

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

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NOV 17 1999

FCC MAIL ROOM

In re Applications of)
)
SPRINT CORPORATION,)
Transferor,)
)
and)
)
MCI WORLDCOM, INC.,)
Transferee,)
)
for Consent to Transfer Control)
of Corporations Holding Commission)
Licenses and Authorizations Pursuant)
to Sections 214 and 310(d) of the)
Communications Act and Parts 1,)
21, 24, 25, 63, 73, 78, 90, and 101)

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

CC Docket No. 99-233

APPLICATION FOR CONSENT TO TRANSFER CONTROL

Dated: November 17, 1999

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APPLICATION FOR CONSENT TO TRANSFER CONTROL

I. Introduction

The telecommunications business is undergoing seismic change. This merger is about preparing for -- and facilitating -- a paradigm shift that will offer consumers a fuller set of services from a larger number of competing providers. The merger of MCI WorldCom and Sprint will produce a new, strengthened competitor able to offer residential customers and businesses an independent, competitive alternative for a full spectrum of voice and data services across all distances utilizing an array of narrowband and broadband, wireline and wireless distribution media.

This merger occurs in the context of rapid, dramatic and pervasive change to the traditional telecommunications marketplace. The familiar categories of local and long distance services are fading, as carriers offer local and long distance packages (soon to be joined by the BOCs) to meet customer demand, as long distance costs and prices continue to fall, and as wireless telephony growth explodes. At the same time, the demand for data is spreading throughout society and is expected soon to exceed that for voice, prompting demand for broadband capabilities for both residential and businesses customers. As a result, the historical lines between voice and data are also eroding.¹

MCI WorldCom and Sprint were each impelled to find ways to respond to these trends. Neither company is willing to simply cede away its residential customers to competitors such as the BOCs and AT&T as those incumbents gear up to offer fully integrated services. Either company might have merged with an RBOC in order to gain the advantage of controlling that critical last mile of copper wire into every home. Instead, MCI WorldCom and Sprint decided to join forces to address these market challenges, creating the opportunity for a new, facilities-based alternative for consumers. Both MCI WorldCom and Sprint were born outside of the Bell System and share an entrepreneurial spirit that has contributed to rapid growth and success. Dedicated to opening markets to competition, both companies have focused on delivering benefits to customers: lower prices, innovation, and higher quality services.

By combining the companies' local assets and technical and entrepreneurial skills, the new WorldCom will be far better positioned to crack open the BOCs' lock on access to customers in

¹ These dramatic changes are explored and analyzed in detail in the Declaration of Daniel Kelley and Robert Mercer, attached as Appendix A ("Kelley/Mercer Decl.").

order to compete for integrated and long distance packages, which can be accurately characterized as "all distance" service. The merger combines the two companies' long distance customer base, which will provide an important base of target customers more likely to purchase local services from the combined company. With more traffic (local and access) carried by the MCI WorldCom local facilities, they become more efficiently utilized, more capable of and ready for expansion, and less dependent on the RBOCs. And the race for broadband is simply a new twist on the "last mile" problem. Bringing together voice and data, narrowband and broadband, wireline and wireless assets of the two companies enables the new WorldCom to offer consumers a strong, independent source for a variety of services and for a single-source package of these services.

The assets of the two companies are remarkably complementary to meet these challenges. While Sprint's local telephone companies serve principally rural and suburban communities in 18 states, MCI WorldCom addresses business needs in virtually all of America's urban centers. This year, as MCI WorldCom rolls out DSL offerings in 1,500 POPs, Sprint ION ("Integrated On Demand") service can use those offerings to provide advanced broadband services to residential and business users with innovations, such as dynamic managed bandwidth. The companies' combined fixed wireless MMDS ("multichannel multipoint distribution services") assets can mean a true local broadband alternative to the RBOCs and the cable incumbents. For mobile communications needs, Sprint contributes its nationwide state-of-the-art digital Personal Communications Service; MCI WorldCom brings paging to the mix. MCI WorldCom holds substantial international investments in 65 countries, and when coupled with the two companies' domestic assets, the merged U.S. company will be a leading telecommunications player in the

global marketplace. The companies' collective experience in long distance and their competitive heritage will create a formidable competitor to AT&T, the RBOCs, and foreign carriers.

MCI WorldCom and Sprint, the sixth and seventh largest domestic telecommunications service companies respectively, are working to be strong enough to compete across all services with the newly consolidated cable and Bell companies, all of which (other than U S West) are larger. Just in the past two years, the Commission's dockets have been filled with mergers and merger proposals, including AT&T/TCG/BT/TCI/MediaOne, Bell Atlantic/NYNEX/GTE/Vodafone/AirTouch, SBC/PacTel/SNET/Ameritech, and Qwest/LCI/U S West. MCI WorldCom and Sprint believe their merger will greatly promote competition in this new arena.

Given this overall context of local incumbents strengthening themselves by bulking up, the long distance issues raised by this merger should be viewed as neither surprising nor threatening. The proposed merger will not harm competition in long distance services in any customer segment, even under the most conservative antitrust analysis, as fully discussed in Section II.D., pp. 29-76. Any merger between companies offering the same service will from a static view increase concentration, but that is a distinct question from assessing its competitive effects. From a wholly static perspective, the transaction will consolidate two long distance providers with a combined market share of 36% overall in 1998 (based on total operating revenues) and 24% of the residential market segment (based on residential toll revenues), according to the most recent FCC data.² This isolated snapshot will no doubt be taken out of context by opponents to raise questions. But context is crucial. The institutional and technological shifts at this critical

² See discussion infra Section II.D.3. (overall) & II.D.3.a (mass market). When considering the most recent data on share of total residential access lines, the combined share is even lower, around 18%. See infra Section II.D.3.a. The data reflect 1998 figures.

crossroads in fact make any picture of a long distance "market" incomplete and any static, backwards perspective irrelevant. First, the once clear division between interLATA services and other voice services is eroding as a result of the dismantling of both legal and technological barriers as well as customer demand. BOC entry is imminent. That entry, by both the BOCs' and the FCC's predictions, will produce immediate effects. Even before the scheduled closing of this proposed transaction in mid-2000, the Commission will likely have the opportunity to pass on several Section 271 applications, representing the first serious attempts by BOCs to gain interLATA authority. Second, many of the cost differences that once marked a plain division between long haul and local transmission have largely disappeared, unmasking the artifice of inflated access charges and the dire need for their reform.

But even without regard to this dramatic change, and employing the most traditional antitrust analysis possible, the facts clearly demonstrate that the merged company will operate in a competitive long distance market. The Federal Communications Commission has recognized for many years now that the long distance market, served by more than six hundred companies, is robustly competitive. The continuing, dramatic price decreases for traditional long distance services bear witness to this fact. The amounts of new long distance transmission capacity will continue to grow exponentially, and that capacity will inevitably be put to service for both residential and business customers, who have demonstrated a marked willingness to buy products that do not bear the brands of AT&T, MCI WorldCom or Sprint.³ Thus, from either a traditional

³ An economic analysis of the merger and its competitive effects is provided in the Declaration of Stanley M. Besen and Steven R. Brenner, attached as Appendix B ("Besen/Brenner Decl.").

or more dynamic perspective, the pervasive changes already at work demonstrate that no harm will befall long distance customers.

The merger would also effectuate a consolidation of the two companies' Internet backbone businesses. When MCI and WorldCom first proposed their merger, an important public policy debate ensued resulting in the divestiture of MCI's Internet backbone business. MCI WorldCom and Sprint are fully cognizant that similar policy issues have been raised in the context of the merger, and that the Internet backbone assets of the two companies will be fully scrutinized by the Department of Justice as part of that agency's review. The result of that scrutiny will be reported to this Commission promptly upon resolution.

MCI WorldCom and Sprint are thus confident that the merger will promote competition for a full range of telecommunications services. As a result, consumers, including residential and small business, will have greater choice in services and service providers. This merger unambiguously promotes the public interest and should be promptly approved.

DESCRIPTION OF THE TRANSACTION

On October 5, 1999, MCI WorldCom and Sprint Corporation announced that the two companies had entered into a definitive merger agreement whereby Sprint will be merged into MCI WorldCom. A copy of the Agreement and Plan of Merger ("Agreement") is attached hereto as Attachment 1. The merger will be achieved through a stock-for-stock transaction, not requiring either company to take on additional debt. Under the Agreement, each share of Sprint's FON common stock will be exchanged for WorldCom group stock valued at \$76.00, subject to a collar. In addition, each share of Sprint's PCS common stock will be exchanged for one share of WorldCom PCS group common stock and 0.1547 shares of WorldCom group common stock. The terms of the WorldCom PCS group common stock will be virtually identical to those of

Sprint's PCS common stock, and will reflect the performance of the WorldCom PCS group. Following the merger, existing MCI WorldCom shareholders will own shares representing a majority of the total voting power of WorldCom capital stock.

The merged company will be named WorldCom and will be led by an experienced management team consisting of top executives from both MCI WorldCom and Sprint. Bernard J. Ebbers, President and Chief Executive Officer of MCI WorldCom, will be President and Chief Executive Officer of WorldCom. William T. Esrey, Chairman and Chief Executive Officer of Sprint, will be Chairman of WorldCom. The board of directors of WorldCom will have 16 members, 10 from MCI WorldCom and six from Sprint.

Upon merger closing, expected to occur mid-2000, the separate corporate existence of Sprint will cease and the present wholly-owned subsidiaries of Sprint that hold Section 214 authorizations, cable landing licenses and/or radio licenses will become wholly-owned subsidiaries of WorldCom. The merger does not involve any assignment of Sprint's authorizations or licenses, or any change in the licensees that hold such authorizations and licenses, and the same companies will continue to provide service to the public. The only change in ownership will occur at the holding company level. The wholly-owned subsidiaries of MCI WorldCom will continue to be held by WorldCom and the merger does not involve a change in control of these companies.

In addition to FCC approval, the transaction is subject to notification to and/or review by other governmental agencies, including the Hart-Scott-Rodino antitrust procedures, approximately 26 public utility commissions, the European Union, and Brazilian antitrust authorities.

DESCRIPTION OF THE APPLICANTS

Sprint is a global communications company at the vanguard of providing long distance, local and wireless communications services. Sprint built and operates the United States' first nationwide all-digital, fiber optic network. Sprint PCS is building the only all-digital, all-PCS nationwide wireless network from the ground up, and currently serves more than 280 metropolitan areas. Sprint's local telephone division serves approximately 7.9 million access lines in 18 states. Sprint earned \$17 billion in 1998 revenues and serves more than 20 million residential and business customers.

MCI WorldCom is a global leader in communications services with established operations in more than 65 countries encompassing the Americas, Europe and the Asia-Pacific regions. MCI WorldCom is a premier provider of facilities-based and fully integrated local, long distance, international and Internet services. MCI WorldCom owns and operates fiber rings serving local customers in more than 100 urban centers. Through its subsidiary SkyTel Communications, Inc., MCI WorldCom is the nation's third largest paging carrier holding approximately a 2% share of the U.S. paging market. MCI WorldCom's global networks, including its state-of-the-art pan-European network and transoceanic cable capacity, provide end-to-end high-capacity connectivity to customers worldwide. MCI WorldCom has \$34 billion in annualized revenues.

DESCRIPTION OF THE LICENSES TO BE TRANSFERRED

Through its subsidiaries, Sprint holds the following types of licenses control of which will be transferred upon the closing of the transaction:

Personal Communications Services (Part 24)

International 214 Service Authorizations (Part 63)

Cable Landing Licenses (Part 1)

Common Carrier Fixed Point-to-Point Microwave Licenses (Part 101)
Business Radio Service Licenses (Part 90)
Cable Television Relay Service (CARS) Licenses (Part 78)
Multichannel Multipoint Distribution Service (MMDS) Licenses (Part 21)
Private Operational Fixed Point-to-Point Microwave (OFS) Licenses (Part 101)
Earth Station Authorizations (Part 25)
Low Power TV Authorizations (Part 73)
Local Multipoint Distribution Service (LMDS) Licenses (Part 101)

II. The Merger Will Create a Robust Supplier for "All Distance" Service Offerings.

The institutional arrangements for telecommunications over the last 15 years have ensured that local services would be offered separate and apart from long distance services. The Bell System divestiture prohibited the RBOCs from offering long distance, and at the same time, state legal barriers persisted in limiting local competitive entry. The 1996 Act sought to end this separation, by mandating entry rules for local services to allow entry by long distance companies and others, and by permitting BOC entry into long distance once those local entry rules were implemented. At the same time, technological developments evolved in ways fully congruent with the changes permitted by policymakers. See generally Kelley/Mercer Decl. With the advent of facilities-based competition for the provision of local telephone service, the separation of the provision of local and long distance services mandated by the Bell System divestiture will be erased. Consumers will be able to choose from a competitive array of local telecommunications products from a variety of suppliers, including an end-to-end voice and data service. As expressed by one state regulatory agency:

Artificial and regulatory boundaries like local exchange areas, LATAs, state lines and international borders will cease to have practical meaning for many telecommunications consumers. Instead they will buy telephone service, the ability to place calls (to their

neighbor or to the other side of the nation or the planet) plus all the additional features that contribute to that ability from one provider.⁴

As the "cornerstone" of the Telecommunications Act of 1996,⁵ Congress enacted an extensive set of statutory requirements specifically designed to promote the development of competitive local telephone service markets.⁶ This goal has critical significance for the fate of competition beyond the provision of local telephone service. Indeed, the Commission has stated that "under the 1996 Act, the opening of one of the last monopoly bottleneck strongholds in telecommunications -- the local exchange and exchange access markets -- to competition is intended to pave the way for enhanced competition in all telecommunications markets."⁷

MCI WorldCom and Sprint are working to have a credible end-to-end service offering available to residences and businesses across the U.S. The merger parties strongly believe that the provision of local connectivity to customers is in fact critical to their telecommunications business.⁸ The last mile is potentially shared by all telecommunications services, making that

⁴ Comments of the Public Service Commission of Wisconsin at 3, Access Charge Reform, CC Dkt. No. 96-262 (Oct. 28, 1999); Business Week, Steven V. Brull, "Why Talk is So Cheap" at 34 (Sept. 13, 1999) (driving force behind bundles "are the changes in technology and regulation that are erasing the distinctions between types of calling. With today's digital network, there's not much reason to think about where a call goes or what it carries...").

⁵ Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, Notice of Proposed Rulemaking, 11 FCC Rcd. 14171, ¶ 24 (1996).

⁶ See 47 U.S.C. Title II, Part II -- Development of Competitive Markets.

⁷ Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶ 4 (1996) ("Local Competition Order").

⁸ See Affidavit of John G. Donoghue at 2, attached as Appendix C ("Donoghue Aff."). Of course, many companies will opt to target particular customer needs, e.g., long distance only, local only, Internet access only, but MCI WorldCom and Sprint have designed a business strategy across all segments and categories.

connection a strategic part of the structure for all services. And from the end user's perspective, the connection to the home is critically significant because it is the end user's on-ramp to the available telecommunications services. Donoghue Aff. at 2. The customer on-ramp is particularly important for long distance services, which are increasingly being packaged with local services (wireline and wireless) to become a single "all distance" service. In this context, the ability to offer a package of "all distance" wireline service is vitally important. This trend is expected to increase. As explained by one analyst:

long distance voice [will not remain] a sustainable stand-alone business. Barriers to entry have diminished, particularly on the consumer side, and the cost to transport voice continues to drop. Moreover, the trend is toward bundling "free" long distance with other services such as local or wireless. This will likely become the norm as the RBOCs begin to enter these markets in early 2000. However, long distance carriers that can build their own value-added, differentiated, product bundles should do well. This sort of bundled, integrated approach, with an emphasis on high-growth, high-margin businesses, will allow the better positioned companies to thrive, once unconditional competition begins in the telecom industry.⁹

The BOCs, once given interLATA authority, will be able immediately to enter long distance, and thus will also be able immediately to offer all distance packages.¹⁰ Given their persisting dominance in local markets, they will a priori hold an advantage in the competition for

⁹ CIBC World Markets Corp., T. K. Horan, "Telecom Services: Strong Volume Growth in 2Q99," TFN Investext 2917251, at *13 (Aug. 4, 1999).

¹⁰ In their Section 271 applications, the BOCs have also described their detailed plans to bundle local and long distance. See Declaration of Paul W. MacAvoy ¶ 9, Application by New York Telephone Company (d/b/a Bell Atlantic - New York) for Authorization to Provide In-Region, InterLATA Services in New York, CC Dkt. No. 99-295 (Sept. 29, 1999) ("MacAvoy Decl.") (arguing that an important public interest benefit of Bell Atlantic's provision of in-region interLATA service will be that Bell Atlantic "along with the incumbent long-distance providers will be free to offer to customers innovative service bundles that combine together local, long-distance, and other services into the sort of 'one-stop' shopping customers prefer").

packages of services: "BOC exercise of monopoly power in local markets can have compound effects because local services will be part of any significant bundle of telecommunications services."¹¹

The availability of packages of "all distance" service to mass market consumers will promote competition and serve the public interest, if consumers have available a choice of service providers. The MCI WorldCom/Sprint merger is necessary to give consumers that choice. The Commission has noted that "there is an overwhelming trend toward carriers offering long distance service as part of an integrated package containing local exchange service, i.e., 'one-stop shopping.'¹² and that "the increased flexibility from being able to offer 'one stop shopping' for both local and interLATA services further promotes competition in telecommunications markets, consistent with the 1996 Act."¹³ Further, the Commission has opined that a long distance provider "that has the flexibility to offer local services is better able to develop innovative service packages targeted at niche markets or new pricing plans or distinct services." Non-Accounting Safeguards Order at *38-*39.

¹¹ See Joint Declaration of Dr. T. Randolph Beard and Dr. John W. Mayo ¶ 14 (appended to Comments of MCI WorldCom), Application by New York Telephone Company (d/b/a Bell Atlantic - New York) for Authorization to Provide In-Region, InterLATA Services in New York, CC Dkt. No. 99-295 (Oct. 15, 1999) ("Beard/Mayo Decl.").

¹² Petition of U S West Communications, Inc. for a Declaratory Ruling Regarding the Provision of National Directory Assistance, CC Dkt. No. 97-172, 1999 FCC LEXIS 4715, at *57 (DA 99-133) (rel. Sept. 27, 1999).

¹³ Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, CC Dkt. No. 96-149, 1999 FCC LEXIS 4871, at *38-*39 (DA 99-242) (rel. Oct. 1, 1999) ("Non-Accounting Safeguards Order").

There is strong consumer demand, especially in the mass market segment, for end-to-end service offerings. User surveys and other studies indicate that many consumers want to buy a package of wireline telephone service together from the same company. See Donoghue Aff. at 3.¹⁴ Importantly, while packages are deemed desirable by consumers, they will not purchase the package at a price higher than the individual products purchased separately. Id.¹⁵

Package customers are benefited first from the price savings typically available in purchasing the package. Id. at 3-4. In addition, the customer's telecommunications service profile is simplified through billing for all packaged services on one statement, having a single contact for customer service, and increasing carrier accountability, as a single service provider is more capable of addressing service issues on an end-to-end basis. See id. at 4.

By responding to this demand, carriers improve customer relations and retain customers for longer periods of time. Id. Service providers also improve their sales of new services when able to sell to an existing customer base. In MCI WorldCom's experience, when offered the choice, an existing long distance customer is more likely to purchase local service from its long

¹⁴ This is far from a surprising development. For example, a 1997 study found that nearly 70% of consumers would prefer to purchase all of their telecommunications needs from a single source. See Communications Daily, "Telephony" at 6 (Jan. 2, 1997). Moreover, data from the United Kingdom and Canada demonstrate that a significant percentage of consumers will choose one-stop shopping packages when they are made available. See Declaration of Professor Jerry A. Hausman ¶ 6, Application by BellSouth Corporation for Provision of In-Region, InterLATA Services in South Carolina, CC Dkt. No. 97-208 (Sept. 26, 1997) ("Hausman Decl.").

¹⁵ Discounts are often made available by companies. See The Denver Post, Stephen Keating, "Phone Price War Breaks Out" (Oct. 23, 1999) ("Local phone service in Aurora from AT&T will be priced at \$14.50 a month, compared to \$14.91 a month from U S West. The sweeter part of the deal is the pricing of additional lines, which. . . AT&T will offer up to three extra lines for \$9 apiece [compared to \$14.91 per additional line from U S West]").

distance company than other potential local customers. Revenue per customer increases because both services may be used more robustly and because package customers generally purchase more additional features. Id. Network efficiencies result from the internalization of the necessary "last mile" connectivity, and further cost reductions result from efficiencies in customer acquisition costs, billing, and customer service, all of which can become largely joint costs of providing the package. Id. at 5.

The market experience of the merger parties themselves has demonstrated the value of packaged offerings. MCI WorldCom's On-Net, introduced shortly after the merger of MCI and WorldCom, allows customers to combine voice and data traffic from local U.S. and international locations on a seamless, end-to-end network. MCI WorldCom's ability to offer such a service stems from its "local-to-global-to-local" network that relies on MCI WorldCom's extensive U.S. local services as well as its local network presence internationally.

In addition, in New York, where MCI WorldCom offers local service primarily relying on Bell Atlantic's UNE-P (Unbundled Network Element-Platform), a significant percentage of new residential customers have chosen MCI WorldCom as their carrier for both wireline services. In addition to obtaining the basic plan local savings of 5%, customers receive access to MCI WorldCom's low long distance rates for all toll calls. This can amount to a 20% additional long distance rate savings with "Everyday Plus," featuring day rates of \$.07/minute and evening-night rates of \$.05/minute. And beyond these rate savings, bundled customers receive other discounts, at present amounting to \$5 per month, or \$60 per year.

Earlier this year, as part of a "One Sprint" strategy, Sprint's local telephone companies began offering customers packages of wireline services, including vertical features with a flat rate option for the package. This marketing program has received enthusiastic acceptance by

consumers, convincing Sprint that the packaging of wireline services is a key strategy in the telecommunications marketplace.

The assets and expertise combined by the proposed merger allow MCI WorldCom and Sprint to make these benefits a reality more quickly and efficiently. By combining the customer base and incumbent local exchange carrier ("ILEC" or "incumbent LEC") facilities of Sprint with the customer base and competitive local exchange carrier ("CLEC") operations and facilities of MCI WorldCom, the merger facilitates the necessary scale and expertise to support a nationwide CLEC entry strategy.¹⁶ The full value of the merger to promote competition for voice and data all distance services is discussed below. The ability of the combined company to offer a broader package of all distance broadband and wireless services, is subsequently demonstrated in Section III.

A. The Merger Will Facilitate the Principal Goal of the Telecommunications Act of 1996: Competition in All Service Markets.

Local market entry is a key part of the combined company's business strategy. Without competitive local facilities, there cannot be competitive choices for "all distance" service providers. By combining their collective strengths in local entry, MCI WorldCom and Sprint together create a stronger, more expert firm to break open the local monopoly stranglehold. In achieving this, the new company will be able to offer consumers more choices for all distance services and for broader packages of services.

Notwithstanding the Commission's efforts to implement the market-opening provisions of the 1996 Act, to date local competition has developed slowly. For example, in 1997, incumbent

¹⁶ See generally Affidavit of Sunit Patel, attached as Appendix D ("Patel Aff.").

LECs earned 98% of all local exchange access revenues nationwide. See Trends in Telephone Service at 9-1 (Sept. 1999) ("Trends Report"). The most recent Commission data estimated that ILECs still earn at least 96% of all local service revenues; the Commission further estimated that CLECs control less than 3% of the switched access lines nationwide. Id. The Commission has further acknowledged that, notwithstanding the development of some competition for the largest business customers, it could find little evidence of any actual competition with large ILECs for the provision of mass market local telephone service.¹⁷

In contrast to the ease of entry that characterizes the long distance market, there remain significant barriers to achieving competition in the local market. Several times this past year, Chairman Kennard has appeared before Congress and reported that the Commission is still in the process of "introducing local competition and then deregulating the competitive markets."¹⁸ In February of this year, although the Chairman stated that local competition "is making significant strides," he also acknowledged that "three years after enactment of the new Telecommunications Act" local competition "is still nascent." Kennard Statement, February 1999 at *7.

¹⁷ See Local Competition: August 1999 at 4-5 & n.9 (IAD, CCB, FCC Aug. 31, 1999).

¹⁸ Statement of William E. Kennard, Chairman Federal Communications Commission, Before the United States Senate Committee on the Judiciary Subcommittee on Antitrust, Business Rights and Competition on State of Competition in the Telecommunications Industry Three Years After Enactment of the Telecommunications Act of 1996, Speech, 1999 FCC LEXIS 753, at *1 (Feb. 25, 1999) ("Kennard Statement, February 1999"); see also News Release, "FCC Chairman Kennard Sees 1996 Telecom Act Working; Notes FCC Contributions to Its Success," 1999 FCC LEXIS 2344, at *1, *6 (May 26, 1999) ("Kennard May 26, 1999 Testimony") (Chairman Kennard testified that "[i]n the local phone sector, this newly-born marketplace is growing . . . [and] that over the past 18 months, the FCC . . . has taken definitive steps to make sure that this growth continues by hastening the transition to a competitive communications marketplace.").

As all competitors and potential competitors are aware, barriers to entry come in several forms, a critical one being the enormous resources -- both facilities and personnel -- needed to provide local service. Id. at *14-*15. Indeed, Chairman Kennard has noted that competition in the local market has been delayed due to a variety of reasons, one of which is "the sheer scale and complexity of the task." Id. The Chairman further made clear that these barriers "cannot be ignored: the development of local exchange competition is simply an order of magnitude more complicated, more labor-intensive and more capital-intensive than was the development of long distance competition." Id. at *15.

Congress and the Commission have attempted to reduce these barriers by enacting, and implementing through regulation, the 1996 Act. Observing that an incumbent provider's existing infrastructure allows it to serve new customers more cheaply than a competitor attempting to build and pay for its own network, see Local Competition Order ¶ 10, the Commission has tried to give entrants practical and expeditious access to ILEC facilities and functions. However, large incumbent monopolists have no economic incentive to aid competitors in market entry, and in fact have acted on incentives to block entry through refusals to interconnect, refusals to provide access to UNEs, and through imposition of supracompetitive prices. Id. Congress' efforts to remove the "economies of density, connectivity, and scale" for the purpose of furthering competition in the local market have not yet succeeded. Id. ¶ 11.

The Commission's recent order acting on the remand proceeding following Iowa Utilities Board¹⁹ fully recognizes the problems of achieving scale as a significant entry barrier: "Because competitors do not yet enjoy the same economies of scale, scope and ubiquity as the incumbent,

¹⁹ AT&T v. Iowa Utils. Bd., 119 S. Ct. 721 (1999).

they may be impaired if they do not have access, at least initially, to certain network elements supplied by the incumbent LEC." Local Competition Provisions of the Telecommunications Act of 1996, CC Dkt. No. 96-98, Third Report and Order and Fourth Further NPRM ¶ 13 (DA 99-238) (rel. Nov. 5, 1999) ("UNE Remand Order"). The Commission's UNE Remand Order should aid materially in this regard. In the recent UNE remand decision, the FCC took steps to enable CLECs, while they undertake the greater risks of constructing independent facilities, to obtain efficient access to these network elements on terms that permit them to share ILECs' economies of scale. See id. ¶¶ 82-98, 107. The Commission's Order applies to UNEs necessary to broadband as well as narrowband services (although both companies have taken issue with the decision not to unbundle packet switching/DSLAMs except in limited circumstances). See id. ¶ 317.

How quickly and to what extent the new rules achieve their objective is unknown. Large ILECs' disincentives to cooperate have intensified since passage of the 1996 Act. In the SBC/Ameritech Order, the Commission expressly recognized that the merger of these monopolies will tend to increase the ability and incentive of the combined company to thwart competitive entry.²⁰ And as the Commission itself has noted, the use of UNEs will not substitute for a facilities-based solution:

We fully expect that over time competitors will prefer to deploy their own facilities in markets where it is economically feasible to do so, because it is only through owning and operating their own facilities that competitors have control over the competitive and operational characteristics of their service, and have the incentive to invest and innovate in new technologies that will distinguish their services from those of the incumbent.

²⁰ Applications of Ameritech Corp. and SBC Communications Inc. for Consent to Transfer Control, CC Dkt. No. 98-141, 1999 FCC LEXIS 5069, ¶¶ 186-194 (DA 99-279) (rel. Oct. 8, 1999) ("SBC/Ameritech Order").

UNE Remand Order ¶ 7.

But the goal of local competition nationwide is not only an important public policy goal, it is the critical business strategy of both MCI WorldCom and Sprint. Both companies have independently recognized that in order to serve mass market customers, they need to be able to provide customers with local telephone service. This is not simply because the costs both companies pay to ILECs for local access represent a substantial portion of long distance costs (although that would be reason enough). Nor is it only because the companies must disengage themselves from their dependence on competitors for these critically strategic inputs (although this, too, would be sufficient). Rather, the need to provide local service stems most fundamentally from the fact that the present distinction between local and long distance service is already eroding. As the provision of local telephone service becomes more competitive, as the BOCs gain interLATA authority, and as wireless usage grows, packages of all distance service will become more readily available. If the new WorldCom does not position itself to compete for these packages, it risks losing the gains each company has made in its core businesses, and consumers will be worse off.²¹ MCI WorldCom and Sprint thus both perceived that the offering of local service was a key component of each company's respective strategic business plans.

²¹ Scale is important to MCI WorldCom and Sprint because they seek to compete for all market segments on a nationwide basis. This does not mean that it is necessary for other entrants' strategies. Just as a wide variety of IXC's (national and regional, presubscription and dial-around, facilities-based and resale) can compete for residential long distance customers, a wide variety of CLECs with differing strategies can compete for residential local service and residential "all distance" if UNEs and UNE-P become in fact available on a commercially viable basis. CLECs of many stripes have also been successful in capturing the business of larger customers. As experience demonstrates, these CLECs can and do deploy their own switches and fiber to serve larger locations. (The UNE Remand Order makes available unbundled switching in part to facilitate service to residential customers. UNE Remand Order ¶ 273.) Other CLECs like Teligent and Winstar have to

The key question, then, was not the setting of the goal of local competitive entry, but the means to achieve it. As noted, the legislative policies designed to open local markets and reduce the initial costs of entry have been largely thwarted by large incumbents' efforts to slowroll the process. New entrants to the provision of local telephone services are faced with substantial upfront fixed costs, even where these entrants seek to rely in part on the purchase of ILEC unbundled elements, or purchase of the ILEC UNE-P. Litigation by incumbents over the most fundamental questions of policy and process has delayed competition substantially. Continued and chronic resistance to established obligations has characterized large ILECs' performance in the marketplace. There is not much point in belaboring these facts here, but their existence provides a crucial context for the decision of MCI WorldCom and Sprint to merge: the need to secure an independent, facilities-based national CLEC business.

Some of the "significant strides" in the local competition effort have been in the form of mergers, such as the AT&T/TCI merger, that combine assets for the provision of local service. Upon approving that merger, the Commission concluded that the new company could produce "benefits for consumers, including a local telephony alternative for many residential customers now served only by incumbent local exchange companies."²² Indeed, achieving substantial scale and scope for MCI WorldCom and Sprint have been made all the more important when considered against the backdrop of the Commission's decision to approve the AT&T/TCI and SBC/Ameritech transactions. Additional pending mergers such as AT&T/MediaOne and

date chosen to specialize in deploying local wireless technology. The so-called data CLECs like Covad, Rhythms, and NorthPoint have also shown that other local entry paths are viable.

²² News Release, "Citing Pro-Competitive Benefits to Consumers, Commission Approves AT&T-TCI Merger," 1999 FCC LEXIS 553, at *1 (Feb. 17, 1999).

Qwest/U S West highlight the continuing and increasing importance of scale and scope to the local entry equation.²³

Thus, MCI WorldCom and Sprint are combining to establish a facilities-based solution to the "last mile" problem they confront. In creating a stronger company with independent means, the merger serves consumers and the public interest.

B. MCI WorldCom's Local Assets Will Contribute Substantially to the New Company's Local Entry Strategy and Will Be More Efficiently Utilized as A Result of the Merger.

MCI WorldCom has invested billions of dollars to construct and acquire independent local facilities in recent years. With annual local service revenues in excess of \$1 billion, it is the nation's second largest CLEC. Its initial focus, like that of other CLECs, has been on the most accessible portion of the local telephone business -- the medium and large business segment. MCI WorldCom, through those facilities, now provides local service to more than 42,000 buildings in 102 U.S. cities in 76 MSAs using fiber optic metropolitan area networks ("MANs"). These local

²³ See, e.g., Application, Ex. A (Public Interest Statement) at 8, Application of GTE Corp. and Bell Atlantic Corp. for Consent to Transfer Control, CC Dkt. No. 98-184 (Oct. 2, 1998) ("BA/GTE Application") (asserting that the combination of GTE's and Bell Atlantic's customers, reputations, and facilities provide the necessary basis "for broad-scale entry into local markets across the country"); Response to Comments on Applications for Transfer of Control of Qwest and U S WEST at 15, Merger of Qwest Communications International Inc. and U S West, Inc., CC Dkt. No. 99-272 (Oct. 18, 1999) ("Qwest/U S West Reply") (stating that the merger "will strengthen the resources and ability of the combined company to enter local markets outside the U S West region"); Application & Public Interest Statement at 27-31, AT&T Corp. and MediaOne Group, Inc. Application for Transfer of Control, CC Dkt. No. 99-251 (July 15, 1999) (stating that the merger will increase the geographic scope and create economies of scale through which AT&T can compete in the local exchange market, and that neither AT&T nor MediaOne could achieve such procompetitive benefits independent of the merger).

fiber rings comprise more than 9,000 fiber route miles. The locations of MCI WorldCom's local facilities are listed in the attached chart, MCI WorldCom Local Facilities (Exhibit 1).

MCI WorldCom also has worked to extend its capability to provide local service to residential and small business customers. For small businesses whose needs cannot cost justify dedicated access, MCI WorldCom made available DSL services in more than 400 POPs by the end of 1998, and is on schedule to be in 1,500 POPs by year end. A variety of DSL "flavors" is available for a range of applications, including Internet access and business services such as ATM and frame relay.²⁴

In attempting to serve residential customers, MCI WorldCom, like other CLECs, learned early on that a long-term resale strategy for local voice services could not succeed. MCI WorldCom thus has shifted its efforts in this area to those geographic markets where the UNE-P has been made available by ILECs on terms and conditions that make UNE-P a commercially feasible entry tool. MCI WorldCom's efforts first centered on New York, where the New York Public Service Commission made significant progress in requiring Bell Atlantic to provision UNE-P. MCI WorldCom has developed its systems and is actively selling UNE-P throughout New York State, despite several remaining Bell Atlantic problems that prevent MCI WorldCom from fully ramping up its sales to commercial volume. MCI WorldCom has signed up over 160,000 residential customers in New York using UNE-P. Its strategy there is to establish a sufficiently large market share using UNE-P and then migrate customers to its own facilities as such investment becomes feasible. MCI WorldCom is now preparing for entry in other states, such as

²⁴ To support its DSL business, in 1998 MCI WorldCom acquired a minority position in Rhythms NetConnections and has contractual arrangements with data CLECs and ISPs.

Texas, and plans to use UNE-P to address the mass market. Even with the FCC's UNE Remand Order, however, the commercial availability and feasibility of UNE-P in jurisdictions other than New York remains uncertain. The combined company will be better able to withstand the substantial costs of negotiating with the RBOCs for the rights re-established in the UNE Remand Order and of the inevitable regulatory battles that will ensue.²⁵

In accomplishing this, the merger will also promote the ability of other competitive local entrants to compete. As the Commission has observed, the importance of UNE access for all CLECs is critical to local entry. The access to UNEs these smaller CLECs have will improve, as they will be able to piggyback on the efforts of larger CLECs like the new WorldCom to break open local markets by exercising their rights to the same UNEs at nondiscriminatory prices under revived pick-and-choose rules. As a result, the new company will be an icebreaker.

The merger will also materially promote the new company's ability to compete with incumbent LECs for local services (and thus for packages of all distance services) on a facilities-basis. To become stronger and more efficient, MCI WorldCom's local facilities need to be more fully utilized with additional traffic. The merger allows this. First, the combined company will have a broader customer base, and thus more potential local customers than either company has today. As described in the Donoghue Affidavit, the long distance customers of the two companies are more likely also to purchase local services from them, thus increasing the likelihood of success in competing locally and reducing customer acquisition costs. Second, MCI WorldCom's local facilities will be more fully utilized by aggregating access traffic from both

²⁵ As discussed in the next section, the negotiation process will also be facilitated by the positive performance of the Sprint ILECs.

companies, thereby reducing unit costs overall for switched access, special access and local services. See Joint Affidavit of Wayne Rehberger and K. William Grothe, Jr. ¶¶ 8-9, attached as Appendix E ("Rehberger/Grothe Aff."). Third, the aggregation of the combined companies' local and exchange access traffic will also allow the merged company to economically justify the deployment of additional local facilities more quickly and in more service areas simultaneously than either company could justify on its own. This will reduce the merged company's dependence on ILEC facilities, accelerate facilities-based entry into local markets, and make use of those facilities more efficient. See Donoghue Aff. at 6. Fourth, the local facilities will significantly promote the availability of Sprint ION by providing the necessary Broadband Metropolitan Area Network ("BMAN") facilities for ION's deployment and by sharing collocation cages necessary for the DSL component of Sprint ION. As the Commission has recognized, Sprint has experienced substantial difficulties in gaining access to large ILEC central offices and special access facilities for the provisioning of Sprint ION.²⁶ Reducing the risk of discrimination by large ILECs will aid substantially to bring Sprint ION and other advanced broadband services to market. In these significant ways, the merger will minimize Sprint's current reliance on ILEC facilities for these purposes and accelerate the new company's ability to bring advanced services such as Sprint ION to market.

C. Sprint's Local Telephone Division Assets Will Significantly Enhance the Combined Company's Ability to Offer Services Nationwide.

Sprint's local telephone companies are another important asset in providing the new companies with a local presence. These assets serve not only to extend the geographic and

²⁶ SBC/Ameritech Order ¶¶ 197, 203.

demographic coverage of the merged company, they also expand significantly its local expertise. Moreover, maintaining these local telephone companies' affiliation with competitive enterprises sustains their positive benchmarking role for public policy decisions.

The Sprint local telephone companies serve approximately 7.9 million access lines in 18 states (approximately 5% nationally). About 5.6 million are residential access lines; the remaining 2.3 million serve businesses. The majority of Sprint's access lines (about 55%) are in Florida, Nevada, and North Carolina. The remaining states served by Sprint Local Telecommunications Division ("LTD") are Indiana, Iowa, Kansas, Minnesota, Missouri, Nebraska, New Jersey, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Virginia, Washington, and Wyoming. For the most part, their service areas cover suburban areas and rural communities. In each of these states, the rates of the Sprint local operating company are regulated by the respective public utility commission.

Sprint is the sixth largest operator of local telephone companies in the United States, although it is considerably smaller than the first five. The fifth largest phone company, U S West, owns more than double the number of access lines operated by Sprint. Despite its relatively small size, Sprint LTD has always served as an important independent voice in local telephony.

Sprint LTD represents more than 100 years of experience in the local telephone business. Its origin goes back to 1899, when local citizens in Abilene, Kansas grew dissatisfied with the Bell Company's expensive and poor service and decided to charter their own company.²⁷ The United Telephone Company, predecessor to Sprint LTD, grew out of a strong movement in rural

²⁷ See generally <www.sprint.com/sprint/overview/world.html>.

midwestern states to develop phone service independent of the Bell System. Today, the Sprint companies operate with 100% digital switching and extensive fiber deployment.²⁸

Sprint's ILEC operations mesh well with MCI WorldCom's CLEC operations. There is virtually no geographic overlap between MCI WorldCom's switches and Sprint LTD service areas. MCI WorldCom's CLEC operations are collocated in only four central offices of Sprint LTD, which are all located in the Orlando suburbs, whereas most of the MCI WorldCom local network is concentrated in downtown Orlando in BellSouth territory. In each of these central offices, there are at least three other collocated CLECs. MCI WorldCom has interconnection agreements with Sprint ILECs in only two states (Florida and North Carolina).

The merger will materially expand the local reach of both companies. As discussed in the previous section, MCI WorldCom's CLEC fiber rings are located in urban centers, addressing principally larger business needs. Sprint LTD helps to extend this reach to suburban and rural communities spread across 18 different states.

Further, Sprint LTD brings to the new company the human resources and talents necessary to enter local markets on a national basis. The Commission has itself recognized that ILEC expertise aids substantially in launching and sustaining competitive local entry in other markets. In Bell Atlantic/NYNEX, the Commission noted that ILECs possess advantages not possessed by other market participants, especially in serving mass market customers of local exchange and local exchange access services. It also described the "particular expertise" ILECs

²⁸ Sprint also owns a directory publishing division, principally as an adjunct to its local telephone business. Sprint North Supply provides materials management to the Sprint local affiliates as well as to non-affiliated LECs. Sprint LTD also provides paging services in its service areas, and these licenses are reflected in the associated applications.

bring to the interconnection process because of their "intimate knowledge of local telephone operations."²⁹ In SBC/Ameritech, the Commission found that each of the merger parties there could be a significant market participant in out-of-region local markets because:

each has the operational capabilities necessary to enter out-of-region markets. In general, each has the requisite access to the necessary facilities, "know-how," and operational infrastructure such as customer care, billing, and related systems that are essential to the provision of local exchange services to a broad base of residential and business customers. These systems are required whether entry occurs through resale, use of UNEs, or some other form of facilities-based entry. SBC and Ameritech also possess special expertise as incumbent LECs that each could bring to the interconnection negotiation and arbitration process when entering out-of-region markets because of their intimate knowledge of local telephone operations and experience in negotiating interconnection agreements with new entrants.

SBC/Ameritech Order ¶ 84 (footnotes omitted) (citing to numerous comments filed by, *inter alia*, AT&T, State Attorneys General Ex Parte, and numerous CLECs).

MCI WorldCom's experience in offering local service has revealed that customer care for long distance customers is quite different from customer care for local customers. Sprint LTD brings expertise and experienced personnel in terms of all of the customer care requirements that a carrier must manage once it has the order successfully placed and the customer is "up." This is one of the hardest items for non-ILECs, *e.g.*, learning how to properly address customer service calls and training customer care representatives to do so, including, *inter alia*, aiding customers in assessing the source of service difficulties (*e.g.*, is the problem due to CPE, inside wiring, etc.), billing questions regarding local/state charges that carriers bill due to state regulatory requirements, and so forth. Sprint LTD's experience in local telephone operations will greatly

²⁹ Applications of NYNEX Corp. and Bell Atlantic Corp. for Consent to Transfer Control, 12 FCC Rcd. 19985, ¶ 107 (1997) ("BA/NYNEX Order").

enhance the combined company's ability to serve local customers and thus compete more effectively in local markets nationwide. Importantly, it is not only this expertise, but the fact that it exists among substantial numbers of personnel (who are also available to train others), that will make the new company more readily able to enter and expand its efforts in multiple local markets simultaneously. The merger will thus significantly accelerate WorldCom's ability to enter local markets throughout the country.

Sprint LTD has also been a significant force in helping to establish the competitive ground rules of the 1996 Act. Unlike large ILECs, Sprint has vigorously advocated for procompetitive rules such as the use of TELRIC methodology for pricing of unbundled network elements and "pick-and-choose," and has actively participated through the appellate process leading to the Supreme Court's Iowa Utilities Board decision³⁰ to ensure a uniform federal framework. Sprint local companies have been far more forthcoming than other ILECs in discharging their obligations under Sections 251 and 252 to fill CLEC requests for collocation, UNEs, UNE-Ps, and resale. A recent review and on-site visit of Sprint's local operations' collocation practices in Nevada conducted by the FCC staff confirmed this. Sprint also has been able to inform public policy debates regarding interconnection issues (such as loop conditioning costs) at times when large ILECs insisted that local telephone operations could not readily accommodate competitive entrants' requests. Sprint LTD's continued affiliation with competitive businesses after the merger will ensure that this beneficial ILEC perspective continues, and a valuable benchmark for measuring other ILECs is preserved.

³⁰ AT&T v. Iowa Utils. Bd., 119 S. Ct. 721 (1999).

Enabling the combined company to build and expand local facilities more efficiently and more rapidly, the merger will facilitate the fundamental goals of the 1996 Telecommunications Act. As local choices expand, they will reduce the relevance of the traditional "stand-alone" long distance markets. This melding of services into "all distance" offerings provides crucial context for any examination of the long distance services of the merging firms, as discussed in the following section.

D. The Merger Will Not Impair Long Distance Competition.

As noted, the traditional category of "long distance" service is fading. Both the identity of the suppliers and their cost structures are changing, promising radically different market pictures in the very near future. The legal barriers that once kept separate local suppliers from long distance suppliers are being razed. Customers are increasingly looking to a single source to purchase an "all distance" package. See generally Patel Aff. From this perspective, the Commission's traditional analysis of a "mass market domestic long distance market" and other stand-alone long distance market segments cannot fully capture the competitive dynamics of the changing telecommunications marketplace.

Notwithstanding this stark reality, questions have been raised about this transaction in the context of long distance service alone. While MCI WorldCom and Sprint respectfully urge the Commission not to lose sight of the overall context, they are fully prepared as well to demonstrate the absence of any competitive harm even in the narrow confines of traditional service categories of long distance. The following sections, along with a detailed paper by Dr. Stanley Besen and Dr. Steven Brenner attached as Appendix B, provide this analysis.