try to answer this question.

Market shares are an intermediate step in determining the effects of the merger on competition. Price-cost margins are also a useful measure of actual market power.

Q. WHAT ARE THE MARKETS ON WHICH A TRADITIONAL ANALYSIS MIGHT FOCUS?

A. There are three: the residential and small business mass market, the large business market and the wholesale market. Many of the forces affecting these individual markets affect the markets collectively as well.

Q. WHAT ARE THE MARKETS A DYNAMIC ANALYSIS WOULD RECOGNIZE?

A. A dynamic analysis would recognize the development of all distance and bundled service markets. Both Dr. Blackmon and Dr. Hausman address the effect of the merger on a market for bundled services. As I describe later in this testimony, I disagree with their conclusions. Morever, the U.S. Department of Justice Merger Guidelines contemplate that a forward-looking view of market conditions should to be taken into account.

Long Distance Competition Generally

Q. PLEASE DESCRIBE THE CURRENT AND ANTICIPATED NATURE OF COMPETITION IN THE OVERALL LONG DISTANCE BUSINESS.

A. The most prominent feature of the current and anticipated long distance market is that it is characterized by robust – indeed intense – competition. In addition to AT&T, the merged firm will face competition from literally hundreds of new firms that presently supply long distance service, as well as companies that have not yet entered the market. (As I describe below, 500 carriers are registered to provide

long distance service in Washington.) These new carriers, several of which have their own, new, high capacity facilities, are capturing an increasing share of long distance customers. These competitors will be joined by Regional Bell Operating Companies (RBOCs) when they are able to satisfy the requirements of Section 271 of the Telecommunications Act of 1996 and provide in-region interLATA long distance service. In addition, large sophisticated purchasers of telecommunications services, and the integrators that serve them, are able to produce these services by combining inputs from a wide and growing variety of suppliers, further increasing the competition faced by traditional long distance carriers.

Q. WHAT IS THE BASIS FOR THE ABILITY OF THE NEWER FIRMS TO COMPETE?

A. The enormous and continuing growth of long distance transmission capacity controlled by emerging carriers is a critical factor in the changing environment in which the merged MCI WorldCom-Sprint will compete. The availability of that capacity has dramatically reduced the dependence of other long distance carriers on the larger carriers for an important input. Moreover, the ability of other carriers, old and new, to use already existing capacity to expand output in the face of any attempted price increase provides an important competitive constraint on the merged firm. This capability is increasing as the capacity controlled by emerging carriers continues to grow rapidly. Emerging carriers not only have access to transmission capacity that will permit them to expand their output, but they have an already demonstrated ability to attract customers from the major long distance carriers.

Q. DO THE DATA SUPPORT YOUR CONCLUSIONS?

A. Yes. The share of toll revenues accounted for by new entrants into long distance service has grown rapidly in the recent past. FCC data show that over the period from 1990 to 1998 (the latest year for which data are available) the share of total residential and business toll revenues accounted for by long distance carriers other than AT&T, MCI WorldCom, and Sprint increased from 10.8 percent to 20.9 percent. There is no reason to believe this trend has been broken. (The data are from Table 11.3 in the FCC's Trends in Telephone Service, March 2000). WorldCom revenue is included in the MCI WorldCom figure.) These data do not count local exchange carriers as long distance carriers. Approximately 1,000 providers account for the combined revenue share of the "other" carriers. These include facilities-based carriers, pure resellers, and carriers with their own facilities that also engage in some resale. (This estimate is based on the number of carrier identification codes assigned by the North American Numbering Plan Administration, FCC, Trends in Telephone Service, September 1999, at 10-1.) The WUTC web site lists 500 carriers registered to provide long distance in Washington. USWestDex.com lists 59 long distance carriers serving Seattle. The same source lists eight carriers serving Spokane – not including AT&T, MCI or Sprint. Competitive carriers offer a broad range of long distance services, ranging from relatively simple basic voice services supplied to residential customers to advanced voice and data services for large business customers. Moreover, non-traditional outlets for long distance service are developing. (The Declarations of

Stan Besen and Steven Brenner filed with the MCI WorldCom and Sprint FCC Application and Reply Comments provide additional details.)

Q. WHO ARE THE COMPETITORS?

A. Several firms are in the process of building nationwide fiber networks. These include Qwest, Frontier/Global Crossings, GTE, Broadwing (formerly IXC), Williams, and Level 3. Numerous smaller firms also are deploying fiber. Among the larger regional firms are Caprock, McLeod USA, GST Telecom and Touch America. (Qwest recently announced its intention to sell its long distance business in US West's territory to Touch America, a telecommunications company associated with Montana Power.) I have identified more than 30 firms in addition to AT&T, MCI WorldCom and Sprint who have deployed intercity fiber facilities. Approximately half of these firms have a presence in Washington. The WUTC web site lists 500 carriers certified to provide long distance service in the state. Large corporations demanding "high end" services can "self-supply" these services, or they can outsource them to integrators such as EDS.

Q. WHAT DO DR. BLACKMON'S DATA SHOW?

A. Dr. Blackmon reports data from Washington. (See Exhibit GB-2) His data show significant share increases by Frontier, GTE and others between 1996 and 1998. I expect that these trends are continuing and will continue.

Q. WHAT ARE THE COMPETITIVE IMPLICATIONS OF THESE DEVELOPMENTS?

A. These developments in effect ensure that the diversion of customers from the combined MCI WorldCom-Sprint to other carriers in response to any price

increase likely would be substantially greater than it would have been even five years ago, and will be even greater in the near future. Because the merged firm could expect a larger fraction of its customers to be lost to other firms if it were to raise prices, its incentive to do so is commensurately reduced.

Q. WHAT IS THE BASIS FOR THE CHANGED ENVIRONMENT IN THE LONG DISTANCE TELECOMMUNICATIONS MARKET THAT YOU DESCRIBE?

A. At the core of the changes in long distance communications in recent years has been the construction of large capacity networks by new entrants. These new networks are being built to respond to the demand for bandwidth to carry data traffic. However, that same capacity is available to carry all types of traffic. Indeed, the distinction between data and voice traffic is becoming ever more blurred. Thus, I believe that Dr. Hausman's attempt to segregate out a separate data market (pages 20-21) is not appropriate.

Q. DO THE DATA CONFIRM THIS COMPETITIVE ACTIVITY?

A. Yes. According to FCC data, between 1995 and 1998 interexchange carriers added 62.8 million total fiber system route miles (the most generally available measure of network size), new carriers added 44.7 million route miles, or more than 71 percent of the total increase over that period. These carriers accounted for more than 30 percent of all fiber route miles by 1998. Qwest has reported that the currently "lit" portion of its network has sufficient capacity to handle the current combined traffic of AT&T, MCI WorldCom, and Sprint. The share of long distance capacity controlled by AT&T, MCI WorldCom and Sprint is diminishing.

Moreover, there are additional competitive pressures from new vertically integrated carriers who are using their own capacity to compete, as well as from resellers that lease that capacity. These pressures assure competition for residential users and small and large businesses as well as for the wholesale business of other carriers. Thus, the growth in the capacity of new entrants confirms directly the competition faced by AT&T, MCI WorldCom, and Sprint. It has also reduced the dependence of resellers on them.

Q. PLEASE DISCUSS THE IDENTITY OF SOME OF THESE CARRIERS.

A. In addition to companies such as Qwest, Level 3, Broadwing and Frontier, an entirely new group of carriers is emerging. These are electric utility companies throughout the country. This source of capacity is significant because many of these companies are building fiber networks in less densely populated portions of the country. Electric Lightwave Inc. ("ELI"), a Vancouver Washington firm, is using utility transmission towers, substations and rights of way. Touch America, which provides service in Washington, is affiliated with Montana Power.

Q. PLEASE PROVIDE DETAILS ON COMPETITORS IN THE STATE OF WASHINGTON.

A. I identified 14 post-merger carriers that own or lease fiber in the Seattle LATA (#674). In addition to the merged MCI WordCom/Sprint, these include AT&T, Cable and Wireless, Frontier, GST, GTE, Level 3, PSINet, Teleglobe, Worldwide Fiber, BTI Telecom Services, Touch America, Williams, and Qwest. Eight of these firms actually own fiber, either directly or through shared ownership with another company. As I noted above, Qwest is selling its long distance business to

Touch America. Six of these carriers own or lease fiber in the Spokane LATA (#676). In addition, Williams has fiber in the LATA, but does not yet market it there. Obviously, it could easily do so. The Portland LATA (#672) includes portion of Washington. There will be eight post-merger fiber networks serving the Portland LATA. Finally, the Coeur d' Alene Idaho LATA (#960), which includes portions of Washington, is of one of only eight LATAs that will be served by two carriers as a result of the merger. However, Coeur d' Alene is only 40 miles from Spokane, which would allow a simple extension of an existing fiber route, or even a microwave route, to extend additional service to that LATA. Avista Communications (formerly Washington Water Power), which is providing local services in Spokane, Washington, reports that it is using "companies like Touch America to provide necessary links to the markets we serve." (1999 Annual Report to Shareholders) Avista is serving cities with population less than 500,000. Moreover, Electric Lightwave Inc. has announced an agreement that with Northwest Telephone to offer high-speed, high-tech telecommunications services to businesses in Wenatchee and in the future to other central and eastern Washington communities. (November 8, 1999 Press Release)

Q. WHAT IS THE NATURE OF THE INVESTMENTS THESE CARRIERS ARE MAKING?

A. Carriers building networks typically install a significant amount of fiber. The largest cost in deploying a network is the initial installation, including acquiring rights-of-way and laying or hanging the fiber. Thus, the investment in fiber is

sunk. Once installed, the fiber can carry a substantial volume of traffic limited basically by the electronics used to light it. At the same time, the cost of electronics is falling rapidly, along with electronic equipment in general. Given sufficient multiplexing capability, a single fiber on the Seattle-San Francisco route can carry a substantial portion of all of the traffic on the route.

Q. ARE THERE ESTIMATES OF THE CAPACITY BEING INSTALLED BY LONG DISTANCE CARRIERS?

A. Yes. Credit Suisse/First Boston estimates that by the year 2003, MCI WorldCom and Sprint combined will have less than one percent of the supply of bandwidth provided by only ten carriers. (Daniel P. Reingold, et al, U.S. Telecom Services Wireline, Credit Suisse/First Boston, January 6, 2000, p. 34). This Credit Suisse/First Boston analysis is reproduced as Exhibit ADK-2. As I have previously noted, the currently "lit" portion of Qwest's network is reported to have sufficient capacity to handle the current combined traffic of AT&T, MCI WorldCom, and Sprint.

Q. ARE THESE FIRMS ABLE TO COMPETE WITH THE LARGER CARRIERS?

A. Yes. Many of these firms offer a full range of telecommunications services and are successful in attracting both larger and smaller customers.

Q. WHY IS CAPACITY IMPORTANT TO A COMPETITIVE OUTCOME?

A. Because capacity quickly can be brought on line to serve customers, it will be difficult to raise prices above competitive levels.

Q. IS TRANSMISSION CAPACITY ALONE SUFFICIENT TO DISCIPLINE PRICING IN THE MARKET?

A. Not necessarily. The competitors must have the capability to market to and bill consumers. However, as I noted above, there are several large carriers with the ability to attract mass market and large customer business from AT&T, MCI WorldCom and Sprint. In addition, hundreds of resellers in Washington have entered the market and have the resources to attract business and serve customers using capacity leased from the many fiber suppliers.

Q. ARE THE EMERGING SUPPLIERS ABLE TO ACCOMMODATE ADDITIONAL CUSTOMERS IN THE EVENT OF A PRICE INCREASE BY THE COMBINED FIRM?

A. Yes. A great deal of the increased fiber capacity that I have described is in the hands of new carriers. Much of it is still unused, and it can be brought into service relatively quickly and at reasonable cost. Therefore, increases in price can be countered by significant expansions in output by new and smaller long distance carriers, the ability of larger carriers to raise prices is reduced. Moreover, the owners of new networks already have plans to "light" additional amounts of their fiber capacity over time. These plans could easily be accelerated. The substantial amounts of additional unused fiber capacity can be used by the carriers themselves, by pure resellers to which they supply capacity at wholesale, and/or by firms such as switch-based resellers or integrators that combine transmission capacity with other inputs. These factors constrain the ability of a combined MCI WorldCom-Sprint to raise prices after their merger.

Q. DR. BLACKMON ARGUES THAT THE 10-25 PERCENT MARKET SHARE HELD BY RESELLERS IN WASHINGTON OVERSTATES THEIR COMPETITIVE SIGNIFICANCE. DO YOU AGREE?

A. No. He bases this finding on the claim that resellers " . . . cannot be expected to constrain the prices of their own suppliers." (p. 9) As I discuss later in this testimony, the hundreds of resellers in Washington that Dr. Blackmon refers to are an important outlet for capacity being built by a number of carriers.

Q. DR. HAUSMAN INDICATES THAT SBC IS INTERESTED IN THIS MERGER BECAUSE OF ITS NEED TO ACQUIRE CAPACITY FOR ITS LONG DISTANCE BUSINESS. (P. 1) DO YOU AGREE THAT THIS WILL BE AN ISSUE FOR SBC?

A. No. SBC's own actions demonstrate that this is not a real issue. A February 29, 2000 SBC Press Release reports that "As part of an alliance agreement entered a year ago, Williams provides the transport, upon regulatory approval, of SBC's long-distance data and voice traffic, while SBC will become an anchor tenant on Williams' advanced fiber- based ATM backbone network." Williams has a fiber route that crosses through Washington.

Q. ARE THERE OTHER COMPETITIVE CHANGES ON THE HORIZON?

A. Yes. At some point, the Regional Bell Operating Companies ("RBOCs") will be allowed into in-region long distance markets. Recently the FCC permitted Bell Atlantic to begin offering long distance service in New York State. Within months, Bell Atlantic began to offer a bundled local/LD service offering in NY. Markets will look dramatically different after BOC entry. As I explained, bundling

of local and long distance services, already a growing marketing factor, will only increase after the RBOCs are able to offer one-stop shopping. Indeed, due to low barriers to entry in the long distance market, the RBOCs will be able to provide interLATA long distance service immediately upon receiving 271 authority.

Q. WILL THE RBOCS PLAY A SIGNIFICANT ROLE IN THE LONG DISTANCE BUSINESS?

A. Analysts believe that RBOCs will be able quickly to acquire a market share as high as 25 percent. This was the experience in Connecticut when SNET entered the long distance business.

Q. DO DRS. BLACKMON AND HAUSMAN AGREE WITH THIS CONCLUSION?

A. No. They both discount RBOC entry. There is no question that the RBOCs have generally failed to meet their Section 271 obligations and RBOC entry is taking longer than expected at the time the 1996 Act was passed. My own analysis shows that SBC's Texas Application was deficient. However, the Department of Justice Merger Guidelines, which I discuss in more detail below, consider a two year time frame in which to evaluate potential entry. (See U.S. Department of Justice Merger Guidelines, Section 3.2) One RBOC has been granted 271 authority, and it is likely that more Applications will be granted within that window.

Q. WHAT IS THE STATUS OF GTE IN THE LONG DISTANCE MARKET?

A. GTE, the second largest local exchange carrier in the state already is providing long distance service throughout Washington. GTE recently reported that

increases in its telecommunications revenues were "attributable in part to increased revenues from long-distance operations, higher contract sales to medium and large business customers and revenues from bundled local, long-distance, wireless, paging and Internet services. The growth in long-distance revenues is due to a 27% increase in the number of customers since September 30, 1998 to approximately 3.2 million customers. On September 30, 1999 there were 239,000 customers of bundled services, an increase of 232% since the third quarter of 1998." (GTE, November 12, 1999 form 10-Q) GTE serves almost 900,000 lines in Washington.

Q. HOW DOES TECHNOLOGICAL CHANGE IMPACT THE ABILITY OF CARRIERS TO MAINTAIN PRICES ABOVE COST?

A. All customers, residential, small business and larger business, have a growing number of alternatives because of the emergence of new carriers and the new network capacity on which they can rely, and because of changes in technology. These alternatives increasingly will constrain the ability of the merged MCI WorldCom-Sprint to raise prices to larger customers. The coordination among competitors necessary to maintain prices above cost is more difficult when there is rapid technological change. As discussed above, the new entrants are building networks with a new generation of IP-based technology. As I discuss below, long distance carriers are integrating into local markets using new technologies.

Q. DOES THE GROWTH OF THE INTERNET AND THE CONSEQUENT DEMAND FOR BROADBAND CAPACITY HAVE IMPLICATIONS FOR VOICE MARKETS?

A. Yes. As broadband data networks have grown in importance to users, interest is growing in integrating data and voice networks. For example, Winstar, which serves Seattle, is competing for corporate network business by providing a single source for local, long distance, Internet and data traffic. This interest is heightened by the Internet's potential ability to serve as a replacement and enhancement for voice and other services customers otherwise purchased from the public switched telephone network ("PSTN"). Specifically, the Internet may develop to support a full range of voice services and features, using what is often referred to as Voice over Internet Protocol ("Internet voice"). Integrated networks could produce a number of advantages, such as more efficient utilization (for instance, interspersing low-priority data in lulls between the transmission of higher-priority voice), consolidated management, and innovative applications involving a mixture of voice and data content. At the same time, there are substantial technical obstacles to the full integration of voice and data, related to the quality of the reconstructed voice signal and the effects of transmission delays and lost packets when voice is sent over a packet network. A substantial effort is underway to analyze and resolve these issues, including any protocol development that may be required. These issues should be resolved within the next year or two, which will allow the Internet to play an increasingly important role in the provision of long distance voice services. As time moves on the distinctions between the "voice" network and the Internet increasingly are likely to blur. As a corollary, there will be a blurring of distinction between today's long distance carriers and Internet Service Providers ("ISPs").

Q. WHAT CONCLUSIONS DO YOU DRAW FROM YOUR ANALYSIS OF THE OVERALL STRUCTURE OF THE LONG DISTANCE BUSINESS?

A. Telecommunications markets are evolving in ways that make it clear that only a forward-looking analysis can be used to evaluate the proposed merger. It is no longer appropriate to view the market in isolation from developments in local markets. In particular, as incumbent local exchange carriers enter the long distance business, competition will focus on supplying a package of local and long distance services to consumers. In this world, it will be important that consumers have as many local alternatives as possible. There will be several large long distance competitors after the merger. These firms have the capacity and the incentive to compete for customers if prices rise above competitive levels. In particular, consumers throughout Washington will continue to have numerous choices of carriers willing to compete for their business. Thus, the merger is not likely to harm long distance consumers. Long distance prices have been falling due to competition for years, and I anticipate that prices will continue to fall after the merger as technology moves forward.

Mass Market Competition

Q. BOTH DR. BLACKMON AND DR. HAUSMAN BELIEVE THAT COMPETITION IN THE MASS MARKET WILL BE REDUCED BECAUSE OF THE LIMITED NUMBER OF "BRAND NAME" CARRIERS SELLING LONG DISTANCE. DO YOU AGREE?

A. No. I believe that there will be robust competition in the mass market after the merger because the newer entrants will be able to compete for mass market business.

Q. WHAT EVIDENCE DO YOU HAVE THAT THE NEW CARRIERS ARE ABLE TO COMPETE FOR THE BUSINESS OF RESIDENTIAL AND SMALL BUSINESS CUSTOMERS.

A. The increasing importance of new carriers has substantial significance to residential and small business customers. Emerging carriers have captured a significant and growing share of residential customer pre-subscriptions and direct dial long distance minutes. In addition, these carriers have been active in providing "dial around" or transactional services that increasingly compete with the subscription services of the three "old line" interexchange carriers. Dial-around and phone card services are growing in importance. Consumers can purchase usage in advance in bulk with pre-paid phone cards. A number of firms are providing pre-paid phone card services. Dial-around services are being promoted heavily with the use of numerous brands not associated with the established carriers – although the established carriers are providing the services in many cases. Both of these services are growing rapidly. As mobile carriers bundle long distance service with their local services, consumers have the option to replace conventional long distance calls with calls from the mobile carriers. AOL and other ISPs are able to market long distance services to consumers at attractive rates. Uniden, a supplier of customer premises equipment, now offers an inexpensive telephone handset with a built-in least cost routing feature for residential consumers.

Q. WHAT ADDITIONAL EVIDENCE DO YOU HAVE THAT THE NEWER COMPETITORS ARE HAVING SUCCESS IN COMPETING FOR THE BUSINESS OF RESIDENTIAL AND SMALL BUSINESS CUSTOMERS?

A. A large number of consumers have demonstrated their willingness to change carriers. There is a substantial body of evidence that shows that from 1995 to 1998, emerging carriers' share of residential direct dial toll minutes increased substantially – or approximately 8.6 share points. (See ADK-3) Stan Besen and Steve Brenner used Paragren Tele-Trend Call Detail data can be used to study consumer purchase decisions. Those data demonstrate that nearly one-half of all households that use MCI WorldCom or Sprint as their main vendor at any point in time shift to another carrier as their main vendor within 12 months; more than one-third of households used an emerging carrier as their main vendor for at least one month during a 12-month period, and nearly 40 percent did so over an 18-month period. The FCC reports data gathered by PNR that show that between 1995 and 1998 carriers other than AT&T, MCI WorldCom and Sprint increased their market share from 8.3 percent to 16.6 percent. (FCC Trends in Telephone Service, March 2000, p. 11-10) These results should not be a surprise. There are hundreds of long distance carriers in Washington for a reason -- they are able to attract customers from the larger carriers and from one another.

Q. WHAT ROLE DOES BRAND RECOGNITION PLAY IN THE LONG DISTANCE BUSINESS?

A. There is evidence that the established brand names of the major carriers are becoming less important. A significant portion of the advertising by AT&T, MCI

WorldCom and Sprint is now devoted to products that do not carry an established brand name. In addition to the new facilities-based entrants I described above, there are literally hundreds of resellers offering service under their own brand names. They evidently rely on selling into specialized customer niches or on familiarity with local markets to succeed in attracting customers. Of course, firms such as Bell Atlantic, GTE, SBC, and US West when it gains in-region authority in Washington, have established and well-recognized brand names. Firms such as AOL are marketing long distance services directly to their customers at attractive rates.

Q. DOES TECHNOLOGICAL CHANGE HAVE AN IMPACT ON THE SIGNIFICANCE OF BRAND NAMES?

A. Yes. Consumers use brand names in order to provide information about quality and reliability. The Internet is making information available to consumers. Carriers make information about their services available on the web and third parties provide information about the alternatives. For example, 1+ Call Saver is a web site that compares long distance rates. Currently seven carriers in addition to MCI WorldCom and Sprint are ranked and special promotions are featured. (See http://www.1callsaver.com) The underlying carriers for the smaller companies are listed as Frontier, IXC, and US WATS. Moreover, Internet competitors such as AOL are entering the business using their market channels to provide service to consumers, proving that brand names do not have to be associated with a traditional carrier to be effective in marketing.

Q. DR. HAUSMAN BELIEVES THAT THE MERGER IS ANTICOMPETITIVE BECAUSE THE MERGING FIRMS' SERVICES ARE CLOSER SUBSTITUTES FOR ONE ANOTHER THAN AT&T. DO YOU AGREE?

A. No. The data I provided above show that customers are switching in large numbers from MCI WorldCom and Sprint to other carriers. Dr. Hausman refers to econometric analysis to support his claim, but no such analysis was presented. Dr. Hausman presented an econometric analysis at the FCC that was thoroughly rebutted in the paper filed by Stan Besen and Steve Brenner.

Q. DR. BLACKMON IS CONCERNED THAT THERE IS A LACK OF COMPETITION IN THE LONG DISTANCE MARKET IN THE STATE OF WASHINGTON. DO YOU AGREE?

A. No. The basis for his concern is that "customers are not permitted to make separate choices of carriers for in-state calls and state-to-state calls, and yet the long distance companies are permitted to charge different prices for the two types of calls." (p. 10) In an intensely competitive environment firms cannot risk losing the business of consumers who make a high proportion of in-state calls. Higher prices for in-state calls are likely explained by higher access charges.

Large Business Market

Q. ARE NEW ENTRANTS HAVING SUCCESS IN COMPETING FOR THE BUSINESS OF LARGE CORPORATE AND BUSINESS CUSTOMERS?

A. Yes. The emerging carriers have announced scores of major contracts with large corporate and government entities, demonstrating that they offer the scope and

quality of services that these customers demand, as shown in my Attachment ADK-4. This material, which consists of a portion of the Declaration of Stan Besen and Steve Brenner filed before the FCC in connection with the Applicants' merger application, demonstrates that the services of emerging carriers are good substitutes for the services of the more established carriers, which in turn implies that efforts by the larger carriers to raise prices would be met with significant losses in sales to the competitors.

Wholesale Market

Q. DR. HAUSMAN CLAIMS THAT THE MERGER WILL IMPACT "COMPETITION IN WHOLESALE SERVICES BECAUSE IT REDUCES THE NUMBER OF WHOLESALERS WHO CAN PROVIDE UBIQUITOUS NATION-WIDE COVERAGE FROM THREE TO TWO." DO YOU AGREE THAT THE MERGER WILL REDUCE WHOLESALE COMPETITION?

A. No. I believe that the wholesale market will remain competitive after the merger.

Q. HOW WOULD YOU CHARACTERIZE CURRENT COMPETITION IN THE WHOLESALE MARKET?

A. Wholesale competition is robust. As I discussed above, a large number of firms are building competitive capacity. Some of these firms explicitly advertise themselves as "carriers' carriers." A recent Frost & Sullivan Report identifies 27 carriers providing outbound wholesale services. MCI WorldCom proprietary data show a trend towards lower prices. Interestingly, these data also show wholesale volumes declining for a number of carriers, likely reflecting the build-out of competitive networks.

Q. WILL LONG DISTANCE CARRIERS THAT DO NOT HAVE A UBIQUITOUS PRESENCE HAVE THE ABILITY TO TERMINATE TRAFFIC TO ALL LATAS?

A. Yes. Many of these carriers serve a large number of LATAs that contain a significant portion of the population. Firms in this industry, including MCI WorldCom and Sprint, rely on other carriers to terminate traffic where they do not have facilities. Markets for the sale of fiber capacity are developing. This will enhance the ability of regional carriers to expand the coverage of their networks. For example, ENRON is "developing standardized terms and conditions to allow for efficient commodity trading of bandwidth." (See Enron Communications, The Bandwidth Commodity Market, White Paper, p. 2) AEP, GPU, Alleghany Communications, FirstEnergy Telecom, CFW Communications and R&B Communications recently announced the creation of a new company, America's Fiber Network, to connect " . . . major markets in the eastern United States to secondary markets with a growing need for broadband access." (See press release at http://www.americasfiber network.com/afn/news.htm)

Q. HOW DOES DR. HAUSMAN REACH A DIFFERENT CONCLUSION?

A. By ignoring the new carrier networks that are being built. For example, his Table 1 lists only six carriers in addition to AT&T, MCI WorldCom and Sprint. I have identified an additional 33 carriers with competitive networks and 12 of them are in Washington.

Q. DO CARRIERS HAVE TO HAVE UBIQUITOUS NETWORKS TO PROVIDE WHOLESALE SERVICE, AS DR. HAUSMAN CLAIMS?

A. No. His Table 1 shows that Qwest, Williams and Frontier each serve LATAs with more than 70 percent of the population. They could easily offer universal termination by making arrangements with the newer carriers I described above. Moreover, it must be remembered that MCI and Sprint did not begin life with universal termination. They expanded their networks over time and relied on other carriers for universal termination. Indeed, today MCI WorldCom and Sprint still rely on other carriers for capacity in some LATAs. Of course, it must be remembered that ILECs terminate virtually all calls and also provide transport within LATAs.

Q. DR. HAUSMAN CLAIMS THAT " . . . OVER 10 PERCENT OF THE POPULATION WILL SEE A REDUCTION IN THE NUMBER OF NATION-WIDE FACILITIES-BASED LONG DISTANCE CARRIERS FROM THREE TO TWO." (P. 16) DO YOU AGREE?

A. No. Again, this result ignores the significant networks being deployed by regional carriers. My analysis shows that only eight LATAs and less than one percent of the population will be affected. Even in the affected LATAs there are prospects for additional entry. Of course, the two LATAs in the state of Washington have, respectively, fourteen and six post merger carriers.

Bundling

Q. DR. HAUSMAN ARGUES THAT THE MERGER WILL REDUCE COMPETITION IN THE MARKET FOR BUNDLED SERVICES. DO YOU AGREE?

A. No. The opposite is true. One of the benefits of the merger is that competition for bundled services will increase. However, Dr. Hausman is correct that bundling of services is an increasingly important issue in telecommunications markets. The distinction between local and long distance markets is changing as local carriers enter long distance markets and long distance carriers enter local markets. A principal implication is that services increasingly will be offered on a bundled basis.

Q. CAN YOU DESCRIBE SOME OF THE CURRENT BUNDLED SERVICE OFFERINGS?

A. Yes. I referred to GTE's bundled service offerings earlier in this testimony. GTE has two bundled offerings: (i) as described on the GTE website, GTE's Unlimited Service, which consists of local phone service, at least 100 LD minutes, two calling features (i.e., Caller ID and Call Waiting), a possible 10 percent discount off total monthly bill and paging and internet access at discounted prices; and (ii) as described in an April 3, 2000 GTE press release, GTE's Big Deal, which consists of: local phone service (monthly price varies by market), the customer's choice of two calling service packages, one of which includes fourteen popular features for $16 month and the other which includes six popular features for $9 per month. Customers who purchase either of the "Big Deal" calling service packages can also purchase: reduced rate GTE long distance service, a block of dial-up Internet access time and GTE standard voice mail ($5 per month).

Q. DOES SBC OFFER BUNDLED SERVICES?

A. Yes. An SBC October 11, 1999 press release announced that SBC has launched a national expansion to market telecommunications packages that include combinations of local and long-distance voice and data services, custom-calling features, Internet access and voice mail.

Q. DOES US WEST OFFER BUNDLED SERVICES?

A. Yes. US West's "Total Package" "brings it all together – CustomChoice® phone features, Voice Messaging Service, wireless service that includes domestic long distance and unlimited Internet Access . . ." (See http://www.uswest.com/pcat/for_home/product/0,1084,517_1_1,00.html)

Q. IS AT&T OFFERING BUNDLED SERVICES?

A. Yes. AT&T has a bundled offering via its cable telephony in several states including Washington. In addition, AT&T has a bundled LD/Internet/wireless offering called Personal Network Plan that is available nationwide.

Q. WHAT IS THE SIGNIFICANCE OF THESE DEVELOPMENTS FOR THIS MERGER?

A. In assessing the likely impact of the MCI WorldCom-Sprint merger, it is important to examine its effects on the ability of the merged firm to offer services that are demanded by telecommunications users. MCI WorldCom and Sprint both believe that their merger will permit them to offer more new services, or to offer some new or existing services at lower cost than MCI WorldCom and Sprint could absent the merger. The merger will permit the combined firm to offer service combinations that neither of the merging parties could have provided on its own.

In particular, Sprint adds mobile wireless services while MCI WorldCom provides fiber ring services. As I discuss later in this testimony, the MMDS assets of the two firms complement one another and complement MCI WorldCom's existing local broadband facilities.

Q. WILL DEVELOPMENTS IN LOCAL EXCHANGE MARKETS AFFECT THE NATURE OF LONG DISTANCE COMPETITION?

A. Yes. Solving the last mile problem is even more important now than in the past, due to both institutional and technological factors. Consumers are increasingly demanding packages of services, including local and long distance, as well as wireline and wireless and as I discussed above, carriers are having success marketing them. The rapid emergence of bundles of services is key evidence that the marketplace demands this and although there is little history upon which to rely, it is a palpable, genuine and important change in the structure of industry services. As RBOCs enter the long distance business, this trend will increase, as demonstrated by Bell Atlantic's prompt offering to provide long distance service. If mass-market customers, who have a preference for these packages, are to have a reasonable choice, alternatives to the ILEC services will have to be developed. AT&T understands this point well, and has purchased or entered into strategic relationships with cable companies to meet this challenge. Companies that fail to offer these packages of services do so at their peril. The substantial risk is that they will cede market share in the emerging environment to AT&T and the ILECs.

Q. DO OTHER CONSIDERATIONS MAKE LOCAL COMPETITION IMPORTANT FOR LONG DISTANCE?

A. Yes. The falling cost of long-haul transmission is also increasing the need for competition for the last mile. The traditional long distance pricing model, at least for small business and residential consumers, is based on usage. As transmission costs fall prices are increasingly postalized – that is, they are no longer distance-sensitive. As they fall even further, and as access charges move towards economic cost, it will make less and less sense to charge on a per-minute basis. Mobile wireless pricing is already moving in this direction with consumers purchasing ever-larger "buckets" of local and long distance minutes for a fixed monthly fee. The Internet pricing model is likely to develop for wireline calling as well: unlimited use of a circuit for a fixed monthly fee. If there is to be full competition in this emerging world, then competitors must be in a position to offer to customers the circuit over which calls originate and terminate. This means effective entry into local telecommunications markets is essential. Without a competitive alternative, customer choices will be considerably narrower than they are today.

Standards for Analysis

Q. IS YOUR ANALYSIS CONSISTENT WITH THE U.S. DEPARTMENT OF JUSTICE MERGER GUIDELINES MENTIONED BY DR. BLACKMON?

A. Yes, I believe it is. The Guidelines allow the dynamic factors I have mentioned to be taken into account. For example, The Guidelines specifically point out that "in some situations, market share and market concentration data may either understate or overstate the likely future competitive significance of a firm or firms in the market or the impact of a merger." (Guidelines, Section 1.52) The Guidelines go

on to state that "the Agency will consider reasonably predictable effects of recent or ongoing changes in market conditions in interpreting market concentration and market share data." (Section 1.521) The substantial growth and competitive success of the new entrant fiber carriers is exactly such a change. The Guidelines also point out that current market shares are less important if entry is easy. (Section 3.0) The RBOCs are particularly important potential entrants because they have an existing customer base and assets that can be used to compete with the established long distance providers. The recent entry and rapid growth by fiber carriers, including the electric utility companies, also demonstrates that entry barriers are small or non-existent.

Benefits of the Merger

Q. DR. BLACKMON BELIEVES THAT "THE PURPORTED BENEFITS DO NOT JUSTIFY THE LOSS OF COMPETITION IN THE LONG DISTANCE MARKET THAT WOULD RESULT FROM THIS MERGER." (P. 12) DO YOU AGREE?

A. No. First, as explained above, I do not believe that competition will suffer as a result of the merger. Second, I believe the benefits are significant because they will spur local competition in Washington.

Q. HOW DOES THE MERGER AFFECT THE PROSPECTS FOR LOCAL COMPETITION?

A. The merger between MCI WorldCom and Sprint has the potential to accelerate the development of local competition because combining the assets of the two firms will lower the cost and increase the speed of local entry. In particular, the

combined firm will be in a better position to bring resources to bear on the local service needs of residential and small business customers, including customers outside major metropolitan areas. Another source of consumer benefits lies in the ability of the merged firms to more efficiently meet consumer demand for bundles of telecommunications services. In other words, increased size and scope will more closely align the merged firm with the direction in which technology and consumer demand is taking the market.

Q. WHAT FORMS CAN LOCAL COMPETITION TAKE?

A. The 1996 Act envisioned three forms of entry into local markets: building facilities to compete directly with ILEC facilities, the use of UNEs, either alone or in combination with a CLEC's own facilities, and resale. Facilities competition can be from fiber rings, cable telephony or wireless technologies.

Q. WHAT IS THE CURRENT STATE OF LOCAL COMPETITION BY FACILITIES-BASED CARRIERS?

A. There has been substantial investment in facilities by competitive local exchange carriers ("CLECs"). Virtually all of this investment has been in fiber rings in the central business districts ("CBDs") of major urban areas. Indeed MCI WorldCom has been a leader in deploying local networks, both nationally and in Washington. MCI WorldCom owns and operates local networks, and provides local telecommunications services in 102 markets nationally, including Seattle, Washington. Competition from cable companies is only beginning to emerge. Given their location in CBDs, those local fiber rings are used primarily to serve the business market.

Q. WHAT IS THE STATUS OF CABLE COMPETITION?

A. Given its location in suburban areas, cable is suitable for serving residential markets. However, cable telephony will typically support only one entrant in any given area. If there is to be a third competitor providing last mile connections in competition with ILEC and cable networks over the near term, broadband wireless is likely to be it. As discussed below, the MCI WorldCom/Sprint merger significantly enhances the prospects of MMDS as a viable local competitor. The traditional mobile wireless service providers have not yet attempted to compete directly with wireline carriers. Broadband wireless alternatives are only now being developed.

Q. WHAT IS THE STATE OF UNE AND RESALE COMPETITION?

A. UNE competition has suffered from procedural delays and implementation issues whose proximate cause has been ILEC resistance to opening their networks. Both large and smaller players have abandoned resale as a retail entry strategy because the wholesale discounts established in state arbitration proceedings are insufficient to allow profitable mass-marketing of the service and because of the significant problems associated with established OSS systems to enable customers to switch easily between the ILEC and the CLEC. The result is that competition for the local business of mass market residential and small business customers is virtually non-existent. With "business as usual" this dynamic is unlikely to change in the near future.

Q. DO YOU HAVE WASHINGTON SPECIFIC INFORMATION ABOUT THE PROGRESS OF LOCAL COMPETITION?

A. Yes. Facilities-based competition has not developed outside the core business districts of major metropolitan areas. According to the recent FCC local competition survey, in June of 1999 US West was providing approximately 2000 UNE loops to CLECs in the state of Washington. This was less than one percent of US West's lines. GTE was providing 82 UNE loops.

Q. HOW IS THE MERGER LIKELY TO STIMULATE LOCAL COMPETITION?

A. In three ways: first, the merged firm will be a stronger wireless competitor. Second, due to its larger scale, the merged firm will be better able to take advantage of unbundled network elements. Third, the merged firm will be able to achieve greater efficiencies in utilizing MCI WorldCom's landline local fiber networks; these efficiencies come from larger customer base and greater traffic flows from Sprint customers, and will create incentives to increase investment in local fiber networks.

Q. WHY WILL THE MERGED FIRM BE A MORE EFFECTIVE WIRELESS COMPETITOR?

A. Broadband wireless is only now being exploited as an alternative to ILEC facilities. By combining the resources of MCI WorldCom and Sprint, the combined company will be able to drive technological development and deploy the service more rapidly and efficiently. The two firms hold a set of largely non-overlapping MMDS licenses, as detailed in the testimony of David N. Porter. MMDS is a broadband wireless spectrum allocation that to date has not been widely used to provide an alternative to local exchange services. The spectrum is suited to local entry

because it does not suffer to the same extent from the interference problems associated with other broadband wireless spectrum. Initially, MMDS will be used to deploy broadband Internet access in competition with cable modems and DSL services. Eventually, with continuing technological development, the spectrum will be used to provide voice services using IP telephony or Sprint's ION service. The merger will accelerate the introduction of broadband wireless services because there are economies associated with nation-wide deployment. Joint technology development, more rapid adoption of standards, larger equipment production runs, reduced tower placement costs, more efficient backhaul of traffic and reduced operating costs will accelerate deployment and reduce costs.

Q. WHO ARE THE BROADBAND WIRELESS SERVICE PROVIDERS?

A There are several. For example, DEMS services are being provided by Teligent, Nextlink is a leading LMDS provider and Winstar is providing 38 GHz service. Touch America has LMDS licenses in eastern Washington. The two largest MMDS license holders are MCI WorldCom and Sprint both of whom have acquired licenses in the recent past. The testimony of David Porter describes the MCI WorldCom and Sprint MMDS holdings in Washington.

Q. WHY ARE THESE SERVICES BEING DEVELOPED AS LOCAL EXCHANGE ALTERNATIVES ONLY NOW?

A. Although some of these allocations were made years ago, there are several reasons why broadband wireless start-ups are not significant competitors in the local access arena today. Most have been struggling to grow for a number of reasons. They have faced restrictive rules concerning spectrum usage; restricted access to roof-

top radio sites; a lack of capital; and, in the case of MMDS, awkward transitions from their original role as cable television competitors to broadband access providers. Although some broadband wireless carriers have developed name recognition, and small pockets of wireless broadband service are available around the country, service is generally localized in the most concentrated commercial areas of the largest urban markets. Most of the broadband wireless services being offered are only available to business customers. Moreover, most of the broadband wireless carriers operate at frequencies well above one GHz. It is only in the past few years that using these frequencies for anything other than point-to-point microwave systems has become economically practical.

Q. HOW CAN MMDS BE DEPLOYED TO PROVIDE COMPETITIVE LOCAL SERVICE?

A. There are two business models for deploying MMDS. One is simply to provide broadband Internet access in competition with cable modems and DSL. This business plan was being pursued by MCI WorldCom prior to the merger. Second, as technology develops, it may be possible to provision voice services over the MMDS broadband Internet connections by using Internet voice (voice over the Internet Protocol or "IP voice"). Sprint's original plans for MMDS involved using it first as a broadband Internet access service and ultimately as a platform for its Sprint ION service, which includes voice capabilities.

Q. HOW IS AN MMDS NETWORK CONFIGURED?

A. An MMDS network consists of CPE at the customer site, radios on towers throughout the service area, backhaul facilities connecting radios with switches, and a hub site connecting the MMDS network to the ILEC local network and the Internet. One of the major advantages of MMDS as a broadband local service competitor is that the infrastructure investment is much smaller than for cable telephony or traditional local telephone service. Within the geographic area encompassed by a license, service to a large number of customers can be achieved by building a single tower and then marketing to potential customers. As demand grows, additional towers can be built to make better use of the spectrum and to alleviate line of sight issues. This attribute of the service is what makes it especially valuable for smaller communities and underserved areas. Depending on terrain, a single tower may allow service within a 35-mile radius. This makes the service cost effective in less densely populated areas.

Q. WHY WILL THE MERGER ENHANCE THE PROSPECTS OF BROADBAND WIRELESS ENTRY INTO LOCAL EXCHANGE MARKETS?

A. The MMDS spectrum has advantages compared to other available broadband spectrum because it provides better propagation characteristics. There are several reasons why the combination of the two firms will allow the potential of MMDS to be exploited more efficiently. Sprint's already-designed Sprint ION platform can be rolled out on spectrum held by MCI WorldCom following the merger. ION allows the user to dynamically allocate broadband capacity to multiple voice

channels. This effectively provides a stronger entrant into the voice market. MCI WorldCom could, of course, develop an independent alternative to Sprint's ION service. However, since Sprint is already well along in developing the technology, the combined firm will be in a position to market it and make it a competitive force much sooner.

Q. WHAT ARE THE CONSUMER BENEFITS OF MORE RAPID DEPLOYMENT OF MMDS?

A. The merger provides several consumer benefits. First, looking only at broadband Internet access service, the merger allows a strong nationwide player to compete with AT&T cable modems and DSL service provided over ILEC copper facilities. The merger effectively adds a third broadband access facilities competitor. Time to market will be a key element of success. Cable modem service and DSL may capture significant first-mover advantages if broadband wireless service is not deployed rapidly. Early approval of the merger will allow the jointly provided service to more rapidly capture the benefits described here.

Q. WILL MMDS DEPLOYMENT BENEFIT MASS MARKET CUSTOMERS?

A. Yes. The advantages of the merger for MMDS deployment are particularly important for the mass market. Marketing and customer acquisition costs for residential and small business users are particularly high in relationship to expected per-customer revenues. The merger will allow the combined firm to use regional and national sales and advertising programs more efficiently. Even more significantly, in any given area, the merged firm will have a larger set of long

distance and mobile wireless customers to whom it can market. MCI WorldCom has found that it can market local services to its long distance customers more cost-effectively than it can market to customers of third parties. Moreover, churn is reduced when the customer uses both local and long distance service. MMDS has particular advantages in smaller markets. The infrastructure can be deployed rapidly and cost-effectively in these markets. Broadband customers in these markets will be especially benefited to the extent current DSL and cable modem providers are concentrating on larger urban areas.

Q. WHY WILL THE MERGER ENHANCE THE PROSPECT OF UNE AND RESALE ENTRY?

A. Each of these entry vehicles is subject, to a greater or lesser extent, to economies of scale. Consequently, the combined MCI WorldCom/Sprint will be better positioned to enter the local market using UNEs than either company would be individually, and will be able to more rapidly extend service to a larger number of customers than either MCI WorldCom or Sprint would be able to do on its own. If it is assumed that the local service market share of a long distance company will be closely related to the market share of lines presubscribed to that carrier for long distance service, the benefits of the merger of MCI WorldCom and Sprint are apparent. MCI WorldCom's share of presubscribed lines was 17.2 percent in 1996. (This is the last year in which the FCC reported shares based on presubscribed lines. See Zolnierek, James, et al, "Long Distance Market Shares Fourth Quarter 1998," Industry Analysis Division, Common Carrier Bureau, FCC, March 1999, p. 9, Table 2.2) Sprint's market share of presubscribed lines was 7.4

percent, which would not permit Sprint profitably to provide local service based on unbundled loops in even the largest wire centers. The market share of presubscribed lines for the combined MCI WorldCom/Sprint would be 24.6 percent. The larger market share of the combined company potentially would permit a substantial expansion in the number of wire centers that could be served using unbundled local loops.

Q. DOES THE ABILITY TO PROVIDE BROADBAND SERVICES WITH UNES CHANGE THE ECONOMICS?

A. Yes. Several firms (sometimes called data CLECs) are now providing DSL using UNE-L. The merger provides immediate additional competition for retail DSL services because Sprint's ION service can take advantage of the MCI WorldCom collocation spaces. Moreover, the ability of the combined firm to justify collocation through the larger long distance customer base plus the Sprint ION potential will lead to investment in more offices, including offices the data CLECs may find unattractive. The data CLECs are collocating in a large number of ILEC central offices. This is consistent with the model presented here because the data revenue streams are much larger than voice revenue streams. To provide voice service of quality comparable to the ILEC, the data CLECs would have to add equipment.

Q. WILL THE MERGER ENHANCE THE PROSPECTS FOR NARROWBAND WIRELESS ENTRY INTO THE LOCAL EXCHANGE MARKET?

A. Sprint does not place a heavy emphasis on fixed wireless at present. Sprint PCS is engaged in a few limited fixed narrowband wireless trials. However, the new firm is more likely to seek fixed wireless alternatives to ILEC loop facilities. This is because the merged firm has larger total profits at risk to RBOC entry, and hence a larger total payoff to developing local access alternatives. As third generation (3G) wireless technology comes along, effectively expanding the call carrying capacity of existing CMRS licenses, the merged firm will have a greater incentive to develop and deploy fixed wireless. This would be particularly true in medium-sized cities and rural areas within the scope of Sprint's existing PCS licenses.

Q. PLEASE EXPLAIN WHY THE MERGER WILL ALLOW MORE EXTENSIVE DEPLOYMENT OF FIBER RING FACILITIES.

A. The merger is likely to stimulate additional fiber-ring investment by the new WorldCom. The combined customer base will allow marketing to Sprint customers that would justify the build-out of fiber rings to more buildings. The larger local transport traffic may also provide justification for extending rings deeper into local service territories. The opportunity to provide backhaul for PCS and MMDS traffic will also provide an incentive to expand local fiber.

Q. WILL THE MERGER ELIMINATE POTENTIAL COMPETITION BETWEEN MCIWORLCOM AND SPRINT IN THE LOCAL EXCHANGE MARKET?

A. No. As Mr. Kapka testifies, Sprint has not deployed local fiber rings or switches in Washington. By contrast, MCI WorldCom has made extensive investments in

local assets in Washington. Since this merger will enhance the efficiency of those assets it will stimulate local competition in this state. Where fiber ring provision is economical today, there are a number of suppliers (including the RBOCs), some of whom have stated plans to compete out-of-region. Sprint's UNE-L entry plans are focused on broadband through Sprint ION deployment. While Sprint is planning to use UNE-P, this form of competition provides the fewest consumer benefits in the local market because it is difficult to differentiate the service from that of the RBOC. As I noted above, the MMDS licenses held by the two firms do not overlap. Spectrum limits prevent each from entering the other's wireless broadband markets.

Q. IN LIGHT OF THE FOREGOING, WHAT DO YOU CONCLUDE?

A. This merger is in the public interest. Washington's economy and Washington users of telecommunications services will benefit from the increased competition for local service that this merger will cause, while long distance competition will not be adversely affected. Moreover, this merger is likely to make a broader array of services available in Washington on a bundled and unbundled basis. Infrastructure enhancements likely are to be produced as a direct consequence of this merger. Washington consumers will be direct beneficiaries.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, except to the extent I may need to supplement my testimony to address or incorporate responses to data requests from SBC.