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Suzi Ray McClellan
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October 14, 1998

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, DC 20554

RECEIVED
OCT 15 1998
FEDERAL COMMUNICATIONS COMMISSION

Re: CC Docket No. 98-141, In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, to SBC Communications, Transferee

Dear Madam:

Please find enclosed an original plus twelve copies of the Petition to Deny, or in the Alternative Petition to Impose Conditions, of the Texas Office of Public Utility Counsel in CC Docket No. 98-141, In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, to SBC Communications Transferee. Copies of this filing were also provided to Ms. Cecilia Stephens of the CCB (including an electronic diskette with accompanying cover letter), ITS, and other parties referenced in the July 20, 1998, Public Notice.

Please return one file-stamped copy of this filing to the office in the enclosed postage-prepaid envelope. You are invited to contact me if you have any questions.

Sincerely,


Rick Guzman
Assistant Public Counsel

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CERTIFICATE OF SERVICE

I, Rick Guzman, do hereby certify that on this 14th day of October 1998, I served by overnight mail, a true copy of the foregoing Texas Office of Public Utility Counsel's Petition to Deny, or in the Alternative Petition to Impose Conditions, CC Docket No. 98-141, In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech Corporation, Transferor, to SBC Communications, Transferee, upon the following:

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Rick Guzman

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

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OCT 15 1998
FCC MAIL ROOM

In Re Applications of)
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AMERITECH CORP.,)
Transferor,)
)
AND)
)
SBC COMMUNICATIONS, 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 5, 22, 24, 63, 90, 95 and 101)
of the Commission's Rules)

CC Docket No. 98-141

**PETITION TO DENY, OR IN THE ALTERNATIVE PETITION TO IMPOSE
CONDITIONS, OF TEXAS OFFICE OF PUBLIC UTILITY COUNSEL**

Respectfully Submitted,

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October 14, 1998

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CC Docket No. 98-141

**PETITION TO DENY, OR IN THE ALTERNATIVE PETITION TO IMPOSE
CONDITIONS, OF TEXAS OFFICE OF PUBLIC UTILITY COUNSEL**

Pursuant to Public Notice DA 98-1492, released July 30, 1998, the Texas Office of Public Utility Counsel (OPC) hereby submits this Petition with supporting affidavits concerning SBC Communications, Inc.'s (SBC's) and Ameritech Corporation's (Ameritech's) Application for Consent to the Transfer of Control of Licenses and §214 Authorizations from Ameritech, Transferor, to SBC, Transferee, in CC Docket No. 98-141 before the Federal Communications Commission (FCC).

I. INTEREST OF OPC

OPC is the Texas State agency designated by its state laws specifically to represent residential and small commercial utility consumer interests of the state. It is responsible for representing these interests before Texas and federal regulatory agencies

as well as the courts. Texas Utilities Code Ann. §13.001-13.063. In Texas, SBC provides telephone service through its affiliate, Southwestern Bell Telephone Company (SWBT). SWBT provides telephone service through approximately 6 million residential access lines in the state. SWBT's Texas operations are subject to state incentive regulation that permits substantial regulatory flexibility in exchange for rate caps on basic network services and other commitments. See Texas Utilities Code §§58.021-58.267. State law also authorizes public interest review by the state public utility commission of certain sales, transfers, or mergers affecting public utilities. Texas Utilities Code §14.101. Significantly, SWBT has not yet been subject to merger public interest review under Texas law, presumably due to the exception from merger public interest review provided at Texas Utilities Code §51.010 for companies electing into incentive regulation, such as SWBT. Therefore, this FCC review of SBC's merger application constitutes the principal venue for testing the public interest impact of the proposed merger on Texas residential and small commercial customers. Accordingly, OPC submits this Petition with accompanying affidavits so that the FCC may be better informed as to the public interest impacts of the proposed merger on the residential and small commercial customers of Texas.

II. SUMMARY

OPC submits that the merger application should not be approved. Significant enough issues exist with respect to the impact of the proposal on local competition that it would not be in the interest of in-region residential and small commercial customers to approve the proposed merger at this time. First, merger history and the experience in other industries gives compelling reasons for discounting the claims of possible economic

benefits from most or all mergers in all sectors, as well as specifically in telecommunications. Shepherd Affidavit ¶¶58-67. In fact, merger history has shown that about half or more of mergers actually prove in the long run to be harmful to the companies, to their investors, and to economic performance. In the present case, relevant merger history indicates that the supposed economic gains in efficiency in the SBC-Ameritech merger are likely to be much less than claimed, or even negative. Id. ¶¶50-55. See also Szerszen Affidavit ¶¶7-22. Approval of the merger, therefore, may well lead to higher costs for in-region residential and small commercial customers.

Second, SBC's market definition fails to distinguish between upstream and downstream markets, thus ignoring the damage the merger will do to competition in upstream markets. While not an explicit consideration at the time of the Bell Atlantic-NYNEX merger, the present merger analysis should give proper recognition to the fact that implementation of the 1996 Act has reinforced the ability of SBC and Ameritech to become vertically integrated firms with wholesale and retail divisions. Privileged access by SBC's retail division to Ameritech's wholesale division would allow SBC to compete in Ameritech's serving area as an incumbent local exchange carrier (ILEC) rather than as a competitive local exchange carrier (CLEC) (and, more importantly, for Texas customers represents a loss of an actual local service competitor in the Texas market). Ankum Affidavit ¶¶21-43. Ameritech is certificated by the Texas Commission to provide both resale and facilities-based local service in Texas. It currently provides competitive local service on a resale basis. SBC's merger advantage may well prove decisive for the Texas market after derailment of the Act of 1996.

Third, a merger between SBC and Ameritech will hamper competitive efforts to lower prices. For certain customers, the merger will actually raise prices, because it will eliminate the incentive each of the companies have to offer sharp prices for local service to potential customers as an offset to sharp prices offered by the other ILEC in their service territories. For example, SBC no longer has to reveal a low cost in Dallas to offset Ameritech's cost advantage in Chicago when attempting to attract a major national customer. Ankum Affidavit ¶¶67-77.

Fourth, the applicants' assertion that the merger is needed to respond to other "formidable competitors" is simply mistaken. Competition in telecommunications markets is characterized by the presence of numerous relatively small and financially weak competitors whose assets, revenues, and income are dwarfed by those of SBC and Ameritech. Szerszen Affidavit ¶¶28-41. In fact, the large merger premium being paid by SBC for acquisition of Ameritech is an indication of expectations that the combined entity will continue to exercise market power on the local service markets. Szerszen Affidavit ¶¶23-27.

Finally, if the FCC is nevertheless committed to going forward with the merger, then OPC alternatively recommends that the FCC adopt certain public interest and competition-promoting conditions as a prerequisite to merger approval.

III. RELEVANT MARKET AND PARTICIPANTS

The Applicants must establish by a preponderance of the evidence that the requests to transfer the licenses, certificates, and authorizations serves the public interest, convenience, and necessity. In the Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX

Corporation and Its Subsidiaries, NSD-L-96-10, Memorandum Opinion and Order (adopted August 14, 1997) (hereinafter the Bell Atlantic-NYNEX Merger Order) ¶29. See 47 U.S.C. §§214(a), 303(r), 309(e), and 310(d) (1997). This public interest obligation is fairly broad so as to encompass all the goals and objectives of the Communications Act. Bell Atlantic-NYNEX Merger Order ¶31. Additionally, in the Bell Atlantic-NYNEX Merger Order ¶35, the FCC expressly noted that “public interest analysis necessarily includes a review of the nature and extent of local competition.” In support, the FCC noted that §271 of the Communications Act of 1934, as amended, specifically applies the public interest standard to a review of local market conditions. Id.

In order to discuss the impact of the proposed merger on the public interest it is important to define the relevant markets and relevant market participants. In his Affidavit, Dr. August H. Ankum finds that the significant market participants include SBC, Ameritech, AT&T, MCI/WorldCom, and Sprint. In his affidavit, Dr. William G. Shepherd examines the relevant markets, finding that local service markets constitute a relevant market distinct from long distance markets. Shepherd Affidavit ¶¶25-48.

The relevant market, for analyzing the effect of merging SBC’s and Ameritech’s retail divisions, is the combined serving areas of SBC and Ameritech, with the exception, perhaps, of more rural areas. Dr. Ankum disagrees with SBC that the relevant markets for merger analysis are the St. Louis and Chicago areas. (See Joint Affidavit of Schmalensee and Taylor, pp. 11 - 13). For purposes of defining the relevant market, the Commission should note that if the customer has locations nationwide, then marketing managers will eventually define the relevant market as a national market. In fact, SBC’s

own affidavit speaks to the need to provide large customers with nationwide service. Ankum Affidavit ¶¶21-28.

Most significant to local competition in Texas is the loss of Ameritech as an actual competitor to SBC's local service affiliate, SWBT. Ameritech was certificated by the Texas Commission in April 1997 as both a resale and facilities-based local service competitor. Petition Exhibit No.1. Ameritech was authorized to serve the entire state of Texas, except for certain rural areas, using all types of competitive services. Petition Exhibit No.1 (Finding of Fact Nos. 6 and 11). Significantly, the Texas Commission found that Ameritech "will eventually provide facilities-based local service in Texas." Petition Exhibit No.1 (Finding of Fact No. 12). Also, an interconnection agreement was negotiated between Ameritech and SWBT in November 1997.

The merger will, therefore, eliminate an actual competitor in Texas with plans to compete against SBC's local affiliate as a facilities-based competitor. Ironically, the merger eliminates one of the few competitors with the financial strength to compete against SBC on a head-to-head basis. See Szerszen Exhibit No. 2. Moreover, the notion that, anyhow, Ameritech was really not going to compete in Texas is patently false. Ameritech made it quite clear in various Texas Commission proceedings that it would be a player in Texas and that its presence would contribute to the "transition to telecommunications competition in the State of Texas" and Ameritech's presence would provide residential customers with "diversity in providers" that "increases customer choices." See Petition Exhibit No. 2 at 2.

Curiously, before the merger, SBC's local affiliate explicitly recognized the competitive benefits of Ameritech's presence in the Texas marketplace. As part of the

interconnection proceedings before the Texas Commission, SWBT stated under oath, that allowing Ameritech to compete against SWBT would give customers in Texas “ a choice between at least two local service providers.” At that time, SBC’s local affiliate asserted that Ameritech’s presence, pursuant to the proposed interconnection agreement “fosters, encourages, and accelerates . . . a competitive advanced telecommunications environment and infrastructure and to that end, not only advances, but also protects the public interest.” Petition Exhibit No. 3 at 4. Those statements were made before the merger announcement. They, thus, reflect the most credible estimation of the value of Ameritech’s presence in the Texas market. As such, it is vital that the FCC recognize that the proposed merger will eliminate one of the few truly “formidable competitors” SBC faces in-region.

Significantly, Kahan observes “SBC and Ameritech have concluded that a regional or niche strategy is not in the best interest of their customers, employees and shareholders. . . .” (p. 10.) Mr. Kahan says this presumably because he believes that the mandates of an evolving market place are that large companies such as SBC and Ameritech eventually would have to compete with one another. If that is the case, then SBC’s and Ameritech’s assertions that they did not have active plans to compete in one another’s territories is patently false. Rather, Kahan’s views indicate that both companies recognize their predicament: (1) the marketplace requires that sooner, rather than later, they will have to compete; (2) *de novo* entry is too expensive (Kahan, p. 5); and (3) SBC’s and Ameritech’s regulatory departments have done such a good job at defense that offense (market entry) by means of unbundled elements and resale is not commercially viable. Ankum Affidavit ¶¶38-40.

IV. MERGER BENEFITS

The SBC affiants believe that the total merger savings will be approximately \$2.5 billion, consisting of \$778 million in revenue synergies, \$1.43 million in cost savings, and \$300 million from jointly entering out-of-region long distance markets. Szerszen Affidavit ¶11. The \$778 million in revenue synergies, however, appear to stem primarily from more effective marketing and sales techniques with respect to traditional intrastate services. According to Mr. Martin Kaplan, the companies have been unequally successful in marketing certain ancillary services in their service territory, primarily caller ID, call waiting, call return, voice mail, additional telephone lines, directory publishing, data services and Centrex. (Kaplan, pp. 4-9.) However, SBC has not provided any evidence that its marketing skills are superior to Ameritech's, and one would expect some existing regional differences in telephone service usage due to variations in income and consumer preferences. Szerszen Affidavit ¶¶11-12. Of course, the only relevant revenue gains would be the net gains available only by this merger, rather than by other arrangements. Shepherd Affidavit ¶50.

The Company's numbers, however, do not reflect such net gains. Significantly, the applicants have not estimated or discussed the costs associated with the merger. Such costs typically include acquisition premiums, severance, retraining and relocation payments, golden parachute payments, as well as the general expenses that will be incurred in integrating the merging companies' operations. Merger costs are likely to be substantial, and may even exceed merger savings for years after the merger is consummated. The applicants' failure to discuss the costs associated with the proposed merger is a serious omission. Szerszen Affidavit ¶¶15-16.

Concerning the cost savings, as Dr. Shepherd explains, merger efficiency claims are frequently discredited as self-serving and unreliable (examples include the Penn-Central merger of 1969, at least half of the mergers during the 1960s merger boom, the calamitous Union Pacific-Southern Pacific merger of 1996, the Republic Steel-LTV merger in 1984, etc.). He notes that the broad economic and business literature on merger impacts has shown that about half or more of mergers actually prove harmful – not helpful – to the companies, to their investors, and to economic performance. Shepherd Affidavit ¶¶50-54.

In the airlines industry, for example, deregulation worked quite well after 1978. But during 1985-1988, major mergers among leading airlines were mistakenly permitted, and they greatly increased concentration and the dominance of airlines over major airports, turning them into "fortress hubs." That dominance led to fares at fortress-hub airports that are commonly more than 20 percent higher. Shepherd Affidavit ¶59. In railroads, the leading recent example is the 1996 merger of Union Pacific with the Southern Pacific railroad. The railroad's own officials, as well as all observers, have universally acknowledged this merger as a fiasco. It has caused enormous congestion and harms for customers, and the damage still continues in 1998. *Id.* ¶¶60-64. Mergers in the utility field can also be particularly anti-competitive and unfavorable in economic terms. These industries clearly illustrate that mergers of deregulation-involved firms like SBC-Ameritech pose two distinct dangers. One is a simple reduction in efficiency, which is likely to be significant but may be much larger, perhaps disastrously so. The other danger is the merger's destruction of actual and potential competition. *Id.* ¶¶65-67.

Furthermore, as Dr. Ankum explains, the Commission should note that the alleged benefits represent no more than the optimistic “best case” guesses of SBC’s and Ameritech’s affiants. For example, the 30-City plan and the associated \$300 million in merger synergies from jointly offering long distance appear contingent (at least in part) upon SBC receiving §271 approval and negotiating numerous interconnection agreements with other carriers at certain prices and under a certain timeline, but if that approval or agreement is not forthcoming, then the projected savings may not be realized. While SBC now touts its intent to become an aggressive competitor, after the merger the company may well decide that it is more profitable to take a defensive rather than an offensive posture or pursue other strategies. Ankum Affidavit ¶¶78-80.

Moreover, Dr. Ankum notes the narrow field across which the merger synergies are expected to flow. For example, the benefits of the merger are based in significant part on greater spending by current and future SBC customers. Absent robust in-region competition compelling SBC to reduce its pricing to more efficient levels, price cap regulation will funnel merger benefits to a select group: i.e., stockholders of SBC and Ameritech. This result does not promote economic efficiencies because it fails to spread the gains of the merger across a broad enough range of interests to be able to turn merger synergies into consumer surplus. See Ankum Affidavit ¶¶78-79.

Dr. Ankum also notes the risk of regional asymmetry in benefits. He finds that while the merger with the accompanying 30-City plan may ultimately strengthen the marketplace out-of-region, leading to greater economic efficiencies in out-of-region areas, it would clearly make it harder, if not impossible, for others to compete in SBC’s region, offsetting out-of-region efficiencies with in-region inefficiencies. In fact, these

inefficiencies are likely to be realized before any out-of-region efficiencies develop. Because SBC has yet to obtain approval for any of its §271 applications, the playing field in-region is still tilted in SBC's favor. Once such approval is obtained, SBC will be allowed to provide one-stop shopping. At that time, SBC will be the only firm that, with almost one-half of the access lines in the country, can effortlessly provide one-stop shopping to all customers inside its serving area using its own facilities. If competing with SBC is already difficult, it will become near impossible after the merger. Ankum Affidavit ¶80.

Concerning the cost savings and the savings from jointly entering the long distance market, Dr. Szerszen explains how the applicants have not demonstrated that the merger is necessary for either company to improve its productivity and customer satisfaction levels. The primary consumer benefits ensuing from the merger are discussed in the affidavits of Drs. Robert Harris and Richard Gilbert, but it is unclear from that discussion whether a merger is actually necessary to implement the "best practice" procedures described in the applicants' affidavits. In fact, Mr. Wharton Rivers provides several instances whereby performance-enhancing information was obtained by Ameritech in the normal course of business (pp. 7-9). For example, in 1995 Ameritech was able to assimilate some of SWBT's best practice procedures through an on-site visit to the Company's facilities (Rivers, p. 7). Mr. Rivers also notes that Ameritech relies heavily on its system and technology vendors to provide performance-enhancing insights. Finally, Mr. Rivers testifies that competitive considerations compel telephone companies to purchase and utilize the best available technology and business practices. Szerszen Affidavit ¶¶7-10.

V. VERTICAL INTEGRATION

Merger approvals should not become a public policy substitute for implementing the pro-competitive provisions of the Act of 96. Ankum Affidavit ¶¶20. As Dr. Ankum explains, SBC's claimed inability to viably offer service out of region outside of merger demonstrates that it is nearly impossible to successfully break into local exchange markets as a CLEC. SBC's proposed merger with Ameritech demonstrates that the only economically viable means of entering out-of-region local markets on a wide scale basis is not by using the provisions of the Act of 96, as implemented to date, but by merging with the out-of-region incumbent LEC. However, if CLECs are truly offered non-discriminatory access to the ILECs' facilities, then there should be only minimal, if any, advantage to owning the incumbent network. That is, if the provisions of the Act are implemented appropriately, SBC's proclaimed need to merge with Ameritech would be substantially diminished. One way to address this issue is to separately review the effect of the merger on SBC's and Ameritech's wholesale and retail operations. Ankum Affidavit ¶¶17-20.

SBC's market definition, however, fails to distinguish between upstream and downstream markets, thus ignoring the damage the merger will do to competition in upstream markets. In its Bell Atlantic/NYNEX Merger Order, the FCC focused almost exclusively on only one cell in this matrix: the merger of the retail divisions. As discussed by Dr. Ankum, the FCC did not consider the ramifications of permitting the mergers of the retail divisions with the out-of-region wholesale divisions. In defining the appropriate markets for purposes of a market-power analysis, the FCC should recognize that SBC and Ameritech are *vertically integrated firms*, consisting of a wholesale

division and a retail division. Under the Act of 96, the wholesale division must provide wholesale services to its own retail division and dependent competitors on a non-discriminatory basis. Dr. Ankum explains how important it is to consider the effects of the merger on both retail and wholesale markets, because it will affect dependent competitors in the upstream market. Therefore, in order to properly take into account the wholesale versus retail aspects of the current marketplace, it is important for the FCC to expand upon the Bell Atlantic-NYNEX Merger Order's focus on retail customers in downstream markets only. See, e.g., Bell Atlantic-NYNEX Merger Order ¶¶50, 55, and 57.

VI. MERGER IMPACT ON CONSUMER PRICES

A merger between SBC and Ameritech will hamper long term efforts to achieve competitive entry in the local market. As Dr. Shepherd explains, deregulatory policies, such as those embodied in the 1996 Act, in order to be successful must rely above all on openness—the continuous and free entry of new competitors into markets that have long had government-approved monopolies. See Shepherd Affidavit ¶¶34-43. Only about 0.3% of SBC's and Ameritech's bottleneck local facilities are being used by competitors. See Ankum Affidavit ¶52. Given the current level of local competition, the present proposal will reduce openness, because the merger eliminates a potential competitor, thereby to some extent delaying the development of a marketplace to regulate prices.

Moreover, approval of a merger of two entities that have not yet opened their markets to local competition will indirectly reward these companies for failure to implement §§251 and 252 of the Act. The majority of the merger synergies (\$2.2 billion of the \$2.5 billion) are associated with in-region services and operations (only \$300

million of the benefits are related to long distance synergies). Significantly, there has been very little actual entry of new competition into SBC's and Ameritech's local markets. That is obvious from the list of supposed CLEC entries that is provided by SBC's witness Dennis Carlton. Shepherd Affidavit ¶80. Moreover, the most credible indication of the openness of SBC's local service market was provided earlier this year in SBC's Texas §271 proceeding. In that proceeding, the Texas Public Utility Commission, after extensive hearings, explicitly rejected the SBC local affiliate's bid for long distance entry, finding over 129 separate areas in which SBC's local affiliate is in need of improvement. See Attachment 4 to this Petition. The Texas Commission has initiated a collaborative review process to address these recommendations, which is still ongoing as of this date. Had these companies opened their markets to competition as they should have under the 1996 Act (evidenced by §271 approval), then the merger benefits associated with local services might not be as valuable. Further, the application, as filed, offers no guarantee that, after SBC-Ameritech merger approval, in-region entry will not be further undermined in order to realize even higher levels of merger benefits for company shareholders.

Dr. Ankum explains how the merger will eliminate the incentive each of the companies have to offer sharp prices for local service to potential customers as an offset to sharp prices offered by the other. For example, to offset the price advantages of other carriers, both SBC and Ameritech will reveal how cheaply they are actually able to offer services over their own networks—these facilities represent the ILECs' principle advantage when competing with other carriers for customers. As a result, the customer obtains pricing information for each area in which it seeks to obtain service. The

customer benefits because he can take the sharpest price in each region into account when putting together a package of telecommunications services. Ankum Affidavit ¶¶67-73.

After the merger, however, the bidding process is simplified. As Dr. Ankum notes, SBC, for example, will gain privileged access to Ameritech's facilities in Chicago. This means that SBC's cost for serving the customer in Chicago will become Ameritech's. More importantly, SBC no longer has to reveal a low cost in Dallas to offset Ameritech's cost advantage in Chicago. That is, SBC is now bidding only against other carriers' cost advantage related to the interstate transport portion, but no longer against Ameritech. As a result, unlike before the merger, the customer no longer can take the sharpest price in each region. Accordingly, for certain customers, the merger will undoubtedly lead to higher prices. Ankum Affidavit ¶¶74-77.

VII. "FORMIDABLE COMPETITORS"

The applicants' assertion that the merger is needed to respond to other "formidable" competitors is simply mistaken. Drs. Schmalensee and Taylor contend that Ameritech and SBC face "formidable" competitors in local exchange markets. They contend that these competitors have "clear" competitive advantages compared to the applicants, including existing wireline networks, customer relationships, and brand recognition (p. 22). However, as Dr. Szerszen explains, SBC has grossly exaggerated and overestimated the extent of the competitive challenges it faces in the telecommunications market. Specifically, in Szerszen Exhibit 2 are shown several financial statistics for virtually all U.S. based telecom or cable companies that are referenced or cited in the applicants' affidavits. Most notably, there are only a few firms in the telecommunications marketplace that currently exceed SBC in revenues and assets.

After the merger, SBC's and Ameritech's combined revenues and assets will be exceeded only by Bell Atlantic and AT&T, once the AT&T-TCG merger is successfully completed. Szerszen Affidavit ¶¶28-32.

Dr. Szerszen further notes that the majority of the competitors that the applicants refer to would not be considered financially sound. Szerszen Exhibit 2 demonstrates that they either have negative common equity balances, negative net income, high debt ratios, high debt costs, low interest coverage ratios, or some combination of these. While the applicants may be correct in their belief that competing telecom firms have been successful in obtaining access to capital, SBC and Ameritech fail to recognize the extremely high debt and equity costs these firms encounter. On the other hand, SBC and Ameritech already have access to the financial resources needed to expand their operations. Ameritech on a stand-alone basis is exceeded in size and revenues by very few non-RBOC carriers, such as AT&T and MCI. Ameritech also had the highest 1997 return on equity for all the telecommunications firms listed in Szerszen Exhibit 2. Szerszen Affidavit ¶¶33-38.

Contrary to the statements of Drs. Schmalensee and Taylor (p. 10), the long distance carriers also cannot be characterized as having unilaterally high profit margins. MCI has had quite modest returns on equity and returns on total capital for the past four years, ranging from 1.7% to 11%. The same is true of WorldCom, whose returns have ranged from 1% to 12%. Sprint has had quite high equity returns ranging from 10.5% to 19%, and its returns on capital have been about 8% to 13.5%. Sprint, however, is both a long distance and local service company. The Company's local service operations operate with substantially higher operating margins than do its long distance operations. SBC, on

the other hand, has experienced returns on equity ranging from 20% to 34% in the last four years, and returns on capital have ranged from 13% to 18.5%. Ameritech's equity returns have ranged from 27% to 28%, and its returns on total capital have been about 18%. Accordingly, Dr. Szerszen concludes that competition in telecommunications markets is characterized by the presence of numerous relatively small and financially weak competitors whose assets, revenues, and income are dwarfed by those of SBC and Ameritech. Szerszen Affidavit ¶¶39-41.

Furthermore, the large merger premium being paid by SBC for acquisition of Ameritech is an indication of expectations that the combined entity will continue in its dominant role into the future. As Dr. Szerszen explains, based on May 8, 1998 pre-merger announcement stock prices and April, 1998 common stock share numbers, the potential acquisition premium for Ameritech is approximately \$13,085,440,000. Based on September 30, 1998 common stock prices, the acquisition premium is \$8,720,856,686. These are substantial purchase premiums, and exceed the 1997 total book value of Ameritech's stock at year-end 1997. In fact, an acquisition premium of this level raises the risk that the merged company will attempt to recover the acquisition premium from its ratepayers. Szerszen Affidavit ¶¶23-27.

VIII. ALTERNATIVES TO FULL APPROVAL

If the FCC is nonetheless committed to going forward with the merger, then OPC alternatively recommends that the FCC adopt certain public interest and competition-promoting conditions as a prerequisite to merger approval. OPC recommends the following conditions:

- At the very least, the FCC should impose the same conditions on SBC-Ameritech as it imposed in the Bell Atlantic-NYNEX Merger.
- The FCC should adopt a provision for ensuring the flow-through of the synergy benefits of the merger to SBC's ratepayers. This recommendation should be accomplished through an adjustment that flows through benefits directly to end-users. Because SBC paid such a large acquisition premium for Ameritech, the FCC should prohibit SBC from charging ratepayers for any of the costs of the merger either through interstate rates charges (i.e., SLC rate increases) or through separation flow-throughs.
- In order to address the vertical integration issue, the FCC should initiate a divestiture review of SBC's and Ameritech's wholesale operations. Only such divestiture can ensure that the retail operations of RBOCs after an RBOC merger do not receive preferential treatment from their wholesale divisions.
- To protect competition, the FCC should require voluntary compliance of SBC with FCC rulings on ILEC requirements to provide common transport and combined unbundled network facilities to CLECs, including access at terms and conditions more flexible and reasonable than standard collocation tariffs.
- Both SBC and Ameritech must have met the conditions necessary for approval of a §271 application prior to merger. Only then can it be asserted confidently that CLECs have non-discriminatory access to SBC's and Ameritech's wholesale divisions and will not be disadvantaged after the vertical merger of SBC's retail division with Ameritech's wholesale division and *vice versa*.

See Ankum Affidavit ¶¶81-82.

OPC, however, cautions the FCC to carefully consider whether this course of action truly represents an acceptable ameliorative substitute to outright rejection of the merger application. Reliance on regulatory oversight to police the implementation of complicated merger conditions is fraught with risk because the effectiveness of such oversight actually depends on the full cooperation of the regulated entity, which may not be forthcoming after the merger is approved. Shepherd Affidavit ¶89.

IX. CONCLUSION

OPC urges the FCC to closely examine the proposed merger. In many ways, SBC's proposed merger signals a regulatory failure – with SBC and Ameritech being the culprits here – to fully implement the pro-competitive provisions of the Telecommunications Act of 1996 (Act of 96). If competitors are truly offered non-discriminatory access to the ILECs facilities, then there should be only minimal advantage to owning or merging with an incumbent network and all carriers would be able to compete, not just SBC. Ankum Affidavit ¶5.

Of course, one may argue that if the FCC allowed last year's Bell Atlantic-NYNEX merger, then it must now allow the SBC-Ameritech merger. However, in 1997 the FCC found that the Bell Atlantic-NYNEX merger would cause substantial competitive harm. The FCC allowed the merger only because Bell Atlantic added a number of important protections. Moreover, the FCC assumed compliance with §§251 and 252 of the 1996 Act, Bell Atlantic-NYNEX Merger Order ¶7, only because there was no track record to speak of in early 1997 on implementation of the 1996 Act. Conditions are now much worse than they were in 1997 and, more importantly, there is now a fairly

extensive track record regarding implementation of §§251 and 252 of the 1996 Act. The economic calculus on the SBC-Ameritech merger would be even more unfavorable now to potential entry, by the FCC's own criteria in the Bell Atlantic-NYNEX merger. Shepherd Affidavit ¶¶15-17. Therefore, the need to reject this merger proposal is actually greater, not less. However, if the FCC were to approve this merger, it should require substantially more protections than required for the Bell Atlantic-NYNEX merger.

Date: October 14, 1998

Respectfully submitted,

Suzi Ray McClellan
Public Counsel
State Bar No. 16607620



Rick Guzman
Assistant Public Counsel
State Bar No. 08654670

OFFICE OF PUBLIC UTILITY COUNSEL
1701 N. Congress Avenue, 9-180
P.O. Box 12397
Austin, Texas 78711-2397
512/936-7500
512/936-7520 (Facsimile)

PETITION EXHIBITS

CONSOLIDATED ORDER

§
§
§
§
§
§

PUBLIC UTILITY COMMISSION

OF TEXAS

DOCKET NO. 16800 *Application of Sprint Communications Company, L.P. For A Facilities Based Certificate of Operating Authority Within Texas*

DOCKET NO. 16965 *Application of Ameritech Communications International, Inc. For A Service Provider Certificate of Operating Authority*

CONSOLIDATED ORDER

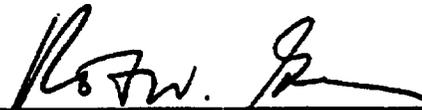
The Commission adopts the attached findings of fact and conclusions of law and issues the orders set out therein.

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SIGNED AT AUSTIN, TEXAS on the 2nd day of APRIL 1997.

PUBLIC UTILITY COMMISSION OF TEXAS


PAT WOOD, III, CHAIRMAN


ROBERT W. GEE, COMMISSIONER


JUDY WALSH, COMMISSIONER

ATTEST:


PAULA MUELLER
SECRETARY OF THE COMMISSION

DOCKET NO. 16965

APPLICATION OF AMERITECH
COMMUNICATIONS INTERNATIONAL,
INC. FOR A SERVICE PROVIDER
CERTIFICATE OF OPERATING
AUTHORITY

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ORDER

The Public Utility Commission of Texas (Commission) finds that this docket was processed in accordance with applicable statutes and Commission rules. The Applicant provided notice to all interested parties. The parties entered into a stipulation in the proceeding, and no hearing on the merits was necessary. The Service Provider Certificate of Authority (SPCOA) requires the Applicant to identify an agent for service of process within the State of Texas. The application is hereby approved as modified.

The Commission adopts the following findings of fact and conclusions of law:

Findings of Fact

Procedural History

1. On January 28, 1997, Ameritech Communications International, Inc. (the Applicant) filed an application with the Commission seeking to obtain an SPCOA within Texas.
2. On January 30, 1997, the Commission issued a preliminary order referring the docket to the State Office of Administrative Hearings (SOAH). On February 4, 1997, the SOAH Administrative Law Judge (ALJ) issued an order in the docket adopting the Commission's preliminary order and the procedural schedule set forth in the preliminary order.
3. The Applicant, together with affiliates, has less than six percent of the total intrastate switched access minutes of use, as measured by the most recent twelve-month period for which data is available preceding the filing of the application.

4. On February 7, 1997, a motion to intervene was filed by Southwestern Bell Telephone Company (SWB). On February 26, 1997, the ALJ granted the motion to intervene.
5. On February 4, 1997, the Commission provided adequate notice of this proceeding in the *Texas Register* and through a posting on the Internet.

Applicant's Request

6. The Applicant proposes to serve the State of Texas. The Applicant will follow established boundaries of underlying carriers in the State of Texas except those certificated areas of companies serving less than 31,000 access lines as set out in the Public Utility Regulatory Act (PURA), TEX. REV. CIV. STAT. ANN. art. 1446c-0 (Vernon Supp. 1997).
7. The Applicant is not a municipality, nor will the Applicant enable a municipality or municipal electric system to offer for sale to the public, directly or indirectly, local exchange telephone service, basic local telecommunications service, switched access service, or any non-switched telecommunications service used to provide connections between customers' premises within an exchange or between a customer's premises and a long-distance provider serving the exchange.
8. The Applicant proposes to provide service to customers other than itself and its affiliates, if any, within the geographical area granted under this certificate.
9. The Applicant filed an affidavit stating that it has been advised that there is no requirement for consent, franchise or permit in the initial area it requests to provide service (as a reseller). If such a requirement is later made or service is expanded to an area requiring such consent, franchise or permit, Applicant shall take steps to obtain any necessary authority.
10. The Applicant does not currently hold a certificate of operating authority or certificate of convenience and necessity within the territories affected by the application.

11. The Applicant proposes to be a reseller and a facilities-based provider of local exchange service, basic local telecommunications service, and switched access service.

12. The Applicant intends to initially resell local exchange services provided by SWB and other similar providers of such service. The Applicant will eventually provide facilities-based local exchange services.

13. The Applicant has the requisite financial qualifications to provide services under an SPCOA within the State.

14. The Applicant has the requisite technical qualifications to provide services under an SPCOA within the State.

Stipulated Issues

15. On February 26, 1997, SWB and the Applicant filed a stipulation that addressed several issues. SWB and the Applicant agree that the Applicant proposes to be a reseller and a facilities-based provider of local exchange service, basic local telecommunications service, and switched access service pursuant to the certificate granted under this Application. The Applicant proposes to provide services through the lease or use of other entities' networks or facilities as well as Applicant's own facilities. The parties have agreed that they will abide by the law applicable to the manner in which the Applicant provides service. This includes, but is not limited to, applicable decisions by the Commission and/or by Courts having appropriate jurisdiction and the results of any appeals thereof or actions of the Texas Legislature, the United States Congress, or the Federal Communications Commission.

16. SWB and the Applicant also addressed the issue that the quality of service standards contained in P.U.C. SUBST. R. 23.61 are applicable to incumbent local exchange carriers (ILECs) as dominant carriers but are not directly applicable to SPCOAs. ILECs are required to meet the quality of service standards of P.U.C. SUBST. R. 23.61 as to any services provided to their customers, including the

Applicant. Approval of the SPCOA application, however, does not expand the scope of the underlying ILECs' quality of service obligations to their own customers, such as the local service resellers. In the resale context, the ILECs' service quality obligations apply only to the Applicant and not the Applicant's customers.

17. The stipulation between SWB and the Applicant addressed that the SPCOA application provides the means by which service quality standards may be made applicable to an SPCOA applicant. The SPCOA application contains a quality of service questionnaire in which the Applicant is required to state its willingness to meet benchmark quality of service standards contained in P.U.C. SUBST. R. 23.61, but the Applicant is permitted to rely on the underlying carrier to meet those standards. The Applicant has committed to meet the benchmark service quality standards set forth in the Service Quality Questionnaire for SPCOA applicants.

18. The stipulation of the parties resolved all issues in dispute.

Informal Disposition

19. More than 30 days have passed since completion of the notice provided in this docket.

20. No requests for hearing have been filed. No issues of fact or law are disputed by any party; therefore, no hearing is necessary.

Conclusions of Law

1. The Applicant is a telecommunications provider as defined in PURA § 3.002(11).
2. The Commission has jurisdiction and authority over the application pursuant to PURA §§ 1.101(a), 3.051(b), 3.201, and 3.2532.
3. The Commission provided notice of the application in compliance with PURA § 3.2531(b).

4. The Applicant is eligible to obtain an SPCOA under the criterion specified in PURA § 3.2532(b).
5. The Applicant is not precluded from providing service under an SPCOA under PURA §§ 3.251(d) or 3.2532(e).
6. The Applicant is entitled to approval of its application for an SPCOA within Texas, having demonstrated the financial and technical qualifications to provide the proposed services and the ability to provide the necessary quality of service to its customers, as required under PURA § 3.2532(a) and (b).
7. The Commission does not, as a result of the entry of an order granting the application, impose any additional or different service quality obligations on the ILECs that provide service to resellers.
8. The SPCOA application complies with PURA § 3.2555(a).
9. The Commission lacks the jurisdiction or authority to determine the necessity of a franchise between a municipality and the holder of an SPCOA.
10. This application does not constitute a major rate proceeding as defined by P.U.C. PROC. R. 22.2.
11. The requirements for informal disposition under P.U.C. PROC. R. 22.35 have been met in this proceeding.

In accordance with these findings of fact and conclusions of law, the Commission issues the following Order:

1. Ameritech Communications International, Inc.'s application for a Service Provider Certificate of Operating Authority (SPCOA) is granted. Ameritech

Communications International, Inc. is granted SPCOA No. 60092 for the State of Texas. The Applicant will follow established boundaries of underlying carriers in the State of Texas except those certificated areas of companies serving less than 31,000 access lines as set out in PURA.

2. As a condition of this SPCOA, the Applicant shall identify an agent for service of process within the State of Texas. The Applicant shall file a listing of the agent within 30 days of the signing of this Order.

3. The Applicant's provision of local telephone service to end-users, whether by its own facilities, flat-rate resale, or usage sensitive loop, must also include "9-1-1" emergency telephone service at a level required by the applicable regional plan followed by local telephone service providers under Chapters 771 and 772 of the Texas Health and Safety Code, TEX. HEALTH & SAFETY CODE ANN. § 771.001, et. seq. (Vernon 1996) (the Code) or other applicable law and any applicable rules and regulations implementing those chapters. The Applicant shall diligently work with the Advisory Commission on State Emergency Communications, local "9-1-1" entities, and any other agencies or entities authorized by Chapters 771 and 772 of the Code to ensure that all "9-1-1" emergency services, whether provided through the certificate holder's own facilities, flat-rate resale, or usage sensitive loop, are provided in a manner consistent with the applicable regional plan followed by local telephone service providers under Chapters 771 or 772 of the Code or other applicable law and any applicable rules and regulations implementing those chapters. The Applicant shall diligently work with the "9-1-1" entities to pursue, in good faith, the mutually agreed goal that the local "9-1-1" entities and emergency service providers experience no increase in their current level of rates and, to the extent technically feasible, no degradation in services as a result of the certification granted herein and the involvement of the certificate holder in the provision of "9-1-1" emergency service.

4. The Applicant has committed to and is bound by the quality of service requirements set forth in the Quality of Service Questionnaire. The underlying ILECs continue to be bound by the quality of service requirements contained in P.U.C. SUBST. R. 23.61. Approval of the SPCOA application does not expand the scope of the underlying ILEC's obligation to its own customers.

5. All other motions, requests for entry of specific findings of fact and conclusions of law, and any other requests for general or specific relief, if not expressly granted herein, are hereby denied for want of merit.

PUC DOCKET NO. 17782

APPLICATION OF AMERITECH §
COMMUNICATIONS, §
INTERNATIONAL, INC. AND § PUBLIC UTILITY COMMISSION
SOUTHWESTERN BELL §
TELEPHONE COMPANY FOR § OF TEXAS
APPROVAL OF INTERCONNECTION §
AGREEMENT UNDER PURA AND THE §
TELECOMMUNICATIONS ACT OF 1996 §

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THE STATE OF ILLINOIS §
COUNTY OF COOK §

AFFIDAVIT OF JOAN C. McGRATH

BEFORE ME, the undersigned authority, on the 20th day of August, 1997, personally appeared JOAN C. McGRATH of AMERITECH COMMUNICATIONS INTERNATIONAL, INC.

("ACII"), who upon being by me duly sworn, on oath deposed and said the following:

1. "My name is Joan C. McGrath. I am over the age of twenty-one (21), of sound mind and competent to testify to the matters stated herein. I am a Director -- Regulatory Affairs for Ameritech, and I have personal knowledge concerning the provisions of the Interconnection Agreement between ACII and Southwestern Bell Telephone Company ("SWBT").
2. "On July 17, 1997, SWBT and ACII executed an Interconnection Agreement pursuant to Section 252(i) of the Federal Telecommunications Act of 1996. I have personal knowledge of the provisions contained in the Agreement.
3. "The Agreement, which includes several appendices, is based on the interconnection agreement between SWBT and AT&T Wireless Services, Inc. ("AT&T") which was executed by AT&T on April 18, 1997 and by SWBT on April 23, 1997 and on the Interim Physical Collocation Agreement that is part of the TCG/SWBT Interconnection Agreement for Texas effective November 19, 1996. Both Agreements have been approved by the Texas Public Utility Commission.
4. "There are no outstanding issues between the parties that need the assistance of mediation and arbitration.

5. "The implementation of this Interconnection Agreement is consistent with the public interest, convenience and necessity. ACH is certificated and once it has effective tariffs, the Interconnection Agreement will further the transition of telecommunications competition in the State of Texas, a policy of this State and the United States. The Interconnection Agreement allows diversity in providers and increases customer choices for telecommunications services.
6. "This Interconnection Agreement does not discriminate against any telecommunications carrier. The Interconnection Agreement is available to any similarly situated local service provider in negotiating a similar Interconnection Agreement."

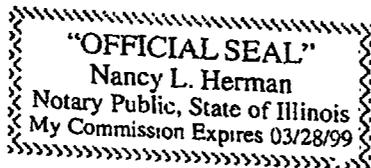
Further, Affiant sayeth not.

Joan C. McGrath
 JOAN C. McGRATH

SUBSCRIBED AND SWORN TO before me by the said Joan C. McGrath on this 26 day of August, 1997.

Nancy L. Herman
 Notary Public, State of Illinois
NANCY L HERMAN
 (Print Name)

My Commission Expires: _____



SWB

September 2, 1997

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DOCKET NO. 17782

**APPLICATION OF AMERITECH §
COMMUNICATIONS INTERNATIONAL, §
INC. AND SOUTHWESTERN BELL §
TELEPHONE COMPANY FOR §
APPROVAL OF INTERCONNECTION §
AGREEMENT UNDER PURA AND THE §
TELECOMMUNICATIONS ACT OF 1996 §**

**PUBLIC UTILITY COMMISSION
OF TEXAS**

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September 2, 1997

Thomas J. Horn
Attorney

Mr. James R. Galloway
Commission Filing Clerk
Public Utility Commission of Texas
1701 N. Congress Avenue
Austin, Texas 78701

Re: PUC Docket No. 17782 - *Application of Ameritech communications international, Inc. and Southwestern Bell Telephone Company for Approval of Interconnection Agreement Under PURA and the Telecommunications Act of 1996*

Dear Mr. Galloway:

Enclosed for filing with the Commission pursuant to its Procedural Order (Order No. 1) released August 25, 1997, are an original and twenty-two (22) copies of the Affidavit of Dennis B. Eidson, Director-Regulatory, addressing the information requested by the Commission to review the interconnection agreement under the Telecommunications Act of 1996. This affidavit addresses how the agreement is consistent with the public interest, convenience and necessity, including relevant requirements of state law.

Thank you for your consideration.

Sincerely,

A handwritten signature in cursive script that reads "Thomas J. Horn".

Thomas J. Horn
Attorney

Enclosures

1616 Guadalupe, Room 600
Austin, Texas 78701-1298

cc: Ms. Robin Casey, Counsel for ACII (via facsimile)
General Counsel, PUC (hand delivered)
Central Records, PUC (hand delivered)

Phone 512 870-5708
Fax 512 870-3420

COUNTY OF TRAVIS §
 §
STATE OF TEXAS §

AFFIDAVIT OF DENNIS B. EIDSON

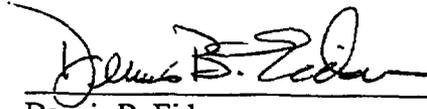
Before me, the Undersigned Authority, on this 2nd day of September, 1997 personally appeared Dennis B. Eidson of Southwestern Bell Telephone Company who, upon being by me duly sworn on oath deposed and said the following:

1. My name is Dennis B. Eidson. I am over the age of 21, of sound mind and competent to testify to the matters stated herein. I am the Director-Regulatory, for Southwestern Bell Telephone Company ("SWBT"). I have personal knowledge of the provisions of the executed Interconnection Agreement (the "Agreement") between SWBT and Ameritech Communications International, Inc. ("ACII"). The parties have diligently negotiated under the Telecommunications Act of 1996, culminating in an executed agreement on July 17, 1997.
2. The Commission has asked for an affidavit explaining how the agreement is consistent with the public interest, convenience and necessity, including all relevant requirements of state law. The purpose of this affidavit is to address this requested information.
3. The Interconnection Agreement between SWBT and ACII is in the public interest and comports with the relevant requirements of state law for numerous reasons. I will address some of these reasons and understand that ACII will also provide further information in support of finding that the agreement is in the public interest and comports with state law.
4. The agreement is pro-competitive in that it allows for ACII to compete with SWBT to provide services under different terms and conditions than are currently offered by SWBT. The agreement was reached through good faith negotiations in accordance

with the Telecommunications Act of 1996. The agreement allows customers who choose to receive local telephone service from ACII to be able to make and receive local telephone calls to the same extent as they could in receiving local telephone service from SWBT, including the ability to have their names listed in the Southwestern Bell White Pages, use of SWBT operator services, and access to 911 services.

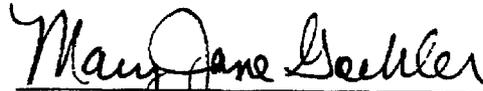
5. From an end user perspective, I believe that by implementing this agreement end users located within the certificated serving area of ACII will have an additional choice for local telephone service, while having the capability of terminating calls to a SWBT end user without any degradation of service quality or diminution in service capabilities from those levels that end users have traditionally come to expect from their local service provider.
6. ACII's Certificate of Operating Authority service area is in the State of Texas. The interconnection agreement entered into between ACII and SWBT is in the public interest in that it allows ACII to resell SWBT's local exchange service to its customers with features and functions packaged in a different manner from those packages of features and functions offered by SWBT, if it chooses to do so. Individuals residing in the ACII serving area will now have a choice between at least two local service providers offering local exchange service.
7. Further, consistent with the policy provisions of PURA 95, I believe that this interconnection agreement fosters, encourages, and accelerates the continuing development and emergence of a competitive advanced telecommunications environment and infrastructure and to that end, not only advances, but also protects the public interest.

Further Affiant sayeth not.



Dennis B. Eidson
Director-Regulatory

Sworn and Subscribed to before me this 2nd day of September, 1997, to certify which witness my hand.



Mary Jane Guebler
Notary Public in and for the State
of Texas

PETITION ATTACHMENT 1

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

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In Re Applications of)
)
AMERITECH CORP.,)
Transferor,)
)
AND)
)
SBC COMMUNICATIONS, 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 5, 22, 24, 63, 90, 95 and 101)
of the Commission's Rules)

CC Docket No. 98-141

AFFIDAVIT OF WILLIAM G. SHEPHERD
ON BEHALF OF THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

October 14, 1998

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AFFIDAVIT OF WILLIAM G. SHEPHERD

STATE OF MASSACHUSETTS)
)
COUNTY OF NEW HAMPSHIRE)

Dr. William G. Shepherd, being duly sworn, deposes and says:

I. BACKGROUND AND QUALIFICATIONS.

1. My name is William G. Shepherd. I am a Professor of Economics (and recently chair) of the Department of Economics at the University of Massachusetts, Amherst, Massachusetts.

2. I have been the General Editor of the Review of Industrial Organization since 1990. It is a peer-reviewed professional journal of research and policy on issues such as those at the center of this case. I also cover these issues at numerous professional and policy-oriented conferences.

3. My past publishing experience includes over 12 books and 80 papers on competitive-monopoly issues in a variety of professional journals and other literature. I also publish and revise textbooks whose main content concerns the fields of competition, monopoly, antitrust, and regulation.

4. I have published frequently on the telecommunications sector, as well as a range of other industries. I have also provided testimony to a number of federal and state commissions on issues of deregulation, competition and mergers. The state commissions include New Jersey, Massachusetts, New Hampshire, Florida, the District of Columbia, Montana, and Arkansas.

5. In 1967-68 I was the economic adviser to the head of the Antitrust Division at the U.S. Department of Justice. That and

subsequent research has familiarized me with the content and standards of U.S. antitrust policies. These and related professional details are summarized in the biographical note attached as Appendix 1 to this testimony.

6. I am appearing in these proceedings on behalf of the Texas Office of Public Utility Counsel. My purpose is to summarize the relevant economic principles and to assess the economic effects on competition from the proposed merger between SBC and Ameritech.

7. My preparation has included reviewing the company statements and filings about the merger, as well as the FCC's opinions and reports on matters relating to mergers in recent years. I reviewed various Texas documents and opinions dealing with relevant telecommunications issues and a number of industry and business press sources on the industry. I am also familiar with economic literature relating to merger issues and the telecommunications sector in general.

II. SUMMARY OF THE MAIN POINTS.

8. First, the Relevant Economic Criteria Have Been Well Defined by the Federal Communications Commission, and This Merger Would Violate Them. The FCC decision and opinion in 1997 on the Bell Atlantic/NYNEX merger contained market definitions and competitive assessments that are relevant to the current proposed merger. The SBC-Ameritech merger violates those economic criteria.

9. Second, in the Context of the 1996 Telecommunications Act,

This Merger Is Even More Harmful to Competition. An SBC-Ameritech merger would further undermine the 1996 Telecommunications Act, which is widely regarded as failing so far (ironically, partly because of obstruction by SBC itself). The Bell Atlantic-NYNEX merger was barely able to gain FCC acceptance last year. The proposed SBC-Ameritech merger would invalidate even that bare basis.

10. Third, more Broadly, the Cascade of Telecommunications Mergers and Alliances Further Increases This Merger's Threats to Competition. Mergers are shrinking down the small set of important potential entrants, both into the local-service and long-distance service markets. Other deregulated sectors (railroads, airlines, and electricity) give clear warnings to the FCC that entrenched companies will use mergers to prevent or destroy competition. Such mergers nullify deregulation's chances to foster competition.

11. Fourth, the SBC/Ameritech Merger Poses a Critical Policy Choice. The merger is itself invalid by economic criteria, and the benefits of averting it would also be multiplied by the precedential effect on other mergers. Denying the merger might substantially revive the 1996 Telecommunications Act's chances to promote competition.

12. Fifth, SBC's Economic Experts Mainly Just Repeat SBC's Unpersuasive Claims about Benefits, Rather than Offering Significant Evidence. There is no economic research basis for SBC's claims, either from its experts or from the economic

literature.

13. These and the other points I make are in accord with the testimony provided by Dr. August H. Ankum. I will discuss the basic economic issues of competition as they apply to this merger, whereas he will deal in more detail with telecommunications conditions.

14. Before I turn to the general economic issues, it may help to review the larger setting of the 1996 Telecommunications Act and the current flood of mergers.

III. IN SPECIFIC POLICY TERMS, IF THE FCC ALLOWED LAST YEAR'S BELL ATLANTIC-NYNEX MERGER, DOESN'T IT HAVE TO ALLOW THE SBC-AMERITECH MERGER NOW?

15. The economic answer is No. In 1997 the FCC found that the Bell Atlantic-NYNEX merger would cause substantial competitive harm. The FCC allowed the merger only because Bell Atlantic promised a number of important protections.

16. Conditions are now worse than they were in 1997. The economic calculus on the SBC-Ameritech merger would be even more unfavorable now to potential entry, by the FCC's own criteria in the Bell Atlantic-NYNEX merger. These other mergers have reduced the prospects for potential entry further. For that matter, the impacts of this SBC-Ameritech merger would reach back to invalidate the FCC's basis last year for approving the Bell Atlantic-NYNEX merger.

17. Therefore, the need to reject this merger proposal is actually greater, not less. And even if the FCC were to approve this merger, it should require substantially more protections.

But it is not clear that those protections could be strong enough to save the merger or that SBC's promises could be verifiable enough to be credible.

IV. THE WIDER SETTING OF POLICIES AND THE GROWING WAVE OF MERGERS SHARPENS THE CASE FOR STOPPING THIS MERGER.

18. The 1996 Act is widely recognized as stalled and ineffective, and is often described in the industry, the business press and Washington policy circles, as being in serious trouble.

19. A prime cause of this trouble has been the local Bells' full-press entry-detering actions, using policy stratagems and economic tactics against every possible entrant. They - and especially SBC - have prevented virtually any entry into local markets throughout the U.S. For one partial indication of the range and strength of the actions by SBC, see the testimony by Sarah J. Goodfriend (Affidavit in Public Utility Commission of Texas, Docket No. 16251, April 1, 1998) (Appendix 2).

20. Despite this widely recognized pattern, the Bells (including SBC and Ameritech) have demanded approval to enter the long-distance markets. They have argued that they are under strong competitive inroads. That contention reflects their willingness in the current case to say that weak competition, or none at all, really is fully effective competition.

21. Some leading instances in the wave of mergers - including Bell Atlantic-NYNEX and now SBC-Ameritech - are included in the table below.

TABLE 1. LEADING RECENT MERGERS AMONG TELECOMMUNICATIONS FIRMS

SBC-AMERITECH	\$62	1998	Become an even bigger local telephone company
BELL ATLANTIC-GTE	\$55	1998	Increase local business; enter long-distance market
WORLDCOM-MCI	\$37	1997	Achieve control over most of the Internet backbone
BELL ATLANTIC-NYNEX	\$26	1996	Bigger is better in the local phone service market
SBC-PACIFIC TELESIS	\$17	1996	Another bigger-is-better acquisition
WORLDCOM-MFS	\$14	1996	Buying a bigger piece of the Internet
AT&T-TELEPORT	\$13	1996	Get back into the local phone business
AT&T-MCCAW CELLULAR	\$13	1993	Buy a cellular system to enter local markets

Source: adapted from a table in the story "Bell Atlantic Said to Agree to Buy GTE for \$52 Billion," New York Times, July 28, 1998, page C6.

22. Any joinder of firms holding full monopoly or dominance, including the Bell Atlantic-NYNEX and SBC-Ameritech mergers, tends to strengthen the ability to deter or block entry. At the same time, it further shrinks the small group of possible significant entrants.

23. Not only has the merger wave further tipped the economic calculation against this merger, this specific merger can become a decisive means for possibly rescuing the 1996 Act and reviving the prospects for effective competition in local markets throughout the U.S.

24. If this merger is allowed to proceed as proposed, however, the chances for effective competition in local markets may well be permanently averted. Acceptance of this merger will open the gates for more monopoly-enhancing mergers, both among Baby Bells and among other leading telecommunications firms.

V. ECONOMIC ISSUES.

25. Turning now to the economic issues and impacts of the merger, I begin by discussing the definition of the relevant markets, as is routine in such matters. I can then discuss the possible monopoly impacts of the merger in those markets.

26. 1. Defining the Relevant Markets. As the FCC recognized in its Bell Atlantic-NYNEX decision last year (e.g., at pp. 30-35), local telephone markets are distinct and they are directly relevant. Also, long distance markets will be affected.

27. **a. Local-service markets.** These markets' product-market dimension involves standard wire-based local-exchange service. Wireless services may exist at the edges of the market, but they are small and their higher prices mark them as a separate sub-market. The markets' geographic dimensions are aligned generally with metropolitan areas, though their exact size and scope is not a serious issue in this case.

28. It is also particularly relevant that the Bell companies cover large regions containing many hundreds of these local markets. That region-wide scale gives the Bells an added dimension of resources to use in competing in the individual local markets. Those region-wide resources may not be "deep

pockets" in the traditional sense, though they seem to be. In any case, they give the Bells an extra ability to marshal and deploy resources so as to deter local entry and to win local competitive battles where they really want to.

29. **b. Long-distance service markets.** These include the U.S.-wide national markets as well as the various regional ones. Their product and geographic dimensions are well known and not seriously at issue in this case. The SBC-Ameritech merger will indirectly but significantly affect these long-distance markets. The combined companies will be able to block entry more strongly, and that will:

i. Continue isolating long-distance markets from new entry by the Bells, under the 1996 Act, and

ii. Continue reducing the number and diversity of possible entrants into long-distance markets, by shrinking them further.

30. **2. The Conditions for Achieving Genuinely Effective Competition.** Before turning to monopoly conditions in these markets, I must review the core topic of **effective competition**. Competition comes in many degrees, ranging from weak and superficial to strong and effective. It is important to be clear about the basic conditions that are required when competition is fully effective. There is voluminous economic research literature on the matter, developed during many decades.

31. It reflects the obvious fact that effective competition requires **strong mutual pressure among comparable rivals, plus no**

collusion among them. (See especially William G. Shepherd, The Economics of Industrial Organization, 4th ed., Prentice-Hall, 1997. See also F.M. Scherer and David Ross, Industrial Market Structure and Economic Performance, 3d ed., Houghton Mifflin, 1990). The principles of effective competition are also reasonably well embodied in the enforcement and criteria of the nation's antitrust laws, by the Antitrust Division of the U.S. Department of Justice, and by the U.S. Federal Trade Commission.

32. In practical terms, the economic criteria usually require:

a. At Least Five Comparable Competitors in the Market.

That prevents most efforts by the firms to engage in price-fixing or other collusion. Otherwise, the very few rivals are likely to engage in explicit or tacit collusion; the temptations for collusion typically become too strong to resist. This is a pattern long established by the economic research literature. It is also firmly fixed in the nation's competitive policies, particularly in the Merger Guidelines, which are applied by both the Antitrust Division, U.S. Department of Justice, and by the U.S. Federal Trade Commission. (See also the Special Issue on Merger Guidelines, Review of Industrial Organization, April 1993).

33. **b. No Single-firm Dominance.** Because no single firm holds a dominant position, able to overwhelm or smother the others, all of the rivals are able to apply strong pressure on each other. That condition yields good performance. However, when one firm is dominant, competition will be quite weak, rather than strong

and genuinely effective. The common technical definition of dominance is: one firm holding at least 50 percent of the market and facing no close rival (on dominance, see especially Donald Hay and John Vickers, Eds., The Economics of Market Dominance, Oxford: Basil Blackwell, 1987; Scherer and Ross, op. cit.; and Shepherd, op. cit., chapter 9).

34. **c. Reasonably Free Entry.** Free entry means that new competitors can get into the market quickly and compete successfully. If entry is indeed strictly or reasonably free, then competition is reinforced by the incumbent's fear of new competition.

35. Instead, entry is often impeded by many kinds of "barriers."

When that happens, then the dominance by one firm or the collusion among several firms is likely to be much worse. The special importance of entry is also central to the Merger Guidelines, as well as to the economic research literature.

36. These three criteria are not extreme, and they also fit common sense. Some Chicago-School analysts are more tolerant. They would be satisfied with a dominant firm, which faces only a fringe of small rivals. But that is an extreme position, which would tolerate high degrees of actual market power.

37. Judged by the three basic criteria, local telecommunications markets do not come even remotely close to being effectively competitive. These local markets all start from a condition of virtually total monopoly, which has been deeply entrenched for many decades under the exclusively-franchised local monopolist

(usually a Bell firm). The firms have large advantages of reputation and consumer familiarity, as well as mastery of the local physical and business terrain. Even Chicago-School economists criticize this type monopoly, because it was government-granted rather than won by superior performance under rugged competition in the marketplace.

38. Ultimately, these markets must somehow evolve down through the stage of single-firm dominance and then even further down through tight oligopoly, where there are several firms holding most of the market. They must evolve down to "loose oligopoly," where many comparable competitors - preferably well more than 5 - function toughly and flexibly and firms often exit and enter freely.

39. In practical terms, the Baby Bell local-monopoly positions must be reduced down to market shares that are well below 50 percent, in sharp contrast to their current near-100-percent monopoly positions. Such a striking shift down to "just another competitor" status is virtually intolerable to the Bell company officials. They seek and expect to stay on top, with most or all of their markets.

40. Yet the markets must not become stuck in a trap of having one dominant firm facing just two or three little rivals. That would be weak and ineffective competition. Unfortunately, that trap is precisely what can be expected. It is commonly agreed in the industry and business press that the Bell (and GTE) incumbents are likely to retain nearly all of their monopoly

positions in local markets.

41. In short, the eventual prospects for effective competition in local markets are really regarded in candid, knowledgeable discussions as being close to zero. The most that is eventually expected is some intrusion of smaller rivals, who will actually be dependent in some substantial degree on the Bells for access and success. Using its controls and strategic pricing abilities, the Bells are likely to keep the fringe of new rivals down to modest levels, while retaining their own high degree of dominance. Of course even small or trivial levels of competition will give the Bells reason to argue - precisely as SBC does in this case - that the fringe competition is actually forceful and fully effective.

42. The SBC-Ameritech merger is in obvious conflict with these three above-mentioned economic criteria, and it would depress further the already-dim chances for effective competition. Approval would strengthen the two companies' positions in hundreds of local markets throughout their own regions. Approval would facilitate entry barriers higher than they already are, and it will help to shrink the already-small group of possible entrants to even fewer.

43. So the merger will reduce further the limited chances for significant entry in local markets, not only in the SBC and Ameritech regions but also throughout the rest of the U.S.

44. SBC's 30-Cities Entry Plan for the Future. SBC says that the merger is indispensable for launching its entirely new plan -

seen here for the first time - to inject local competition in other regions. SBC is quite vehement about the importance of this plan, but that can be taken - ironically - as an indication of the lack of competition in SBC's and Ameritech's own regions. If such initiatives are valuable out-of-region, logically, they would be equally valuable and needed in the SBC and Ameritech regions (especially because SBC is known as the most energetic Baby Bell in resisting new competition).

45. It is possible, perhaps likely, that the plan is a clever effort to concoct the appearance of an impressive "net merger gain." It would seem to offset the loss of competition in SBC's and Ameritech's regions by creating some new competition in other regions. And it would meet a specific clause in the FCC's list of merger criteria.

46. But this plan may merely be "pie in the sky;" there is no good way to verify that it will actually occur. Even if some entry were to occur in some or all of the 30 cities, the entry might not be substantial. Also, it might not last very long or be pursued with large resources and efforts.

47. Not only does the plan seem doubtful in many ways, it is unable to withstand a reasonably cautious appraisal. There is no persuasive basis for SBC's assertion that the 30-city program can only happen after the merger is approved. SBC already has ample resources to implement a substantial part of the plan - and some of that entry would presumably be inserted into Ameritech's region. Significantly, the FCC itself has formally determined

recently, after full consideration, that there has been little local competition in Ameritech's region. The SBC-Ameritech merger would only aggravate that problem by blanking out any future SBC-versus-Ameritech entry, into hundreds of possible Ameritech city markets.

48. In short, SBC's unconvincing 30-cities plan should not divert serious attention from the major loss of potential competition that the merger will cause, both in the SBC and Ameritech regions as well as the rest of the U.S. by stopping mutual invasions.

VI. THE ECONOMIC REASONS DRIVING THIS MERGER DO NOT JUSTIFY IT.

49. Merger history and business experience give compelling reasons for discounting the claims of possible economic benefits from most or all mergers, in all sectors as well as specifically in telecommunications. The need for skepticism is especially great now amid the current overheated wave of telecommunications mergers.

50. 1. The supposed economic gains in efficiency in the SBC-Ameritech merger are likely to be much less than claimed, or even negative. The only relevant gains would be the net gains available only by this merger, rather than by other arrangements. Also, as the FCC has made clear, the types and amounts of the gains must be definitely verified, not just timidly accepted on faith (Bell Atlantic/NYNEX Order at pp. 77-80).

51. In business history there has been a corporate craze for "bigness" about every 20 years or so: for example, in 1897-1901,

the 1920s, the 1950s, in the 1960s in Europe, and since 1980 in the U.S. The claims are usually soon discredited for being self-serving and unreliable (examples include the Penn-Central merger of 1969, at least half of the mergers during the 1960s merger boom, the calamitous Union Pacific-Southern Pacific merger of 1996, the Republic Steel-LTV merger in 1984, etc.). The leading business media make it clear that knowledgeable, careful officials (including the investment world) regard most merger claims of "great efficiencies" and "synergies" as being exaggerated and largely empty marketing spin.

52. The broad economic and business literature on merger impacts has shown that about half or more of mergers actually prove harmful - not helpful - to the companies, to their investors, and to economic performance. (See Scherer and Ross, Industrial Market Structure and Economic Performance, op. cit., chapter 7. See also David J. Ravenscraft and F.M. Scherer, Mergers, Sell-offs, and Economic Efficiency, Washington, D.C., Brookings Institution, 1987; Shepherd, op. cit., chapter 6; Dennis C. Mueller, The Determinants and Effects of Mergers, Cambridge, MA: Oelgeschlager, Gunn & Hain, 1980; and Walter Adams and James W. Brock, Dangerous Pursuits, Pantheon Books, 1991).

53. The business press also has extensive, withering commentary about the harmfulness of most mergers. (A few examples include "The Case Against Mergers," Business Week, October 30, 1995, pp. 122-30; Laura Landro, "Giants Talk Synergy but Few Make It Work," Wall Street Journal, September 14, 1995, page B1; and Jim

Carlton, "Reverse Synergy," Wall Street Journal, September 15, 1995, p. R10).

54. Economic harm is particularly likely to occur when the merger reduces competitive pressures on the companies to perform well. Because this SBC-Ameritech merger would indeed reduce competition, that harmful effect on performance is quite likely to occur, perhaps substantially.

55. Also, such mergers tend to slow down the rate of **innovation**.

That slowing is unusually harmful in economic terms, because innovation is the real core of economic progress. (See Shepherd, op. cit., chapter 5; Scherer and Ross, op. cit., chapter 17; and the classic Edwin Mansfield et al, Research and Innovation in the Modern Corporation, New York: Norton, 1971). Even if this merger's net efficiency gains improbably turned out to be significant after all, these gains might still be overbalanced easily by the retardation of innovation - as well as by losses of freedom of choice and other values.

56. 2. The notion that telecommunications firms must be "large enough to survive in the new global circumstances" is mainly merger-hype rhetoric, not based on reliable evidence. The supposed benefits from greater size in this case are mainly matters of speculative talk and self-interested claims.

57. Ironically, the flood of mergers is itself perpetuating the illusion that this "necessity" actually exists. That is seen, for example, in current stories about how the SBC-Ameritech merger is putting the survival of U S West in even more jeopardy.

(This is a prime topic in Stephanie N. Mehta, "U S West Communications May Be Vulnerable to Rivals," Wall Street Journal, May 13, 1998, page B4. See also Peter Burrows, "U S West Scouts a New Frontier," Business Week, May 18, pp. 163-66). If the merger flood were not occurring, the supposed "need" for the large SBC-Ameritech merger (and many of the others that will no doubt follow suit) would probably be seen as empty. Of course, as a practical matter all RBOC mergers will tend to look alike. If the FCC approves the SBC-Ameritech merger, it will be hard pressed to find a unique ground that would support rejection of subsequent merger applications.

58. 3. Mergers in Other Deregulated Industries also show the Harms that This Merger May Cause. Airlines, railroads, and electricity offer important examples.

59. In the airlines industry, deregulation worked quite well after 1978. But during 1985-1988, major mergers among leading airlines were mistakenly permitted. They greatly increased the concentration and dominance of airlines over major airports, turning them into "fortress hubs." That dominance led to fares at fortress-hub airports that are commonly more than 20 percent higher. Alfred Kahn, the leader in deregulating the airlines in 1978, called the mergers "abominations" for their anti-competitive impacts. (See "The Competitive Consequences of Hub Dominance: A Case Study," Review of Industrial Organization, August 1993, pp. 381-406; William N. Evans and Ioannis Kessides, "Localized Market Power in the U.S. Airline Industry," Economic

Statistics, February 1993, pp. 66-75. See also Steven A. Morrison and Clifford Whinston, The Evolution of the Airline Industry, Washington, D.C., Brookings Institution, 1993).

Recently, the sharp rise in airline fares for business passengers is known to reflect the industry's concentration and its fortress hubs.

60. **In railroads**, the leading recent example is the 1996 merger of Union Pacific with the Southern Pacific railroad. The railroad's own officials, as well as all observers, have universally acknowledged this merger as a fiasco. It has caused enormous congestion and harms for customers, and the damage continues in 1998. Indeed, Union Pacific has just announced that it is reversing the centralization of controls that the merger was supposedly meant to provide.

61. Yet Union Pacific's officials and expert witnesses had declared - categorically and under oath in official hearings before the U.S. Surface Transportation Board - that the merger would yield huge efficiency gains. These efficiencies were estimated at over \$300 million per year. (See the controversial record in the case for official approval: U.S. Surface Transportation Board, Finance Docket no. 32760, Union Pacific Corp. et al. Control and Merger, Southern Pacific Rail Corp. et al., 1996). They also declared that the merger would have no adverse effect whatsoever on competition, in any market or as a whole.

62. My own Statement in that record noted the merger's monopoly

impacts and the gross exaggerations by Union Pacific of the merger's supposed gains. Yet the regulators trusted the glib promises by Union Pacific officials and their witnesses, with devastating results both to competition and to economic efficiency.

63. The Antitrust Division of the U.S. Department of Justice strongly opposed the merger in the Surface Transportation Board proceedings. The DOJ pointed out that it would sharply increase the extent of railroad monopoly at hundreds of cities and shipping points, particularly in the Gulf Coast areas of Texas and Louisiana.

64. Many shippers saw their choices drop from three to two or even down from two to one. In hundreds of instances there was no realistic possibility of using trucking instead. The chemicals, plastics and other petroleum-products companies were hard hit, but so were thousands of other shippers in a wide range of industries. This disaster echoes the Penn-Central merger of 1969, whose devastating effects included lost trains, monumental confusion and higher costs. In the 1970s the failure led to the creation of Conrail as a desperate attempt at rescue.

65. In electricity, the onset of competition has stirred a rash of some 15 major mergers since 1994, typically between utilities that are located next to each other. (Among many sources, see Mark W. Frankena and Bruce M. Owen, Electric Utility Mergers, Westport, CN: Praeger, 1994; Douglas A. Gegax and Kenneth Nowotny, "Competition and the Electric Utility Industry: An

Evaluation," Yale Journal on Regulation, Winter 1993, pp. 63-87. See also the hearing records for mergers before the Federal Energy Regulatory Commission and various state commissions).

66. Many of these mergers are particularly anti-competitive and unfavorable in economic terms. For example, these adjacent utilities would otherwise be the leading direct competitors against each other as competition develops. But many of the mergers have been permitted, on a variety of tenuous claims and promises, and many of the mergers have directly blocked that competition. As one result, the advent of competition in many electricity markets is widely recognized to not be going well.

67. All three of these industries clearly illustrate that mergers of deregulation-involved firms like SBC-Ameritech pose two distinct dangers. One is a simple reduction in efficiency, which is likely to be significant but may be much larger, perhaps disastrously so. The other danger is the merger's destruction of actual and potential competition. That reduction of competition is often precisely the unstated purpose of the merger, as the firms try to avert the onset of real competition. The mergers are clothed in favorable rhetoric and claims, but the protection of the firms' market power is often the true purpose. VII.

BARRIERS TO ENTRY.

68. If it is to succeed, deregulation must rely above all on the entry of new competitors into markets that have long had government-approved monopolies. Any "barriers" which impede that entry threaten to make the deregulation a sham.

69. The evaluation of the current proposed merger must consider the barriers into local telephone markets with utmost care. The SBC-Ameritech partners and their expert witnesses claim that entry is already extremely easy. But that assertion should be regarded as merely predictable and mistaken.

70. To understand the scope of entry barriers, we must start with the basic patterns of barriers in the normal range of industrial markets.

71. **1. Types of Barriers.** Table 2 summarizes the many sources and forms of entry barriers. (See Shepherd, op. cit., chapter 9; Joe S. Bain, Barriers to New Competition, Cambridge, MA: Harvard University Press, 1956; Paul A. Geroski and J. Schwalbach, eds., Entry and Market Contestability: An International Comparison, Oxford: Basil Blackwell, 1991; and Paul Geroski, Richard J. Gilbert, and Alexis Jacquemin, Barriers to Entry and Strategic Competition, New York: Harwood Academic, 1990).

TABLE 2. COMMON CAUSES OF ENTRY BARRIERS

I. EXOGENOUS Causes: External Sources of Barriers

1. Capital Requirements: related to MES of plants and firms, capital intensity, and capital-market imperfections.

2. Economies of Scale: both technical and pecuniary, which require large-scale entry, with greater costs, risks, and intensity of retaliation.

3. Absolute Cost Advantages: many possible causes, including lower wage rates and lower-cost technology.

4. Product Differentiation: may be extensive.

5. Sunk Costs: any cost incurred by an entrant which cannot be recovered upon exit.

6. Research & Development Intensity: requires entrants to spend heavily on new technology and products.

7. **High Durability of Firm-Specific Capital (Asset Specificity):** imposes costs for creating narrow-use assets for entry, and losses if entry fails.
8. **Vertical Integration:** may require entry at two or more stages of production, for survival; raises costs and risks.
9. **Diversification by Incumbents:** massed resources re-deployed among diverse branches may defeat entrants.
10. **Switching Costs:** complex systems may entail costs of commitment and training, which impede switching to other systems.
11. **Special Risks and Uncertainties of Entry:** entrants' higher risks may raise their costs of capital.
12. **Gaps and Asymmetries of Information:** incumbents' superior information helps them bar entrants and may raise entrants' cost of capital.
13. **Formal, official barriers set by government agencies or industry-wide groups:** examples are utility franchises, bank-entry limits, and foreign trade duties and barriers.

II. ENDOGENOUS Causes: Voluntary and Strategic Sources of Barriers

1. **Pre-emptive and Retaliatory Actions by Incumbents:** including deep selective price discounts that deter or punish entry.
2. **Excess Capacity:** the incumbent's excess capacity lets it retaliate sharply, and threaten retaliation credibly.
3. **Selling Expenses, including Advertising:** increases the degree of product differentiation.
4. **Segmenting of the Market:** segregates customer groups by demand elasticities and makes broad entry more difficult.
5. **Patents:** may provide exclusive control over critical or lower-cost technology and products.
6. **Exclusive Controls over Other Strategic Resources:** such as superior ores, favorable locations, and unique talents of personnel.
7. **Raising Rivals' Costs:** actions that require entrants to incur extra costs.
8. **"Packing the Product Space:"** may occur in industries with high product differentiation.

9. Secrecy About Crucial Competitive Conditions: specific actions may create secrecy about key conditions.

Source: adapted from William G. Shepherd, The Economics of Industrial Organization, 4th ed., Prentice-Hall, 1997, pp. 209-214.

72. 2. "Exogenous" Barriers. Many of these causes are objectively verifiable conditions, which may possibly be measurable. Examples include the great size of necessary dollar assets or revenues to enter a large and/or capital-intensive market; or the economies of scale; or the need for intensive and costly advertising. These are the "exogenous" barrier sources listed in the first half of Table 2 (exogenous means that the size of the barriers is simply fixed, outside the companies' own control).

73. 3. "Endogenous" Barriers. Many important barriers are also "endogenous," as listed in Table 2's second half (endogenous means that the incumbent company can create or control the size of the barriers by its own choices). These are often quite subjective matters, and largely represent discretionary actions of the incumbents. For example, the dominant firms (just as SBC or Ameritech in local phone markets) can hit aspiring entrants with rapid and severe price cuts - either ahead of time to prevent the entry or in retaliation to punish the entrant.

74. Such high-impact tactics have, in fact, been the usual move by dominant firms against competition in all industries, including telecommunications. AT&T in long-distance markets, and

the Baby Bells in local markets, have used such pricing strikes and counter-strikes to block or punish little new entrants. These pricing strikes are often powerful and successful in excluding entrants.

75. Most of the debate about barriers considers only the "exogenous" barriers, and they are indeed numerous and important in telecommunications. But the "endogenous" tactics are also numerous and they may be even more important. Any judgment about the entry-blocking effects of the SBC-Ameritech merger must consider them thoroughly and expect them to be substantial. Regulatory officials must be particularly careful to consider them because the merging parties naturally wish to deny them and to draw attention away from them.

VIII. THE LOSS OF POTENTIAL COMPETITION.

76. Taken together, the Bell Atlantic-NYNEX merger, the pending Bell Atlantic-GTE merger, and the AT&T-TCI merger and AT&T-British Telecoms alliance, all make it more important to deny or postpone the SBC-Ameritech merger. Moreover, other international mergers are further reducing the independent sources of entry from abroad.

77. The already-small group of main potential entrants is shrinking further, and the treatment of this merger could be important in arresting that process. If this merger were denied, then the whole process might well pause or at least resume a more reasonable pace, with long-run benefits for competition throughout the U.S.

78. **1. Potential competition doctrine and criteria.** In its Bell Atlantic-NYNEX decision last year, the FCC noted five elements in assessing the most likely entrants and the reduction of competition (Bell Atlantic/NYNEX Order at pp. 67-71):

- a. **The target market is concentrated.**
- b. **The merger partner is a leading potential entrant.**
- c. **The merging partner was likely to enter.**
- d. **The partner could enter by means other than the merger.**
- e. **Alternative entry would promote competition.**

79. All of these conditions were met in last year's merger and the SBC-Ameritech merger meets them too. By these criteria - as well as by knowledgeable opinion in the industry and the business press - the SBC-Ameritech will substantially reduce potential competition now and also reduce actual competition in the future.

80. 2. Actual Results. There has been very little actual entry of new competition into SBC's and Ameritech's local markets. That is obvious from the list of supposed entry that is provided by SBC's witness Dennis Carlton. Though he puts together a list of numerous items, they add up to little: a scattering of fringe-type competitors in a number of local markets. They leave the majority of local markets in both SBC and Ameritech service areas with little or no substantial competition.

81. The merger would shrink the number of Bells down to merely four, and GTE will also apparently be gone because of its planned merger. Therefore, the original eight local firms (the seven Bells plus GTE) will be only four.

82. Other potential entrants from abroad are also shrinking in number, as mergers and alliances continue to spread (for example, the WorldCom-MCI merger and the AT&T-British Telecoms alliance). SBC and Ameritech are prominent among the few major firms that are able and likely to enter each other's markets. They are also leading potential entrants in all of the US regions.

83. 3. The Bell Atlantic-NYNEX Merger. Last year the FCC barely approved the Bell Atlantic-NYNEX merger because the FCC found that it would reduce competition substantially. Only promises of special protections saved the merger. The current merger is worse in at least three ways:

84. **a. SBC would be a more powerful entrant** in Ameritech's and other regions, because it has been a large and widely known aggressive "maverick" Bell firm, under Edward E. Whitacre Jr.

85. **b. The merger will enlarge both SBC's and Ameritech's ability to prevent new entry** by other firms into local-service markets throughout their large regions.

86. **c. The total set of potential entrants is now much less than it was in 1997** when the FCC acquiesced in the Bell Atlantic-NYNEX merger. The SBC-Ameritech and AT&T-GTE mergers have, for that matter, nullified last year's FCC evaluation. The FCC's own evaluation would, under today's conditions, probably require the FCC to reject the Bell Atlantic-NYNEX merger, under any terms.

87. **d. There is little reliable evidence that the Bell Atlantic-NYNEX promises of protecting competitive chances have been effective.** Objective evidence about the protections'

effects is scarce. Some of them may be merely formal, and there may be ways for Bell Atlantic officials and personnel to weaken them.

88. Moreover, there are indications that Bell Atlantic is still not able or willing to eliminate its long-standing deficiencies in the quality of its service to customers. (See, e.g., Scott Woolley, "Changing the Smother Culture," Business Week, May 4, 1998, pp. 166-67. See also John J. Keller, "It's Hard Not to Notice Phone Service Leaves A Lot to Be Desired," Wall Street Journal, April 7, 1998, pp. A1, A6). Some of that may be attributable to the effects of the 1997 merger, which reduced the pressure on it to raise its service quality. Similar problems with service quality can be expected from an SBC-Ameritech merger.

IX. THE POLICY SETTING AND LESSONS.

89. To summarize, the 1996 Act has had little effect or success thus far in opening local markets to competition. Consequently, there is even greater need now to protect possible competition, prevent anti-competitive or efficiency-dubious mergers, and to try to revive the 1996 Act. This merger especially threatens effective competition in this sector in the future, for these reasons:

- 1. It reduces competition by shrinking the small remaining groups of leading potential entrants, by the FCC's logic and evaluations.**

- 2. It strengthens the combined Bells' ability to block**

local-service competition in their areas, with a variety of barriers to entry. In fact, with one exception, no state in the SBC-Ameritech twelve-state region has determined that its incumbent RBOC has irreversibly opened its local market to competition so as to satisfy the requirements of sect. 271. The one exception involved the 1997 Oklahoma 271 proceedings, which the FCC rejected anyway. Those states that have conducted a 271 review almost universally agree that the incumbent RBOCs have successfully prevented the development of facilities-based local competition in their regions (other than *de minimus* or resale-based competition). The FCC itself has noted in several 271 proceedings the harmful effects upon local competition from the shuffling implementation of the Act from RBOCs, such as SBC and Ameritech. Thus, approval of the merger by the FCC at this time would not complement the FCC's prior competition promoting 271 policies.

3. It also weakens the FCC's and State PSCs' ability to regulate and protect competition and consumers. That violates the economic basis for the FCC's and State commissions' regulatory responsibilities.

4. Competitive protections may well be futile. Absent competitive entry, as the Bell Atlantic/NYNEX merger's aftermath appears to show, traditional regulatory oversight may not be up to the task of overseeing implementation of another set of complicated merger conditions whose success depends on the full cooperation of the regulated entity.

The information contained in this affidavit is true and correct to the best of my knowledge and belief.

Signed on October 8, 1998.

William G. Shepherd
William G. Shepherd

SWORN TO AND SUBSCRIBED BEFORE ME on October 8, 1998 by William G. Shepherd.

Jacquie McCreedon
Notary Public, State of Massachusetts

My Commission expires on 9/9/2005

APPENDIX 1

WILLIAM G. SHEPHERD

Office: Department of Economics, University of Massachusetts,
Amherst, MA 01003 (Tel 413-545-0443; Fax 413-545-2921)

Home office: 155 Northampton Road, Amherst, MA 01002
(Tel 413- 549-1177; Fax 413-549-4476)

Married, with four children. Born: August 15, 1936.

Education:

Ph.D. in Economics, Yale University, 1963; M.A. in Economics,
1958.

B.A. in Economics, Amherst College, 1957 (with honors).

Professional Positions and Awards:

Professor of Economics, University of Massachusetts, since 1986.
Chairman, Department of Economics, University of Massachusetts,
1991 to 1994.

General Editor, Review of Industrial Organization, since 1990.
Professor of Economics, Department of Economics, University of
Michigan, 1971-86.

Associate and Assistant Professor, Department of Economics,
University of Michigan, 1963-71.

Special Economic Assistant to the Assistant Attorney General
for Antitrust, U.S. Department of Justice, Washington,
D.C., 1967-1968.

Chairman, The Transportation and Public Utilities Group of
the American Economic Association, 1976-1977.

President, the Industrial Organization Society, 1990-1991.

"Distinguished Member," Transportation and Public Utility Group,
American Economic Association, 1995.

Fields of Teaching and Research:

Industrial organization. Public policies toward business,
particularly Antitrust and Regulation. Microeconomics.

Books Published:

The Economics of Industrial Organization, 4th ed., Englewood
Cliffs, N.J.: Prentice-Hall, 1997 (with a Teacher's
Manual).

Public Policies Toward Business, 8th ed., Homewood, IL: Richard
D. Irwin, 1991.

- The Economics of Industrial Organization, 3d ed., Englewood Cliffs, NJ: Prentice-Hall, 1990 (with a Teacher's Manual).
- Unconventional Wisdom: Essays on Economics in Honor of John Kenneth Galbraith, Boston: Houghton Mifflin, 1990, co-editor (with Samuel Bowles and Richard Edwards).
- Mainstreams in Industrial Organization, 2 vols., Dordrecht: Kluwer Academic Publishers, 1986, co-editor (with H. W. de Jong).
- The Ultimate Deterrent: Foundations of US-USSR Security Under Stable Competition, New York: Praeger Publishers, 1986.
- The Economics of Industrial Organization, 2d ed., Englewood Cliffs: NJ, Prentice-Hall, 1985.
- Public Policies Toward Business, 7th edition, Homewood, IL: Richard D. Irwin, 1985.
- Economics, Englewood Cliffs, NJ, Prentice-Hall, 1983 (with W.H. Locke Anderson and Ann Putallaz). Also Microeconomics, and a Teacher's Guide.
- Economic Regulation: Essays in Honor of James R. Nelson, East Lansing: Michigan State University Press, 1981, co-editor (with Kenneth D. Boyer).
- The Economics of Industrial Organization, Englewood Cliffs, NJ: Prentice-Hall, 1979.
- Public Policies Toward Business, 6th ed., Homewood, IL: Richard D., Irwin, 1979.
- Public Policies Toward Business: Readings and Cases, 2d ed. Homewood, IL: Richard D. Irwin, 1979.
- Public Enterprise: Economic Analysis of Theory and Practice, Lexington, MA: Heath-Lexington Books, 1976, editor.
- Regulation and Entry, East Lansing: Institute of Public Utilities, Michigan State University, 1976, co-editor (with M.W. Klass).
- The Treatment of Market Power, New York: Columbia University Press, 1975.
- Public Policies Toward Business: Readings and Cases, Homewood, IL: Richard D. Irwin, 1975.
- Public Policies Toward Business, 5th ed., Homewood, IL: Richard D. Irwin, 1975, (with Clair Wilcox).

Regulation in Further Perspective: The Little Engine that Might, Cambridge, MA: Ballinger Publishing, 1974, co-editor (with T.G. Gies).

Market Power and Economic Welfare, New York: Random House, 1970. Chinese edition, 1980.

Utility Regulation: New Directions in Theory and Policy, New York: Random House, 1966, co-editor (with T.G. Gies).

Economic Performance under Public Ownership: British Fuel and Power, New Haven: Yale University Press, 1965. Italian edition, L'economicita di Gestione Nell'impresa Pubblica, CIRIEC, 1968.

Journals Edited and Published:

Review of Industrial Organization, Kluwer Academic Publishers, 6 issues per year, approximately 900 pages total, including occasional Special Issues and Symposia. Continuing as General Editor, since 1990.

Articles and Contributions Published:

"Forbearance/Deregulation in the Face of Continued Dominance and Market Power," chapter in David W. Conklin, ed., Adapting to New Realities, Richard Ivey School of Business, University of Western Ontario, London, Ontario: 1998.

"Scholarly Restraints? ABA Accreditation and Legal Education" (with George B. Shepherd), Cardozo Law Review, vol. 18, no. 6, July 1998, pp. 2091-2257.

"Electric Power: From Monopoly to Effective Competition?" chapter in Larry L. Duetsch, ed., Industry Studies, 2d ed., Armonk, N.Y.: M.E. Sharpe, 1998.

"Market Power in the Electric Utility Industry: An Overview," Electric Industry Briefing Papers, National Council on Competition and the Electric Industry, National Association of Regulatory Utility Commissioners, November 1997, pp. 1-18.

"Inconsistency in U.S. Merger Policies," in Jorn Kruse, Wettbewerbspolitik im Spannungsfeld nationaler und internationaler Kartellrechtsordnungen, 1997.

"Monopoly and Antitrust Policies in Network-Based Markets Such as Electricity," chapter in Shimon Awerbuch and Alistair Preston, eds., The Virtual Utility: Accounting, Technology and Competitive Aspects of the Emerging Utility, Kluwer Academic Publishers, 1997.

- "Creating Effective Competition: What Has Worked, What Hasn't," a chapter in David Gabel and David F. Weiman, Competition in Network Industries, 1997.
- "Control Over Technology by Deregulated Monopolies," Revue d'Economie Industrielle, 80, Spring 1997.
- "Dim Prospects: Competition in Electricity, Telecommunications and Railroads," Antitrust Bulletin, Spring 1997.
- "Anti-Competitive Impacts of Secret Strategic Pricing in the Electricity Industry," Public Utilities Fortnightly, February 14, 1997.
- "Donald Turner and the Economics of Antitrust," Antitrust Bulletin, Winter 1996-97.
- "Deregulation: From Monopoly Only to Dominance? Telecommunications, Railroads and Electricity," Quarterly Review, National Regulatory Research Institute, Summer, 1996.
- "Contestability vs. Competition -- Once More," Land Economics, vol. 71, no. 3, August 1995, pp. 299-309.
- "Some Praise for the Reviewing Process, and a Primer on It," a chapter in George B. Shepherd, ed., Rejected: Leading Economists Ponder the Publication Process, Sun Lakes, AZ: Thomas Horton and Daughters, 1995.
- "The Airline Industry," (with James W. Brock), chapter in Walter Adams, ed., The Structure of American Industry, 8th ed., New York: Macmillan, 1994.
- "Reviving Regulation and Antitrust," Electricity Journal, May 1994.
- "Economic Criteria for Setting National Defense Spending," chapter in Manas Chatterji, ed., Economic Issues in World Disarmament, New York: Macmillan, 1994.
- "Antitrust Repelled, Inefficiency Endured: Lessons of IBM and General Motors for Future Antitrust Policies," Antitrust Bulletin, Spring, 1994, pp. 203-34.
- "DuPont and the Titanium Dioxide Industry," (with Douglas Dobson and Robert Stoner) a chapter in John E. Kwoka and Lawrence J. White, eds., The Antitrust Revolution, 2d ed., New York: Macmillan, 1994.
- "Comment on Paper by Edythe Miller," Utilities Policy, October 1993.

- "Constraining Hub Dominance in the Airline Industry," (with Lisa Saunders), Logistics and Transportation Review, September 1993, pp. 201-20.
- "Long Distance Telephone Service: Dominance in Decline?" a chapter in Larry L. Duetsch, ed., Industry Studies, Englewood Cliffs, N.J.: Prentice-Hall, 1993.
- "Ramsey Pricing: Its Uses and Limits," Utilities Policy, October 1992.
- Regulation and Efficiency: A Reappraisal of Research and Policies, Columbus, Ohio: National Regulatory Research Institute, Ohio State University, August 1992, 88 pages.
- "Market Dominance under U.S. Antitrust," Review of Industrial Organization, 6 (Summer 1991), pp. 161-76.
- "Economic Analysis to Guide Antitrust Enforcement: Prospects for Section 2," New York Law School Law Review, 35 (Fall 1991), pp. 917-38.
- "Theories of Industrial Organization," chapter in Harry First, Eleanor M. Fox and Robert Pitofsky, eds., Antitrust for Its Second Century, Westport, Conn.: Greenwood Press, 1991.
- "Section 2 and the Problem of Market Dominance," in A Symposium on the 100th Anniversary of the Sherman Act and Upon the 75th Anniversary of the Clayton Act, The Antitrust Bulletin, 35 (Winter 1990), pp. 833-78.
- Dominance, Non-Dominance, and Contestability in a Telecommunications Market: A Critical Assessment, Columbus, Ohio: National Regulatory Research Institute, April 1990 (with Robert E. Graniere), chapters 2-5.
- "The Process of Effective Competition," Review of Industrial Organization, Autumn 1990.
- "Potential Competition versus Actual Competition," Administrative Law Review, Winter 1990.
- "Mainstreams and Recent Schools in Industrial Organization," Revue Economique, May 1990.
- "Publishing Performance in Industrial Organization: A Comment," Review of Industrial Organization, Summer 1990.
- "On the Nature of Monopoly," chapter in Samuel Bowles, Richard Edwards and William G. Shepherd, eds., Unconventional Wisdom: Essays on Economics in Honor of John Kenneth Galbraith, Boston: Houghton Mifflin, 1989.

- "Efficient Profits vs. Unlimited Capture, as a Reward for Superior Performance: Analysis and Cases," Antitrust Bulletin, Spring 1989.
- "Capital Gains as Economic Rent," Review of Social Economy, Summer 1989.
- "Self-Interest and National Security," American Economic Review, May 1988.
- "Mainstream Economic Criteria in Fourteen Recent Antitrust Cases," Antitrust Law and Economics Review, 1988.
- "Three 'Efficiency School' Hypotheses About Monopoly Power," Antitrust Bulletin, Summer 1988.
- "Public Enterprise: Criteria and Cases," chapter in Henry W. de Jong, ed., The Structure of the European Economy, 2d ed., The Hague: Martinus Nijhoff, 1988.
- "Vindicating Private Antitrust Litigation: A Review Article," Antitrust Law and Economics Review, 1988.
- "Contestability and Railroad Mergers," International Journal of Transport Economics, June 1988.
- "Converting Dominance to Competition: Criteria for Effective Deregulation," chapter in Harry M. Trebing, ed., New Regulatory and Management Strategies in a Changing Market Environment, East Lansing: Institute of Public Utilities, Michigan State University, 1987.
- Four articles in The New Palgrave's, London, Macmillan, 1987, on: "Market Share," "Concentration," "The Hirschman-Herfindahl Index," and "Joe S. Bain."
- "Tobin's Q and the Structure-Performance Relationship: A Comment," American Economic Review, December 1986.
- "On the Core Concepts of Industrial Economics," chapter 2 in Henry W. de Jong and William G. Shepherd, eds., Mainstreams in Industrial Organization, 2 vols., Dordrecht: Kluwer Academic Publishers, 1986.
- "Assessing 'Predatory' Actions by Market Share and Selectivity," Antitrust Bulletin, Spring 1986.
- "Illogic and Unreality: The Odd Case of Ultra-Free Entry; and Inert Markets," in R. E. Grieson, ed., Regulation and Antitrust, Lexington, Mass.: D.C., Heath, 1986.
- "Economics in Court: An 8-Case Antitrust Summary," Antitrust Law

and Economics Review, 1986.

- " 'Contestability' vs. Competition," American Economic Review, September 1984.
- "Winning Bids in Five Types of Auctions: Concentration Matters," Antitrust Bulletin, Spring 1984.
- Concepts and Effects of Barriers to Entry, a volume of the Journal of Reprints for Antitrust Law and Economics, 1983 co-edited (with J.S. Heywood.)
- "Concepts of Competition and Efficient Policy in the Telecommunications Sector," in Eli Noam, ed., Regulation and New Telecommunications Networks, 1983.
- "Sustainability, Entry Restrictions, and Induced Technological Bias," Quarterly Review of Economics and Business, Winter 1982 (with David Sappington).
- "Causes of Increased Competition in the U.S. Economy, 1939-1980," Review of Economics and Statistics, November 1982.
- "Monopoly Profits and Economies of Scale," in John V. Craven, ed., Industrial Organization, Antitrust, and Public Policy, Boston: Kluwer Academic Publishers, 1982.
- "Public Enterprise: Purposes, Performance, Structure," in W.T. Stanbury and F. Thompson, eds., Managing Public Enterprises, New York: Praeger, 1982.
- "Price Structure in Electricity," in A.L. Danielson and D.R. Kamerschen, eds., Current Issues in Public Utility Economics: Essays in Honor of James C. Bonbright, Lexington, MA: Heath-Lexington Books, 1982.
- "Sustainability and Competition," chapter in Thomas G. Gies and Werner Sichel, eds., Deregulation: Appraisal Before the Fact, Ann Arbor: Bureau of Business Research, University of Michigan, 1982.
- "Sustainability, Deregulation and Separate Subsidiaries," in Harry M. Trebing, ed., Regulatory Issues in the 1980s, East Lansing: Institute of Public Utilities, Michigan State University, 1981.
- "Public Enterprise in Western Europe and the United States," in H.W. de Jong, ed., The Structure of the European Economy, The Hague: Martinus Nijhoff, 1980.
- "Forward," in Christopher Green, Canadian Industrial Organization and Policy, Scarborough, Ontario, McGraw-Hill Ryerson, 1980;

and in the 2d edition, 1986.

- "Anatomy of a Monopoly: (I) Excess Capacity and the Control of Price," Antitrust Law and Economics Review, 11 (1979).
- "British and United States Experience," in P. Fernandes, ed., Financing of Public Enterprises in Developing Countries, Ljubljana, Yugoslavia: International Center for Public Enterprises, 1979.
- "The Dominant Firm in Relation to Market Structure," in A.P. Jacquemin and H.W. de Jong, Welfare Aspects of Industrial Markets, The Hague: Martinus Nijhoff, 1977.
- "Bain's Influence on Research into Industrial Organization," chapter 1 in R.T. Masson and P.D. Qualls, Essays on Industrial Organization in Honor of Joe S. Bain, Cambridge, Mass.: Ballinger, 1976.
- "Rate Structure, Social Efficiency and Equity," chapter in Harry M. Trebing, ed., New Dimensions in Public Utility Pricing, East Lansing: Institute of Public Utilities, Michigan State University, 1976.
- "General Conditions of Entry," a chapter in Michael W. Klass and William G. Shepherd, eds., Regulation and Entry, East Lansing: Institute of Public Utilities, Michigan State University, 1976.
- "Banking," chapter in Walter Adams, ed., The Structure of American Industry, 5th ed., New York: Macmillan, 1976; and (with Arnold Heggstad) in the 6th and 7th editions.
- "The Elements and Evolution of Market Structure," in Henry de Jong and Alex Jacquemin, eds., Markets, Corporate Behavior and the State, The Hague: Martinus Nijhoff, 1976.
- "Objectives, Types and Accountability," Chapter 3, "British and United States Experience," Chapter 6, and "Public Enterprise in Financial Sectors," Chapter 8, in William G. Shepherd, ed., Public Enterprise: Economic Analysis of Theory and Practice, Lexington, MA: Heath-Lexington Books, 1976.
- "The Scope for Reversal: Foreign Multinational Firms in the United States," chapter in Werner Sichel, ed., Multinational Corporations and the U.S. Economy, Ann Arbor: Bureau of Business Research, University of Michigan, 1976.
- "The Economics of Section 2," Papers and Proceedings, American Bar Association, 1974.
- "Regulation, Entry and Public Enterprise," chapter in Thomas G.

Gies and William G. Shepherd, eds., Regulation in Further Perspective: The Little Engine that Might, Cambridge, MA: Ballinger Publishing, 1974.

- "Managerial Discrimination in Large Firms," Review of Economics and Statistics, November 1973.
- "The Yields from Abating Market Power," Industrial Organization Review, Spring 1973.
- "Entry as a Substitute for Regulation," American Economic Review, May 1973.
- "Public Enterprise," chapter in Ralph Nader and Mark J. Green, eds., Corporate Power in America, New York, Grossman, 1973.
- "British Industrial Concentration: A Comment," Oxford Economic Papers, November 1972.
- "Structure and Behavior in British Industries, With U.S. Comparisons," Journal of Industrial Economics, July 1972.
- "Elements of Market Structure: An Inter-industry Analysis," Southern Economic Journal, April 1972.
- "The Elements of Market Structure," Review of Economics and Statistics, February 1972.
- "Large-Firm Employment Policies Toward Blacks and Women," Report to U.S. Office of Economic Opportunity, Washington, D.C.: 1971.
- "The Margin of Competition in Communications," chapter in William M. Capron, ed., Technological Change in Regulated Industries, Washington, D.C.: Brookings Institution, 1971.
- "Changing Contrasts in British and American Antitrust Policies," chapter in Werner Sichel, ed., Antitrust Policy and Economic Welfare, Ann Arbor: Graduate School of Business, University of Michigan, 1970.
- "Regulation and its Alternatives," Stanford Law Review, February, 1970.
- "Market Power and Racial Discrimination in White-Collar Employment," Antitrust Bulletin, Spring 1969.
- "Leading-Firm Conglomerate Mergers," Antitrust Bulletin, Winter 1968 (with James S. Campbell).
- "Alternatives for Public Expenditure," chapter in Richard E. Caves and Associates, Britain's Economic Prospects,

Washington, D.C.: Brookings Institution, 1968.

- "What Does the Survivor Technique Show About Economies of Scale?" Southern Economic Journal, July 1967.
- "On Appraising Evidence About Market Power," Antitrust Bulletin, Spring 1967.
- "Regulatory Constraints and Public Utility Investment," Land Economics, August 1966.
- "Residence Expansion in the British Telephone System," Journal of Industrial Economics, July 1966.
- "Marginal-Cost Pricing in American Utilities," Southern Economic Journal, July 1966, and "A Reply," ibid., January 1967.
- "Changes in British Industrial Concentration, 1951-1958," Oxford Economic Papers, March 1966.
- "Comparative Economic Systems: Nationalized Industry," American Economic Review, May 1965.
- "Cross-Subsidizing: A Reply," Oxford Economic Papers, March 1965.
- "British Nationalized Industry: Performance and Policy," Yale Economic Essays, Spring 1964.
- "Trends of Concentration in American Manufacturing Industry, 1947-58," Review of Economics and Statistics, May 1964.
- "Cross-Subsidizing and Allocation in Public Firms," Oxford Economic Papers, March 1964.
- "Development Loans to Private Borrowers," Economic Development and Cultural Change, April 1964.
- "Simultaneous Equations Techniques," chapter in Geoffrey S. Shepherd, Agricultural Price Analysis, 5th edition, Ames: Iowa State University Press, 1962.
- "On Sales-Maximizing and Oligopoly Behavior," Economica, November 1962.
- "A Comparison of Industrial Concentration in the United States and Britain," Review of Economics and Statistics, February 1961.
- "Competition and Growth: The Lesson of West Germany - A Comment," American Economic Review, December 1960 (with Alasdair I. MacBean).

Research in Preparation or Submitted:

Competition and Progress, a book-length reassessment of the nature of competition and of policies toward market power.

Classic Micro-Economics, with George B. Shepherd. A concise textbook of micro-economic concepts.

"Competition and Extremism: Failures in the Marketplace of Ideas"

"The Emergence of Dominance: Properties of Instability in the Competitive Process"

"The Trend of Competition in the US. Economy, 1980-1997"

"The Theory of Actual Entry"

Other Professional Activities:

Visiting Professor: Williams College, 1982; University of Massachusetts, 1984-1985.

Preparation of numerous conferences on industrial organization, antitrust, regulation and public enterprise.

University of Glasgow, Fulbright Graduate Fellowship, 1959-60.

Research in Britain, in 1959-60, 1962, 1964, 1967, 1969, 1971, 1974, 1978, 1985 and 1987.

Awarded Ford Foundation Faculty Fellowship, 1967-68 (declined, to do the year at the Antitrust Division).

Numerous book reviews, refereeing of articles and books, screening research proposals, comments on other papers in conference volumes, etc., not listed individually here.

Addresses and seminars at various universities and colleges in the U.S. (University of Chicago, University of Michigan, University of Cincinnati, Wesleyan University, Amherst College, Miami University, University of Miami, University of Wyoming, Michigan State University, Middlebury College, College of William & Mary, University of New Hampshire); Canada (McGill University, Dalhousie University); Britain (London School of Economics, Oxford University, Cambridge University, University of Lancaster); Europe (University of Amsterdam, University of Ljubljana, University of Louvain, University of Rome); China (Nankai University) and Japan (Doshisha University).

Associate Conferee at The Merrill Center for Economics, summer

session, June-August, 1956.

Invited 4-week lecture series on Industrial Organization, Nankai University, Tianjin, China, April-May 1983. Further lectures at Nankai University, May, 1989; and September 1994 (for three weeks).

Director of Graduate Studies, Chairman of the Graduate Program Committee, and Chairman of the Graduate Admissions and Fellowships Committee, Department of Economics, University of Michigan, 1966-67, 1968-70.

Director of Graduate Studies in Economics, University of Massachusetts, 1990-91.

Statement and testimony for the Subcommittee on Antitrust and Monopoly, U.S. Senate; on industrial concentration, 1965; on antitrust policy in Britain, 1968; on discrimination in managerial employment, 1972; and for the House Committee on Energy, on Electric Sector competition, 1985.

Adviser at various times to: Antitrust Division, U.S. Department of Justice. U.S. Federal Trade Commission. U.S. Senate Subcommittee on Antitrust and Monopoly. Regulatory commissions in Massachusetts, the District of Columbia and Michigan. The African Development Bank, Abidjan, Ivory Coast. Various city governments, foundations, and private companies.

Testimony and consulting as an expert witness in antitrust and regulatory cases, including cases involving: IBM Corp. (California Computer Products), AT&T (Diversified Industries), DuPont Company (the titanium dioxide case), G.D. Searle, Pfizer Inc. (International Rectifier), the Santa Fe and Southern Pacific railroad merger, Southern California Edison (Cities of Anaheim et al); Macy's-Federated merger; Chicago Daily Herald v. Chicago Tribune et al; Rochester Gas & Electric; drug producers (price discrimination); the Union Pacific and Southern Pacific railroad merger; and before the Federal Energy Regulatory Commission (the Williams Pipeline case, 1992), and the regulatory commissions of the District of Columbia, New Jersey, Florida, Illinois, Maine, Massachusetts, Montana, New Hampshire, and Virginia. Also, extensive participation after 1995 in electric-industry competitive questions, among all sides of the industry (utilities, would-be entrants, commission staff, conferences, public and cooperative groups, etc.).

Adviser to the African National Congress, South Africa, on South African antitrust and related industrial policies, during 1992-94.

Adviser on industrial policies to officials of the Republic of Slovenia, since March 1995; visits in 1995 and 1996.

Chairman, the Ann Arbor Cablecasting Commission, 1973.

Co-Editor (with Henry W. de Jong) of the monograph series, Studies in Industrial Organization, Dordrecht: Kluwer Academic Publishers, since 1978.

Included in Who's Who in Economics: A Biographical Dictionary of Major Economists, 1700-1980, by M. Blaug and P. Sturges, London: Harvester Wheatsheaf/MIT Press, 1983; revised edition, 1986; and 3d ed., Edward Elgar Publishing, 1999.

APPENDIX 2

#2

PUBLIC UTILITY COMMISSION
OF TEXAS

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PROJECT NO. 16251

PUBLIC UTILITY COMMISSION
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In the matter of)
)
Application of SBC Communications Inc.,)
Southwestern Bell Telephone Company)
Service Inc., d/b/a Southwestern Bell)
Long Distance, for Provision of In-Region)
InterLATA Service in Texas)

AFFIDAVIT OF SARAH J. GOODFRIEND

ON BEHALF OF THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

Suzi Ray McClellan
Public Counsel
State Bar No. 16607620

Rick Guzman
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State Bar No. 08654670

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1701 N. Congress Avenue, 9-180
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Austin, Texas 78711-2397

April 1, 1998

DOCKET NO. 16251

**INVESTIGATION OF §
SOUTHWESTERN BELL TELEPHONE § PUBLIC UTILITY COMMISSION
COMPANY'S ENTRY INTO THE §
INTERLATA TELECOMMUNICATIONS § OF TEXAS**

**AFFIDAVIT OF SARAH J. GOODFRIEND
ON BEHALF OF THE OFFICE OF PUBLIC UTILITY COUNSEL**

**STATE OF TEXAS §
§
COUNTY OF TRAVIS §**

APRIL 1, 1998

BEFORE ME, the undersigned authority, personally appeared SARAH J. GOODFRIEND, who, by me duly sworn, deposed as follows:

I. Qualifications

1. My name is Sarah J. Goodfriend. I am a Ph.D. economist and former Commissioner of the Public Utility Commission of Texas (PUCT). My business address is 701 Brazos, Suite 310, Austin, Texas 78701. In my consulting practice, I specialize in competition and antitrust issues in the U.S. electric power and telecommunications industries. Prior to starting my firm, I was employed by MCI Telecommunications Corporation in Washington, DC. For MCI my primary responsibility was to develop economic and regulatory policies addressing implementation of the FTA by state commissions. On behalf of MCI and another client, I have provided expert testimony to state commissions in Florida, Texas, Missouri, North Carolina and Kentucky in GTE, BellSouth and SWBT FTA § 251 proceedings. I have also supervised and assisted in the development of costing and pricing comments by MCI engineering consultants before the

PUCT. In that capacity, I attended the Jan. 27-31, 1997 SWBT Arbitration Cost Work Shop at Lakeway, Texas.

After receiving my doctorate, I joined the Bureau of Economics of the Federal Trade Commission. In 1987, I joined the Office of Economic Policy of the Federal Energy Regulatory Commission. I have testified on behalf of these federal agencies and as well as private clients. My resume, appended to this affidavit, supplies additional details of relevant experience.

II. Scope Of Testimony And Recommendations

3. I have been retained by the Office of Public Utility Counsel of the State of Texas (OPC) to evaluate SBC Communications Inc., *et. al.*'s draft application for § 271 relief before the FCC and to provide comments to the PUCT to assist in the PUCT's assessment of SBC's draft application.

4. In light of (1) SWBT's historical tendency to manipulate regulatory processes to frustrate entry into the local exchange by competitors, and (2) the incomplete development of performance metrics to police SWBT's ability and incentive to engage in discriminatory and anticompetitive behavior in the local exchange market, I recommend that the PUCT withhold its support for the application at this time.

5. First, the FCC is interested in evidence bearing on whether barriers to entry into the local exchange have been eliminated and whether the RBOC will continue to cooperate with new entrants after receiving in-region interLATA authority. I find that SWBT has applied its legal obligations under FTA § 251 (and PURA) and administered its responsibilities in ways that, had there not been PUCT intervention, SWBT would have successfully delayed, retarded or denied entry into the local exchange.

6. I recommend the PUCT withhold support for SWBT's application until SWBT has taken real, significant and irreversible steps ¹ to permit CLECs in Texas to respond to the

¹ *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, interLATA Services in Michigan*, CC Docket No. 97-137, Memorandum Opinion and Order, FCC 97-298 (rel. Aug. 19, 1997) at ¶18. (hereafter

needs of small business and residential customers with an end-to-end quality of service that meets or exceeds these customers' accustomed or expected levels. For this situation to occur, both CLECs and regulators must be able to determine that SWBT's pre-ordering, provisioning, billing, repair, and other services are provided in a nondiscriminatory manner.

7. Second, CLEC's must rely on SWBT for service delivery of interconnection, unbundled elements and resale. As long as it remains profitable for SWBT to discriminate in its service delivery functions, local exchange competition is in jeopardy. As a result, regulators, RBOCs and CLECs have begun to focus intensively on developing meaningful performance measures. However, this important work is far from complete.² My review indicates that opportunities and incentives for SWBT to discriminate in service delivery are not yet past. SWBT's exercise of discrimination has not been rendered largely unprofitable.

8. I provide four recommendations addressing SWBT's compliance with FCC requirements for nondiscrimination in service delivery. I recommend the PUCT require SWBT to: (1) further disaggregate, analyze and refine data to minimize ambiguity in reported results; (2) eliminate the bankable credit provisions of the SWBT-AT&T agreement when offering conditions for liquidated damage determination to other CLECs; (3) demonstrate the viability of its performance monitoring systems at commercial quantities. In addition, I recommend that the PUCT develop a rule prohibiting discrimination in service delivery and that this rule, under PURA, be modeled after rules promulgated by the Texas Railroad Commission prohibiting discrimination in natural gas purchase. By augmenting the performance monitoring which CLECs achieve, in part,

"Ameritech").

² Performance Measures and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance (RM-9101) will be addressed by the FCC at its April 2, 1998 Open Meeting. See <http://www.fcc.gov/Bureaus/Miscellaneous/Public Notices/Agenda/1998/agenda.html>.

through reliance on negotiation with SWBT, the PUCT rule will advance the objective of the FTA to open all telecommunications markets to competition.

III. The FTA And PURA Require A Demonstrated Commitment To Irreversible Local Exchange Competition Before RBOC In-Region InterLATA Entry.

9. Commenting on the BellSouth Petition, FCC Commissioner Ness explained:

The thousand of pages of pleadings and the detailed debates over arcane statutory provisions must not obscure the simple legislative bargain that governs Bell company entry into long distance. Once Bell companies fulfill their responsibilities to eliminate barriers to entry in [the] local marketplace, the barrier to their entry into the long distance market will in turn be removed. Today's order eliminates all doubt that the new Commission will enforce that sequence.³

10. This statutory design is grounded in sound economic policy. First, it properly requires the irreversible elimination of monopoly. As former Federal Circuit Judge Bork explains, "The only real check on the potential abuse of a BOC monopoly is the elimination of that monopoly" because regulation alone will not deter anticompetitive conduct.⁴ Unless local exchange monopoly is eliminated, the opportunity interLATA entry provides to profitably leverage and extend this monopoly means that anticompetitive abuses of access, price and service discrimination, cross-subsidy and strategic abuse of the regulatory process remain in an RBOC's best interest, as profits can be increased thereby.⁵ The public interest analysis by Dr. Marius Schwartz on behalf of the Department of Justice also stresses that prematurely granting RBOC interLATA entry would,

³ *Application of BellSouth Corporation, et. al. Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA services in South Carolina, CC Docket No. 97-208 Separate Statement of Commissioner Ness, FCC Docket No. 97-418 , (rel. Dec.24, 1997), See also Memorandum Opinion and Order at ¶9. (hereafter BellSouth - South Carolina).*

⁴ *See Affidavit of Robert H. Bork on Behalf of AT&T Corp., AT&T Exhibit B, BellSouth-South Carolina, ¶¶35-36.*

⁵ *Id.*

“substantially impede the development of local competition” because, among other reasons, as IXC access needs change over time, preventing discrimination in new or evolving arrangements will be considerably more difficult than in preventing discrimination in established arrangements.⁶

11. Second, the statutory design is consistent with the view that consumer gains from eliminating local exchange monopoly very likely exceed the gains available from making the long distance market more competitive. Dr. Mark Cooper, on behalf of the Consumer Federation of America, has estimated that while excess profits that might be returned to consumers from greater competition in long distance amount to \$ 0-2 billion annually, excess profits that could be returned to consumers from greater competition in all local markets amount to \$ 8-12 billion annually.⁷

12. Third, by statutory design, RBOC in-region, interLATA entry is the positive payoff for RBOC satisfaction of requirements necessary to dismantle the local exchange monopoly so that entrants can be afforded a meaningful opportunity to compete.⁸

IV. The Section 271 Inquiry Must Assure that the Local Exchange Market Remains Open.

13. The FCC defines its public interest mandate under § 271(d)(3)(C) to compliment its analysis of competitive conditions and checklist compliance and to identify for RBOCs what is necessary to meet the terms of § 271. The public interest analysis is used broadly to further the Congressional objective of assuring that the local exchange market is, and will remain, open.⁹ In its public interest analysis, the FCC recognizes the value of input

⁶ See Schwartz Affidavit, Schwartz Supplemental Affidavit at 11 and at 70 and Appendix A of DOJ Evaluation of BellSouth – Louisiana titled “Response To Prof. Hausman’s Criticisms of Prof. Schwartz’s Analysis For the Department” at 2.

⁷ See Table A-1, Reply Comments of the Consumer Federation of America, BellSouth – South Carolina.

⁸ *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order at ¶315.

⁹ In particular, see the discussion of Congressional Record statements in Sloan, *Creating*

from state commissions, particularly in the context of specific applications.¹⁰ The FCC focuses on the status of market-opening measures in the relevant exchange market;¹¹ assesses whether all procompetitive entry strategies are available to new entrants;¹² ensures that all barriers to entry to the local exchange have been eliminated; and, most importantly, evaluates whether the RBOC will continue to cooperate with new entrants after receiving in-region interLATA authority. “While BOC entry into the long distance market could have procompetitive effects, whether such benefits are sustainable will depend on whether the RBOC’s local telecommunications market remains open after RBOC interLATA entry. Consequently, we believe we must consider whether conditions are such that the local market will remain open as part of our public interest analysis.”¹³

14. Describing its public interest assessment, the FCC explains that, although the checklist prescribes certain minimum requirements, “we believe that compliance with the checklist will not necessarily assure that all barriers to entry to local telecommunications market have been eliminated, or that a BOC will continue to cooperate with new entrants after receiving in-region, interLATA authority.”¹⁴

15. The FCC has identified the type of evidence relevant to its determination of whether a BOC will “continue to cooperate” with new entrants after interLATA entry. The existence of broad based competition through the various methods of entry (resale, unbundled elements, and interconnection) suggests these entry avenues are “truly

Better Incentives through regulation: Section 271 of the Communications Act of 1934 and the Promotion of Local Exchange Competition, Federal Communications Law Journal, March 1998 at 371-374.

10 Ameritech ¶398.

11 Ameritech ¶385.

12 Ameritech ¶387.

13 Ameritech ¶390.

14 Ameritech ¶390.

available.” In the absence of broad-based competition, however, the FCC examines other factors conducive to the inference that local exchange markets are, and will remain, open:

We would, for example, be interested in evidence that a BOC is making available, pursuant to contract or otherwise, any individual interconnection agreement to any other requesting telecommunications carrier upon the same rates, terms and conditions as those provided in the agreement. Such evidence would demonstrate that competitive alternatives can flourish rapidly throughout a state, by assuring that new entrants can enter the market quickly without having to engage in lengthy and contentious negotiations or arbitrations with the BOC.¹⁵

16. Under the above standard it is clear that the FCC would like to be apprised of instances where an RBOC is not making available any individual interconnection agreement to any other carrier, on the same terms as previously provided, and of other evidence suggesting new entrants cannot enter the market quickly and without lengthy and contentious negotiations or arbitrations. Section V below develops such evidence.

17. It is crystal clear that evidence of how SWBT has interpreted its obligations under the FTA and PURA is relevant to an assessment of SWBT’s commitment to market opening. SWBT acknowledges the need for state commission input to the FCC on this matter, as evidenced by the “public interest” affidavits included in its § 271 application.

V. SWBT Evidence Relevant to the Public Interest Inquiry

18. SWBT affiant Jon R. Loehman states that SWBT has complied with its obligations under the FTA to negotiate in good faith and has fulfilled its contractual obligations spelled out in the interconnection agreements themselves.¹⁶ Mr. Loehman’s choice of the words “spelled out” is right on target. The evidence below demonstrates that, time and time again, the PUCT has had to “spell out” exactly what it expects from SWBT: market-opening, pro-competitive behavior.

¹⁵ Ameritech ¶392.

¹⁶ *Application of SBC Communications, Inc. et. al., for Provision of In-Region, InterLATA Services in Texas*, Draft Affidavit of Jon RLoehman Affidavit a¶ 14.

19. SWBT affiant Michael C. Auinbach claims that SWBT's record in meeting CLEC requests has been outstanding.¹⁷ Mr. Auinbach also states: The Texas PUC recently determined that Internet traffic is "local" in nature and thus subject to the reciprocal compensation provisions of Section 252 of the Act. *Although disagreeing with this conclusion, SWBT will follow the PUC's order and treat such traffic as local, subject to any appeal or intervening decision by the FCC in this area.* [emphasis added]¹⁸ On both counts, Mr. Auinbach is wrong. SWBT continues, even in the shadow of its § 271 application, to employ negotiating and regulatory tactics befitting the most bellicose of monopolists. Post-entry RBOC behavior is particularly relevant to the existing situation in Texas where (1) CLEC residential entry (particularly via UNEs or owned facilities) is minuscule,¹⁹ (2) appropriate performance measures are not in place,²⁰ and (3) SWBT persists in bullying small local entrants and national IXCs alike.²¹

20. Two specific questions are relevant to the FCC's public interest investigation of SWBT's interLATA application in Texas: (1) How has SWBT interpreted its legal obligations, under PURA and the FTA, and administered its responsibilities created through privately-negotiated agreement or PUCT arbitration? (2) Has SWBT developed

¹⁷ *Application of SBC Communications, Inc. et. al., for Provision of In-Region, InterLATA Services in Texas*, Draft Affidavit of Michael CAuinbach ¶11.

¹⁸ *Id.* ¶84.

¹⁹ *Application of SBC Communications, Inc. et. al., for Provision of In-Region, InterLATA Services in Texas*, Draft Confidential Affidavit of Michael L. Montgomery. (hereafter SBC draft application – Texas).

²⁰ SBC draft application – Texas, Draft Affidavit of William Bysart.

²¹ "Bells have charged that entrants are behaving strategically and withholding from entry when they can to hold them out of long distance. But, if the local market were truly open and the long distance companies were just sitting on the sidelines, we would expect to find the start-up local phone companies – i.e., the competitors with no base to protect in long distance – using the Bell's wholesale services and facilities without difficulty. As our filings in the four section 271 applications to date make clear, however, even those competitors have had difficulty getting the necessary wholesale services and facilities from the Bells." Address by Philip J. Weiser, Senior Counsel, Antitrust Division, U.S. DOJ, *The Section 271 Process: Reflections on the Quest for Local Competition*, Before the Computer and Telecommunications Section of the DC Bar, Washington, DC, December 15, 1997 at 4.

processes (e.g., for performance measurement) demonstrating that SWBT has irrevocably institutionalized the market opening obligations that in-region interLATA entry under § 271 requires?

A. SWBT Has Interpreted Its Legal Obligations Under § 251 Of The FTA (And PURA) And Administered Its Responsibilities In Ways That, Had The PUCT Not Repeatedly “Spelled Out” SWBT’s Obligations, SWBT Would Have Successfully Delayed, Retarded Or Denied Entry To The Local Exchange.

1. PUCT Final Orders and Arbitration Awards

21. The FCC has found that an incumbent LEC has the ability to act on its incentive to discourage entry and robust competition through insistence on supracompetitive prices or other unreasonable terms and conditions of interconnection.²² Thus, the FCC’s Orders implementing the Local Competition Provisions of the FTA,²³ and FTA § 271 requirements for RBOC entry into in-region long distance contain guidelines, standards and prohibitions to encourage incumbent cooperation with entrants. PURA²⁴ also recognizes that an incumbent’s pursuit of self-interest may unreasonably conflict with PURA’s policy goals and so imposes unilateral requirements on ILECs.²⁵ Despite these regulatory protections, delay through procedural maneuvering remains a powerful tool for

²² *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98, First Report and Order, ¶ 10.

²³ Telecommunications Act of 1996, Pub. L. No. 104-104*, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C.) (FTA).

²⁴ Public Utility Regulatory Act, 75th Leg., R.S. ch. 166, §*1, 1997 Tex. Sess. Law. Serv. 713 (Vernon) to be codified at TexUtil. Code Ann. §11.001-63-063) (PURA).

²⁵ Subchapter I § 60.161 recognizes the unique status of local exchange incumbents. This Subchapter authorizes the Commission to forbid ILEC conduct found to unreasonably: (1) discriminate against another provider by refusing access to the local exchange; (2) refuse or delay interconnection to another provider; (3) degrade the quality of access the company provides another provider; (4) impair the speed, quality, or efficiency of a line used by another provider; (5) fail to fully disclose in a timely manner on request all available information necessary to design equipment that will meet the specifications of the local exchange network; or (6) refuse or delay access by a person to another provider.

an incumbent. SWBT has been unable to avoid the temptation to use procedure and technicalities as weapons to delay or deter competitive entry.

22. The following PUCT docketed cases provide instances where SWBT has increased the costs of entry, and burdened the regulatory process unnecessarily by requiring the PUCT to repeatedly "spell out" SWBT's obligations under the FTA in exacting detail. In many cases, the PUCT has had to craft (and re-craft) precise contract language. The following cases illustrate by example SWBT's efforts to:

- leverage its monopoly access to 911,
- change its commitment to combine network elements,
- control the adoption of contract language,
- stretch interpretations of Interim PUCT Awards,
- require entrants to seek alternative, costly, substitutes,
- impose initial use of SWBT's generic form agreement, and,
- refuse to provide new UNEs.

23. Had SWBT been permitted to leverage its monopoly access to the 911 database by requiring execution of a completed interconnection agreement before granting access to its 911 database, entry would have been delayed, retarded or denied. Apparently recognizing the potential political fallout, SWBT did an "about face" on this issue only after receiving a post-hearing filing by the State of Texas Advisory Commission on State Emergency Communications. The Arbitrators accepted the change of position taken by SWBT in response to intervention by the Advisory Commission.²⁶

24. Had SWBT been allowed to change its commitment to combine network elements on behalf of entrants (rather than, in the alternative, permit entrants the means necessary to combine elements themselves), new issues would have been created in mid- arbitration, and entry via the combining of UNE switches and ports would have been significantly

²⁶ See SWBT letter of Dec. 18, 1997 responding to the Advisory Commission on State Emergency Communications Amended Public Comment and Statement of Position in Dockets 17922 and 18082. See also discussion, Docket No.17922, Nov. 1997 Award at 20.

delayed. The PUCT denied SWBT's mid-arbitration change of heart concerning the provision of UNEs, saying, "The 8th Circuit's Order on Rehearing reveals no ground for abrogating SWBT's voluntarily commitment to combine network elements."²⁷ Repeatedly citing the evidentiary record before it, the PUCT found:

That SWBT voluntarily committed to combining network elements, even though it understood that it had no legal obligation, could not be clearer. SWBT's recent recantation of its commitment to combine network elements and, in the alternative, its unilateral imposition of new conditions to its performance come too late...Moreover, SWBT's explicit commitments to provide network elements in combination when requested had a substantial impact on the arbitration proceedings...relying on SWBT's representations, the LSPs responded by relinquishing their right to seek direct access to SWBT's network.²⁸

25. Had SWBT been permitted to control the adoption of contract language through its concept of the § 252(i), "most favored nation" clause, *i.e.*, that even when an entrant willingly accepts contract language subject to PUCT modification, only PUCT-approved and executed language can form the basis of Agreement language, entry would have been significantly delayed, or denied. Whereas SWBT counseled "patience," the Arbitrators recognized that, for small entrants, waiting can be a costly denial of entry:

In substance, the entrant's use of the Revised AT&T/SWBT Agreement is similar to the entrant's adopting the agreement and then petitioning for further arbitration to incorporate the additional provisions it seeks in this docket. *Such a process could unnecessarily delay the execution of a final agreement for up to a year. Such a delay is inconstant [sic] with the FTA's intent to jump-start the rapid introduction of competitive entry.* [footnote omitted, emphasis added]²⁹

26. Had SWBT prevailed in its stretched interpretations of Interim PUCT Awards governing TELRIC cost modeling, UNE-based entry would have been economically

27 Docket No. 16189, et. al. Nov.24, 1997 Award at 4.

28 *Id.* at 5-6.

29 Docket No. 17922, Arbitration Award Dec. 29, 1997 at 5.

impaired. Permanent prices reflecting at least three of the PUCT's "Top Twenty Costing Input Issues" would have reflected costs departing from any reasonable interpretation of TELRIC. Three Interim Award issues illustrate the extent to which the PUCT had to "spell out" its Award to SWBT. Illustrative TELRIC issues are: (1) 2-wire distribution loop investment; (2) Signal Transfer Points (STP) link utilization; and (3) depreciation planning for capital items. First, by choosing to ignore the PUCT schematic showing four wires clearly applying to two loops,³⁰ SWBT instead, seized upon a potential ambiguity in the Interim Award language to contend that the number of distribution wires in a 2-wire, 8db loop is four wires. Applying the PUCT-mandated fill factor for distribution, *i.e.*, 0.40, to the SWBT-assumed four distribution wires for a 2-wire 8db loop, or $(4 \div 0.4)$ resulted in modeling investment in distribution at 10 wires (5 wire pairs) per 2-wire 8db loop. This assumption comported with no prior SWBT (or other ILEC) cost study, and no SWBT network engineering. Applying the fill factor appropriately to each 2-wire loop (*i.e.*, $2 \div 0.40$) provides for 5 distribution wires, one-half the investment SWBT asserted for 2-wire dB loop and related facilities (*i.e.*, BRI loop, 2-wire 8dB distribution subloop, and BRI distribution loop).

27. Second, SWBT again stretched the limits of understanding by applying the PUCT's Interim Award of a 32% utilization rate for STP links as an "input" to its model, thereby producing an actual utilization rate of 12.8%. SWBT ultimately modified this position prior to delivery of the permanent Cost and Pricing Award. Finally, and possibly most egregiously, SWBT modeled the depreciation planning period as 3 years. This choice affected all cost factors which depended in any way on capital costs. An AT&T cost expert estimated that the use of the 3 year planning horizon rather than the appropriate 99-year planning horizon *overstated total costs by approximately 20%*.³¹

30 Docket No. 16189, *et. al.*, Interim Award, Nov.7, 1996 at Appendix D.

31 *Application of AT&T Communications, Inc. for Compulsory Arbitration*, Docket No. 16226 and *Petition of MCI Telecommunications Corp. et. al. for Arbitration and Mediation*, Docket No. 16285 Prefiled Direct Testimony of Daniel PRhinehart, Aug. 27, 1997, at 9.

The PUCT Website document summarizing the grant of permanent Awards on the Top Twenty Issues, comments tellingly on this issue, "Assumed 99 years, as SWBT has always done, not the 3 years they used only in their arbitration studies."³²

28. Had SWBT prevailed in its view that an entrant be required to seek alternative, but more expensive, substitutes for Unbundled Dedicated Transport jointly-provisioned by ILECs, entry would have been delayed and frustrated by heightened costs. In responding to the entrant MCI's allegations, SWBT reargued what the 8th Circuit had clearly rejected.³³ In deciding the threshold legal issue presented by MCI, the Arbitrator rejected SWBT's argument that, "FTA obligations apply to ILECs and since SWBT is not the ILEC in GTE-SW's territory, SWBT has no obligation to provide UNEs in GTE-SW's territory."³⁴ The Arbitrator reasoned that for UNEs to be provided in a nondiscriminatory fashion, jointly provided facilities, need be, at least in part, available as a UNE.

Such a result is necessary to allow competitors the same access... as an ILEC has for itself. Otherwise, ILECs could frustrate the development of competition by classifying all facility interconnecting ILECs as "jointly-provided" and require purchase...at rates that are not cost-based or develop[ment of] alternatives ...which are more costly than what the ILEC can provide itself, [contrary to] FTA § 251(c)(3).³⁵

29. After this ruling, SWBT and MCI still could not come to agreement on the interpretation of contract terms previously awarded. Going over much the same ground as before, the Arbitrator found that SWBT must comply with UDT between the facilities

32 <http://www.puc.state.tx.us/arb-sum.HTM> at 6.

33 SWBT stated: SWBT specifically denies that money is not the issue; MCI is seeking to require SWBT to provide an UNE outside SWBT's certificated territory or to jointly provide such service with GTE, when the very same service is available in the competitive market; it is just not available at the same price. *Complaint of MCI Telecommunications Corporation and MCI Metro Access Transmission Service, Inc. Against SWBT For Violation of Commission Order in Docket No.s 16285 and 17587 Regarding Provisioning Unbundled Dedicated Transport*, Docket No. 18117, SWBT Response to Amended Complaint, Item 9 at 4. SWBT reargues the rejected position that the necessary and impairment standards of §251(d)(2) require an inquiry into whether the competing carrier could obtain the element from another source. See *Iowa Utilities Bd. V. FCC*, No. 96-3321 (July 18, 1997) at 136. (hereafter Docket No. 18117).

34 Docket No.18117, Order No. 2, Order on Threshold Legal Issues, Nov.24, 1997 at 3.

35 *Id.* Order No. 2 at 4.

requested by MCI and that SWBT was not entitled to rely on language not incorporated into the SWBT/MCI agreement as approved January 29, 1997. Although the Award was ultimately resolved largely in MCI's favor, SWBT apparently achieved its intended effect, delaying MCI's provisioning of facility-based service to the Houston metro area.³⁶

30. Had SWBT been allowed to impose an initial use of SWBT's generic form agreement on an entrant pursuing non-standard interconnection, entry would have been delayed, retarded or denied. Instead, the Arbitrators allowed the entrant Waller Creek Communications (WCC), to use its form agreement, based on the AT&T/SWBT agreement. The Arbitrators found that the record evidence demonstrated that WCC presented the general form during the negotiation period. Moreover, from the testimony presented, the Arbitrators found that SWBT was on notice that WCC would present its own form agreement prior to the 152nd day of the negotiation period.³⁷ In an attempt to delay and control, SWBT had contended that, if the Arbitrators are to use any document as the base document, it should be the SWBT "generic" document or, failing that, the Arbitrators should direct the parties to "draft from scratch" to resolve the "limited issues raised by the entrant in its DPL [Decision Point List]."³⁸

31. Had SWBT not been required to provide a new UNE for Ethernet Loops, entry would have been delayed, retarded or denied. The entrant WCC stated that SWBT had been providing unbundled loop for 10Base T Ethernet and 100Base T Ethernet to its end users on an individual case basis, and that unbundled loop was presumptively required to be a UNE. SWBT stated that neither the FCC's rules nor the FTA require it to unbundle

36 In bringing the petition, MCI asserted that SWBT's refusal to provide UDT violated the PUCT Award and precluded MCI's provision of scheduled local service to affected customers until such time as the issue was resolved. Owing to the effect of SWBT's refusal on MCI's ability to provide local service, the Complaint requested expedited treatment, an interim ruling, and penalties and sanctions (under applicable PURA provisions). *Complaint of MCI*, Docket No.18117 Mar. 23,1997 at 9-10.

37 *Petition By Waller Creek Communications, Inc. For Arbitration With SWBT*, Docket No. 17922, Dec. 29, 1997 Award at 5.

38 *Id.* SWBT Post-Hearing Brief at 4.

deregulated, non-telecommunications services. SWBT further contended that 10Base T Ethernet and 100Base T Ethernet are not regulated.³⁹ The Arbitrators found in favor of the entrant, concluding that SWBT should provide unused dark fiber facilities, as requested, subject to the take-back and reciprocity provisions the entrant had willingly accepted.⁴⁰

32. The PUCT is not alone in finding SWBT's regulatory maneuverings, at the very least, uncooperative. For example, in considering SBC's § 271 Application for Oklahoma, the FCC found that Congress intended for Track A to be the primary vehicle for BOC entry in § 271, observing that Congress regarded the presence of one or more operational competitors to be the most reliable evidence that BOC markets are, in fact, open to competitive entry. In rejecting SWBT's interpretation, the FCC found that, under SBC's view, "the BOCs' only incentive would be to cooperate with operational carriers that are already receiving access and interconnection" - rather than, as the statute contemplates the larger and more significant class of carriers - *potential* competitors requesting access and interconnection.⁴¹ The D.C. Circuit recently affirmed the FCC Order and logic in rejecting SBC's narrow reading of "such provider" in Track B, finding that under SBC's interpretation, "BOCs would have a considerable incentive to delay and prevent interconnection...."⁴² The Court concluded:

In truth, neither the statute itself not the legislative history focuses specifically on the issue this case presents. If the draftsmen had so focused, it seems to us quite unlikely that the language of Track B would have been written as it was. Indeed, it is flatly inconceivable that a competent draftsman would have chosen the language of Track B if he or she had

³⁹ *Id.* Arbitration Award at 15.

⁴⁰ *Id.* at 16.

⁴¹ See, e.g., *Application by SBC Communications Inc. Pursuant to 271 To Provide In-Region, InterLATA Services in Oklahoma*, CC Docket No. 97-121, Memorandum Opinion And Order, FCC 97-228, (rel. June 26, 1977) ¶37, ¶42, ¶46, and ¶52.

⁴² *SBC Communications, Inc., et. al. v. Federal Communications Commission*, No. 97-1425, 1998 WL 121492 (D.C.Cir.) at 4.

consciously intended SBC's interpretation.⁴³

2. SWBT's Actions In Pending Cases Convincingly Demonstrate Continuing Monopoly Abuse.

33. The most recent evidence suggests that SWBT's need to have the PUCT "spell out" its obligations has not diminished, even in the shadow of the PUCT's evaluation of SBC's §271 draft application. This section examines three pending PUCT dockets.

34. Docket No. 16226 et. al. EASE for AT&T's UNE implementation. The PUCT has awarded AT&T the right to order and provision UNEs in combination at parity with SWBT, e.g., loop/switch port combinations must be provided at parity with SWBT's delivery of service to its POTs customers served through equivalent SWBT loop and switch ports.⁴⁴ Pursuant to this and other awards, the PUCT requires SWBT to modify its EASE ordering system for AT&T's ordering of UNEs.⁴⁵ AT&T has claimed that, unless EASE is modified as requested, "the potential for AT&T to enter [the residential market] on a high volume UNE basis is nonexistent."⁴⁶ The DOJ in its BellSouth - Louisiana evaluation, similarly stresses the benefit of UNE-based entry for residential customers.⁴⁷ SWBT, however, views the PUCT's Order requiring provisioning of UNEs through EASE as unlawful, although technically feasible. SWBT has pledged to fight the PUCT Order to "the last lawyer" and is refusing to comply with the PUCT Order.⁴⁸

⁴³ *Id.* at 8.

⁴⁴ "Network element combinations provided to AT&T by SWBT will meet all performance criteria and measurements that SWBT achieves when providing equivalent end-user service to its local exchange service customers (e.g., POTS, ISDN)" Docket Nos. 16189, *et. al.* Award of Sept. 29, 1997, Appendix B, "Attachment 6" at 12 and "Attachment 7" at 10.

⁴⁵ *See, e.g.,* Docket Nos. 16226 *et al.*, Order Approving Implementation Schedule and Establishing Docket No. 1900 Regarding Implementation Issues, March 17, 1998 at 13.

⁴⁶ Docket Nos. 16189 *et. al.*, Joint Implementation Schedule of AT&T, MCI and SWBT, February 19, 1998 at 31.

⁴⁷ Evaluation of the U.S. Department of Justice Bell-South Louisiana, Dec. 10, 1997 at 16-17.

⁴⁸ Docket No. 16189 *et. al.*, Arbitration Workshop, Compressed Transcript (Mar. 4, 1998) at 14, 21, 29.

35. Docket No. 18975: Taylor Communications Request for Temporary Injunction
Had the PUCT not granted a temporary injunction, prohibiting SWBT from disconnecting services during the pendency of a dispute over SWBT payment of reciprocal compensation to a small CLEC, Taylor Communications (Taylor) more than 10,000 individuals and businesses would have experienced disrupted telephone and/or Internet service.⁴⁹

36. The basis for the Arbitrator's grant of temporary injunction to Taylor becomes clear when the facts of a related docket, Docket No. 18082, are examined. In October, 1997, Time Warner Communications (TWC) filed a complaint against SWBT. TWC complained that SWBT was violating its interconnection agreements; SWBT owed TWC reciprocal compensation monies related to TWC's termination of SWBT customers' calls to Internet Service Providers (ISPs). In response, SWBT claimed that calls made to ISP customers are not local traffic, consequently, the reciprocal compensation provision in SWBT's interconnection agreements with TWC do not apply. The PUCT found that SWBT's non-payment of reciprocal compensation for the disputed calls violated the interconnection agreements, saying:

The Commission is troubled by SWBT's unilateral decision to refuse payment of reciprocal compensation. *Such conduct, if it recurs, could possibly be found a barrier to entry.* [emphasis added] Now that the Commission has post-interconnection procedural rules, the Commission anticipates that SWBT would make use of those procedures when it believes competitors are misapplying or misinterpreting interconnection agreement provisions.⁵⁰

37. Applying PURA's substantive rules, the PUCT required SWBT to pay past due amounts to TWC with interest.⁵¹ In addressing reciprocal compensation for termination

⁴⁹ *Complaint of Taylor Communications Group, Inc.*, Docket No. 18975, Order No. 1, quoting verified complaint at 1.

⁵⁰ *Complaint and Request For Expedited Ruling of Time Warner Communications*, Docket No. 18082, Order, Feb. 27, 1997 at 6, footnote 6. See also P.U.C. Proc.R. 22.321-328.

⁵¹ *Id.* at 6.

of ISP calls in the TWC proceeding, Docket No. 18082, the PUCT recognized that it was deciding a generic issue of compensation.⁵² With prescience, the PUCT expressed concern about the financial consequences for smaller companies, should SWBT withhold compensation again.⁵³ In the aftermath of the threat to disconnect Taylor, the PUCT's concern that SWBT could bully financially vulnerable entrants with threats of disconnection for non-payment, rather than follow the appropriate procedures, appears absolutely on-target. Clairvoyance wasn't necessary for the prediction; an understanding of how SWBT operates suffices.

38. In granting Taylor's request for temporary injunction, the Arbitrator explained:

Parties Must Comply With Terms and Conditions of Interconnection Agreement The Arbitrator would note that the issue of whether the reciprocal compensation provision for the termination of local traffic in a SWBT interconnection agreement includes compensation for termination of SWBT's customers' calls to ISPs, *has already been addressed* by this Commission....The Arbitrator is troubled by SWBT's unilateral decision to refuse payment of reciprocal compensation, especially in light of the Commission's decision in Docket No. 18082. [emphasis added]⁵⁴

39. In its response to the Arbitrator's issuance of a temporary injunction, SWBT took issue with (1) the PUCT's jurisdiction over Internet traffic; (2) the applicability of the PUCT's TWC finding to Taylor; and (3) the lawful ability of the Arbitrator to issue an injunction.⁵⁵

40. A March 18, 1997 letter to Taylor's legal counsel in which SWBT pledges to comply with the PUCT March 16, 1998 Order enjoining SWBT from disconnecting

52 Commissioner Curran, Final Order Meeting Transcript (Dec. 29, 1997) at 13.

53 Chairman Wood, Final Order Meeting Transcript (Dec. 29, 1997) at 24.

54 *Complaint of Taylor Communications Group, Inc.*, Docket No. 18975, Order No. 1: Granting Temporary Injunction; Requiring Parties To Comply With Terms of Interconnection Agreement During Pendency of Proceeding, March 16, 1998 at 2. (hereafter Docket No. 18975).

55 Docket No. 18975, SWBT Motion for Reconsideration and to Vacate; and Motion to Dismiss and Answer at 1-6.

Taylor, suggests what a post § 271 entry environment might be like. SWBT states that it will make payments to Taylor for Internet traffic terminated on Taylor's network *after appropriate arrangements for adequate financial security and Internet traffic tracking mechanisms can be agreed upon* .[italics and underline added]⁵⁶ On March 19, 1998, SWBT appealed the PUCT Order in Docket No. 18082 to the U.S. District Court.⁵⁷

41. Docket No. 17922: Waller Creek Communications (WCC) Motion to Approve Interconnection Agreement Incorporating and Implementing Arbitration Award On March 23, 1998, WCC filed a petition for Arbitration of its proposed Interconnection Agreement. Included therein is a 13 page, single-spaced affidavit of WCC's CEO, describing the difficulties WCC has had negotiating with SWBT to implement WCC's Dec 29, 1997 Award. Among other infractions, WCC claims:

SWBT refused to abide by the Award provision allowing WCC to use the revised AT&T/SWBT agreement as the baseline; SWBT failed and refused to negotiate in an attempt to develop text to implement the "ISP/Reciprocal Compensation" decision after the PUCT decided the Time Warner case involving the same issue. . . . In short, SWBT has "negotiated" in bad faith in an obvious attempt to deny WCC's [sic] the rights it won. The Company's clear goal is to deny WCC the right and ability to compete.⁵⁸

42. WCC recognizes the financial jeopardy into which it is now placed. WCC explains that SWBT's filing of March 18, 1998, before the Midland-Odessa Federal District Court could effectively create a procedural roadblock against WCC, should SWBT obtain an injunction against the PUC before the PUC issues a ruling in WCC's Motion to Approve the Interconnection Agreement Incorporating and Implementing Arbitration Award.⁵⁹

56 Docket No. 18975, SWBT Motion for Reconsideration, Attachment D at 2.

57 SWBT's Original Complaint for Declaratory and Injunctive Relief, Civil Action No. Mo98CA043, U.S. District Court Western District of Texas, Midland-Odessa Division, March 19, 1998.

58 *Petition by Waller Creek Communications, Inc. For Arbitration with SWBT*, Docket No. 17922, March 23, 1998, Feldman Affidavit at ¶¶4-5.

59 *Id.* Footnote 2 at 10.

43. These PUCT docketed cases indicate that SWBT is relentless in its quest to manipulate the regulatory process to delay, deny and destroy the expected profits of entering SWBT's largest home market. The signal has been so loud, clear and persistent that there can be no doubt whatsoever that investment has been discouraged and entrant plans redrawn.⁶⁰ The PUCT and the FCC possess the ability to corral SWBT until the local market is irreversibly open and, thus, SWBT's energies can be redirected from the preservation of monopoly to activities enhancing competition.

44. At this critical stage of the transition to competition in the local exchange, uncertainty facing potential entrants about the cost of entry is real. How the PUCT responds to SWBT's tactics provides information valuable to potential entrants, who continue to assess how the PUCT navigates (and re-navigates) through arbitrations and, now, § 271 proceedings. All the PUCT's previous hard work in opening the local exchange market in Texas could be lost, if the PUCT were to support SWBT's application prematurely.

B. SWBT has not instituted processes for performance monitoring necessary to ensure consistent wholesale service delivery.

45. In light of FCC requirements, I recommend that before the PUCT recommends entry, it require SWBT to: (1) further disaggregate, analyze and refine data to minimize ambiguity in reported results; (2) eliminate the bankable credit provisions of the SWBT-AT&T agreement, which are anticompetitive, when offering terms and conditions to other CLECs; and (3) demonstrate the viability of its performance monitoring systems at commercial levels of operation. To further SWBT's application before the FCC, I also

⁶⁰ Mr. Charles Land, executive director of the Texas Association of Long Distance Companies testified recently that 20 member companies have obtained SPCOA status. Only half are providing local service as of September, 1997. According to Mr. Land, "...members attempting to compete in the local service market are proceeding cautiously." Hearing before the Senate Interim Committee On Economic Development, Texas State Senate, September 24, 1997 (Tr. at 154). Mr. Land explains that uncertainty over the how issues of availability, reliability and pricing of interfaces are resolved has resulted in certificated members adopting a Wait and see@ attitude toward actual entry. See *id.* (Tr. at 161).

recommend that the PUCT develop specific rules, under PURA §55.006 prohibiting discrimination and restriction of competition. These rules may be modeled after rules promulgated by the Texas Railroad Commission under the Common Purchaser Act (prohibiting discrimination in natural gas purchase).

46. SWBT's stated policy is to treat performance measures as "the fifteenth point on the fourteen point checklist."⁶¹ Policy pronouncements are all to the good. To comply with its statutory burden, however, SWBT must show empirically that nondiscriminatory access is, indeed, provided to OSS functions as required by § 251 and § 271.⁶² The analysis of the previous section as well as SWBT's boast that it offers "the smallest welcome mat" of all the RBOCs,⁶³ requires that SWBT demonstrate a genuine commitment to nondiscrimination in service delivery through implementation of stress-tested performance monitoring systems designed for, and capable of, identifying deterioration in quality of service delivery.

47. The AT&T-SWBT performance negotiations, the PUCT Award,⁶⁴ and negotiations between SWBT and the DOJ have collectively produced a definition and test of parity, an initial set of performance measures, and non-exclusive recourse to liquidated damages when SWBT fails to meet contractually-specified criteria.⁶⁵ This is real progress.

61 SBC draft application – Texas Dysart Affidavit ¶3.

62 "...For the Commission to conclude that Ameritech is providing nondiscriminatory access to OSS functions, we must have a proper factual basis upon which to make such a finding. In this case, Ameritech has failed to provide all of the data we believe are necessary in order to evaluate its compliance with the statutory nondiscrimination standard. As the Department of Justice has stated, 'proper performance measures with which to compare BOC retail and wholesale performance and to measure exclusively wholesale performance, are a necessary prerequisite to demonstrating compliance with the Commission's 'nondiscrimination' and 'meaningful opportunity to compete standards.'" Ameritech at ¶204.

63 Peter Burrows, *Pick of the Litter: Why SBC Is The One To Beat*, Business Week, Mar. 6, 1995 at 70.

64 Docket No. 16189, et al, Amendment and Clarification of Arbitration Award, Nov. 24, 1997 at 6-7, Appendix A and Appendix B.

65 AT&T Interconnection Agreement, Attachment 17: *Failure to Meet Performance Criteria*, dated 2/10/98.

But, the FTA requires more.

48. The FCC has properly set a high standard in order to conclude that an RBOC's commitment to and implementation of performance monitoring is sufficient to ensure compliance with the established performance standards.⁶⁶ In accordance with its standard for §271 applications that local markets in a state have been "fully and irreversibly opened to competition" the DOJ stresses that proper implementation of performance measures is key.⁶⁷ Similarly, the FCC envisions private and self-executing enforcement mechanisms, automatically triggered by noncompliance with the applicable performance standard. The FCC explains: The absence of such enforcement mechanisms could significantly delay the development of local exchange competition by forcing new entrants to engage in protracted and contentious legal proceedings to enforce their contractual and statutory rights..."⁶⁸ The following recommendations address these concerns.

1. SWBT should be required to further disaggregate, analyze and refine data to minimize ambiguity in reported results.

49. If protracted and contentious proceedings are to be avoided, ambiguity in interpretation of results must be held to a minimum.⁶⁹ One source of ambiguity is created when performance measures are not developed in sufficient detail. Said differently, the performance measures are not sufficiently disaggregated. The results reported by Mr. Dysart suggest that greater disaggregation could resolve some of the ambiguity in results he finds.⁷⁰ For example, the comparison of aggregate CLEC data and SWBT data for the

66 Ameritech ¶394.

67 See letter from Donald J. Russell, Chief, Telecommunications Task Force, U.S. Dept. of Justice, Antitrust Division to Liam S. Coonan, Esq, SBC Communications, Inc. dated March 6, 1998.

68 Ameritech ¶394.

69 The PUCT has addressed this issue in its awarded definition of "delaying event." PUC Dockets Nos. 16189, et. al. Nov. 2nd Award, Appendix A, Issue 4.

70 When the phenomena of interest are characterized by different underlying population distribution parameters, one would expect to see the types of variation in month-to-month means and variances Mr. Dysart reports.

residence POTS mean installation interval (No Field Work or NFW) indicates the aggregate CLEC mean exceeds the SWBT mean by more than 3 standard deviations. As Mr. Dysart suggests, further disaggregation of the data to separate New, Transfer and Change orders, or simply Migration (Transfer and Change) orders from New orders is necessary.⁷¹ A similar problem appears to plague the business POTS NFW results;⁷² the business POTS NFW percent installed within 3 days;⁷³ and residence POTS NFW installation reports within 10 days.⁷⁴ It is too early to tell whether these are truly instances of discriminatory CLEC provisioning or not. For similar reasons, reports indicating that CLECs are receiving superior performance are also suspect without further analysis and reporting including a breakdown of the results by individual CLECs and an analysis of differences. SWBT is investigating apparent specific performance breaches that appear in the data for business POTS (FW) percent SWBT caused missed due dates;⁷⁵ business maintenance dispatch receipt to clear out-of-service;⁷⁶ and POTS percent out-of-service less than 24 hours for both residence and business.⁷⁷ Billing metrics for timeliness, accuracy and completeness are under construction.⁷⁸ Data disaggregation, analysis and reporting refinements are necessary to minimize ambiguity in the reporting of results.

2. SWBT should be required to eliminate the bankable credit provisions of the SWBT-AT&T Agreement whenever SWBT offers terms and conditions for the payment of liquidated damages to other CLECs.

71 *Id.* ¶42.

72 *Id.* ¶43.

73 *Id.* ¶46.

74 *Id.* ¶58.

75 *Id.* ¶54.

76 *Id.* ¶70.

77 *Id.* ¶83.

78 *Id.* ¶92.

50. SWBT appears to commit to the SWBT-AT&T or SWBT-MCI negotiated performance measures as a minimum offering to other CLECs. Initially, the PUCT should clarify that other CLECs have the right to “opt in” not only to the performance measures but to the overall performance monitoring frameworks that have been developed, e.g., Attachment 17 of the AT&T-SWBT Interconnection Agreement.⁷⁹ However, other CLECs should not be required to accept, through negotiation or as a directed award, the bankable credit provision of the SWBT-AT&T Agreement.⁸⁰ The bankable credit provisions are anticompetitive.

51. First, the ultimate goal is for SWBT to develop and engineer systems *in which the ability to discriminate is absent*. Assuming the data is properly disaggregated (as discussed above) under a “blind” system design, remaining variation in treatment is entirely random.⁸¹ Second, the presence of “bankable” performance credits available to offset potential performance breaches does not provide SWBT the incentive to develop “blind” systems. Rather, the ability to create credits provides the opposite incentive. Availability of credits encourages SWBT to develop systems designed to manipulate outcomes. If SWBT is able to create positive bank balances, it is likely able to “spend” balances as well, and can thereby target discrimination to periods of maximum competitive damage, e.g., before or during competitors’ expenditure on expensive marketing and

⁷⁹ It is unclear whether SWBT is committing to offer the performance monitoring mechanism or only the measures. Mr. Dysart’s affidavit at ¶4 and ¶ 5, speaks only in terms of performance measures: He says: The performance measures to which SWBT has committed have been included in interconnection agreements in Texas that have been negotiated with MCI and AT&T which are currently under review for the State Commission. Any future interconnection agreements will contain this set of measurements as a minimum, if the CLEC so desires. (*Id.* at ¶5). In the preceding paragraph, Mr. Dysart explains that the CLEC will have to negotiate and pay for any additional performance measures, other than those already negotiated (presumably including those also awarded) to AT&T and MCI. (*See, Id.* at ¶ 4).

⁸⁰ Dockets Nos. 16189, et al. Amendment and Clairification of Arbitration Award, Nov. 24th Appendix A – Liquidated Damages at 1.1.42 and 1.1.43.

⁸¹ In certain cases, however, it may be impossible to move to a “blind” system design, e.g., in the case of operator branded services. For branding purposes, operators identify each CLEC by an eight field identifier appearing on the screen.*Id.* ¶ 130.

advertising campaigns.⁸² (In addition, if overly-aggregative data is “generating” credits, SWBT has no incentive to disaggregate the data.) Third, SWBT has a duty not to discriminate, and to provide CLECs a meaningful opportunity to compete. Monthly bankable credits do not accomplish competitive neutrality.⁸³

3. SWBT should be required to demonstrate viability of performance monitoring systems at commercial quantity levels.

52. Both the FCC and the PUCT have recognized that UNE-based entry must receive parity.⁸⁴ As discussed above, Mr. Dysart’s affidavit makes clear that SWBT systems are not yet ready for “prime time.” Assuming that SWBT disaggregates data and undertakes other revisions necessary to produce consistent wholesale performance at CLEC levels reported in Mr. Dysart’s data, there remains the question of whether SWBT systems will perform at commercial levels of operation. This is particularly important because of the current problems with residential POTs service delivery (noted above) and the fact that, in order for residential customers to participate fully in the fruits competition can bring, it is imperative that CLECs using their own facilities and UNEs to serve residential customers receive nondiscriminatory service. Permitting SWBT to enter long distance under SWBT’s existing performance monitoring capability invites monopoly abuse and regulatory embranchment.

4. Under PURA § 55.006, the PUCT should develop a rule prohibiting specific forms of discriminatory conduct. To address alleged infractions, the rule can be applied under expedited procedures.

⁸² Note that SWBT can accomplish the same objective by failing to staff its operations or otherwise being incapable of ramp-up when commercially meaningful levels of service delivery are required by competitors. Conceivably, there are ways to avoid this outcome through design of systems.

⁸³ In accepting conditions offered by BellAtlantic-NYNEX, the FCC allowed crediting. All merger conditions sunset 48 months after FCC merger approval. *Application of NYNEX and Bell Atlantic for Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, FCC 97-286, August 14, 1997 ¶ 263, item 8.

⁸⁴ BellSouth –South Carolina ¶ 148, See also Ameritech at ¶ 140, ¶ 142.

53. Currently, the only framework for providing “swift and certain” consequences for violations of parity in service delivery are the negotiated (and awarded) provisions of interconnection agreements. The FCC in its local competition order has recognized that the monopolist holds “all the cards” in a typical bargaining situation, and in this respect the bargain struck does not resemble a commercial transaction. The DOJ has found this problem of unequal bargaining power to apply specifically to the negotiation of performance measures. In reviewing SWBT’s prior application for interLATA entry in Oklahoma, the DOJ’s independent expert on performance measures, Mr. Friduss, noting a lack of performance measures referenced in interconnection agreements, explained:

Based on discussions with numerous CLECs, a primary reason for this [lack of references] appears to be the weakness of the CLEC negotiating positions and a higher priority placed on entering the market versus delaying negotiations or enduring arbitrations to establish long-range safeguards such as performance measures. The CLECS reason that once in the market, they’ll attempt to renegotiate the subject of performance measures, or merely rely on those established by larger carriers such as AT&T. As a result, interconnection agreements in general, and as discussed below SWBT’s in particular, provide insufficient performance measures necessary to allow for a § 271 determination of nondiscriminatory performance of wholesale functions.⁸⁵

54. Similarly, in recognition of the diminished power of CLECs to achieve conditions of parity through negotiation, the FCC has stated:

Because section 271 of the Act requires BOCs to comply with the statutory standard of providing nondiscriminatory access to OSS functions, evidence showing that a BOC is satisfying the performance standards contained in the interconnection agreements does not necessarily demonstrate compliance with the statutory standard. If a BOC chooses to rely solely on compliance with performance standards required by an interconnection agreement, the Commission must also find that those performance standards embody the statutorily-mandated nondiscrimination standard.⁸⁶

⁸⁵ *Application of SBC Communications, In. et al, Pursuant to Section 271 of FTA 1996 to Provide In-Region InterLATA Services in the State of Oklahoma*, CC Docket No. 97-121, Affidavit of Michael JFriduss On Behalf of the Antitrust Division, DOJ, May 20, 1997 ¶68.

⁸⁶ Ameritech at ¶ 142.

55. The PUCT has an opportunity and the authority to provide a forum for “swift and certain” resolution of issues related to discrimination. To advance competition and minimize costs for SWBT and entrants alike, the PUCT could craft a clear and specific rule providing the PUCT’s view of what constitutes discriminatory conduct in service delivery. There are at least four competition-enhancing benefits from this undertaking. First, by identifying the PUCT’s view of the relationship between data, analysis, and damages (e.g., the issues addressed in SWBT-AT&T Attachment 17) necessary for a regulatory (as opposed to contractually-negotiated) finding of discrimination in a rule, the PUCT provides an explicit regulatory standard of discrimination. Second, the PUCT rule serves as a “default” or backstop for CLEC negotiation of performance measures and monitoring standards. Third, the rule when combined with expedited procedures provides “swift and certain” dispute resolution (e.g., as contemplated by P.U.C. Proc. R. 22.327) for SWBT and CLECs alike. Fourth, the rule addresses FCC uncertainty concerning the operation of “self-enforcing” mechanisms, post-entry.

56. The Code of Conduct recently promulgated by the Railroad Commission of Texas⁸⁷ and other provisions of the Common Purchaser Act,⁸⁸ e.g., the ability of the Commission to initiate a mandatory suit for injunction against a common purchaser who is discriminating in purchases; the ability to require forfeiture of the charter of corporations found to violate the Act; and the “death penalty” provision enjoining and prohibiting certain common purchasers from doing business in Texas all speak to the extremely serious nature of practicing discrimination in natural gas transportation services. Discrimination in service delivery to local exchange competitors should be taken with equal seriousness. The PUCT has the authority to create a regulatory and enforcement

87. The Code sets out five standards of conduct. Violations of the standards could constitute illegal discriminatory activity and warrant action by the TRC or a court. The Commission’s informal complaint procedure may also be invoked. The Natural Gas Transportation Standards and Code of Conduct. Texas Railroad Commission, adopted August 18, 1997.

88 The Common Purchaser Act (V.T.C.A. Natural Resources Code) Chapter 111, §§111.091-095.

scheme which makes it unprofitable for SWBT to practice discrimination in service delivery now and post-interLATA entry. Once such a scheme is in place, the PUCT should approve SWBT entry into interLATA competition.

VI. Conclusion

57. Considering SWBT's ability and evident desire to continue using the regulatory process so as to delay, deter and deny entry into the local exchange, it is premature to support SWBT's application for in-region interLATA authority before the FCC. However, the PUCT can take actions to assist SWBT in directing its energies from monopoly abuse toward outlets that enhance competition. The four recommendations for modifying SWBT's current performance monitoring are steps to transform SWBT's incentives. These recommendations should be implemented before the PUCT supports SWBT's application.

The information contained in this affidavit is true and correct to the best of my knowledge and belief.

SIGNED on April 1, 1998.

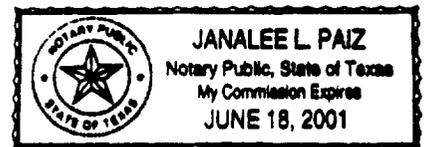
Sarah Goodfriend
Sarah J. Goodfriend

SWORN TO AND SUBSCRIBED BEFORE ME on April 1, 1998 by Sarah J.

Goodfriend.

Janalee L. Paiz
Notary Public, State of Texas

My Commission expires:



ATTACHMENT

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Summary of Qualifications

Sarah Goodfriend is actively engaged in analyzing and developing policy in response to the changing frontier of electric and telecommunication utility regulation. Sarah combines a strong analytical background with extensive, yet varied, practical experience in regulation and competition analysis. Having worked as a policy advisor and expert witness for the Federal Trade Commission and the Federal Energy Regulatory Commission, she understands national regulatory policy "from the bottom up." Having worked as a staff member, division director, and Commissioner of the Public Utility Commission of Texas, she understands state regulatory policy "from the top down." Sarah is often invited to address national and regional meetings on regulatory and competition issues. Immediately prior to starting her consulting practice, Sarah worked for MCI Telecommunications as a national regulatory policy strategist. As A Ph.D. economist, she has testified as an expert witness on behalf of each of her previous employers.

EXPERIENCE

Goodfriend Consulting, Austin, TX

Principal, 9/97 - present Provide advice and advocacy for client's economic, regulatory and antitrust policy positions. Specialty areas include antitrust and competitive issues, market power, discrimination, economies of scope and scale, efficient pricing and investment incentives and public welfare effects of industrial and regulatory change, with applications for the U.S. electric power and telecommunications industries.

MCI Telecommunications Corporation, Washington, DC

Executive Staff Member, Regulatory and Public Policy Analysis 9/95 - 5/97 Joined four person team of economists responsible for creation of MCI's national economic regulatory strategy. Specific responsibilities included developing and delivering presentations to the FCC, NARUC and State PUCs. Expert witness testimony addressed competitive, economic and regulatory aspects of federal and state implementation of the Federal Telecommunications Act of 1996. Directed outside teams of economic and engineering experts advocating MCI's national regulatory policy.

Public Utility Commission of Texas (PUC), Austin, TX

Commissioner 9/93 - 5/95 Appointed by Governor Ann Richards to the three member commission responsible for regulating the electric and telephone utilities of Texas. Advocated for procompetitive regulatory reforms. Significant electric decisions included the Texas Utilities' rate proceeding and the proposed CSW-EPEC electric merger. Significant telecommunications decisions reformed telecommunication utility pricing and required unbundling of network components.

Public Utility Commission of Texas -- continued

Director, Economic and Regulatory Policy Division 11/92 - 8/93

Graduate Internship, Economic Research Division Summer, 1980

Economist, Economic Research Division 5/78 - 5/79

Federal Energy Regulatory Commission (FERC), Office of Economic Policy, Washington, DC
Advisory Economist and Expert Witness 6/87 - 9/92

Federal Trade Commission (FTC), Bureau of Economics, Washington, DC
Expert Witness and Research Economist 10/85 - 6/87

***Carolina Power and Light Company, Conservation and Load Management Department,
Raleigh, NC Consulting Economist 5/83 - 5/84***

***University of North Carolina, Department of Economics, Chapel Hill, NC
Teacher Training Program Supervisor 5/81 - 5/83, Teaching Instructor 8/80 - 5/81,
Research Assistant 8/79 - 5/80***

EDUCATION

- Ph.D. Economics, University of North Carolina, Chapel Hill, NC 1985**
Dissertation: *Estimation of a Q-Ratio Function for Regulated Electric Utilities: A Test of the Stigler-Peltzman Hypothesis of Regulatory Behavior*
- B.A. Economics (with high honors), University of Texas, Austin, TX 1978**
Phi Kappa Phi Honorary Society
Grinnell College, Grinnell, IA 1974-1976

EXPERT WITNESS TESTIMONY

Client or Sponsor	Caption of Proceeding	Before the	Testimony and Date
Coalition of Commercial Customers	Application of Houston Lighting and Power Company For A Change in Accounting Procedures and Approval of Certain Base Rate Credits	Public Utility Commission of Texas	Direct 3/98 Deposition 3/98 Cross-Examination 3/98
Enron Energy Services	Texas-New Mexico Power Company's Application for Approval of TNMP's Transition Plan	Public Utility Commission of Texas	Direct 2/98 Cross Examination 3/98
Texas Office of Public Utility Counsel, Missouri Office of Public Utility Counsel, Consumer Federation of America and Consumers Union	Motion for Leave to File Brief <i>Amicus Curiae</i> and Brief in Support in SBC, et al. Plaintiffs v. FCC and USA defendants	U.S. District Court for the Northern District of Texas – Wichita Falls Division (Civil Action No. 7-97-CV-163-X)	Attachment (Affidavit) 11/97
Waller Creek Communications Inc.	Petition for Arbitration of Interconnection with SWBT-Texas	Public Utility Commission of Texas	Affidavit 10/97 Direct 11/97 Deposition 11/97 Cross Examination 11/97

MCI Telecommunications Corp. and MCImetro Access Inc.	Petition for Arbitration of Interconnection with GTE of Florida	Florida PSC	Direct 8/96 Rebuttal 9/96 Deposition 9/96
	Petition for Arbitration of Interconnection with Bell South of North Carolina	North Carolina UC	Direct and Rebuttal 9/96 Cross Examination 10/96
	Petition for Arbitration of Interconnection with GTE of North Carolina	North Carolina UC	Direct 9/96 Rebuttal 10/96 Cross Examination 11/96
	Petition for Arbitration of Interconnection with Southwestern Bell of Missouri	Missouri PSC	Direct 9/96 Rebuttal 10/96 Cross Examination 10/96
	Petition for Arbitration of Interconnection with Bell South of Kentucky	Kentucky PSC	Direct 10/96 Cross Examination 11/96
	Affidavit in Opposition to GTE Supplemental Non- Recurring Cost Studies	Kentucky PSC	Affidavit 3/97
Public Utility Commission of Texas	Impact of Federal Telecommunications Legislation on Texas Regulatory Policy	Texas State Senate Joint Interim Committees on Telecommunication and the PUC	Report 5/94
	PUC Initiatives Related to NAFTA	Texas State Senate Committee on International Relations, Trade and Technology	Report 12/94
Staff of the Federal Energy Regulatory Commission	Proposed Merger between Southern California Edison and San Diego Gas and Electric Company	FERC ALJ	Direct 5/89 Cross Examination 5/90
	Northeast Utilities Service Co. (Re: Public Service Company of New Hampshire)	FERC ALJ	Direct 5/90 Rebuttal 6/90 Deposition 6/90 and 7/90
Bureau of Economics of the Federal Trade Commission	Analysis of the 256K DRAM Market in Japan	U.S. Dept. of Commerce ALJ	Direct 4/86
	Analysis of the DRAM Market in Japan	U.S. International Trade Commission	Direct 4/86 Cross Examination 4/86

NATIONAL PRESENTATIONS OR PAPERS

Policies For Telecommunications And The Electric Industry: Industry Differences and Transition Pricing, NARUC Staff Subcommittee on Communications, Washington DC,

2/97

- Breaking the Enduring Local Bottleneck: Prospects for Local Competition*, Consumer Leaders Forum, MCI Telecommunications, Washington DC, 3/96
- Federal-State Legislation and Regulation: Competition in the Local/IntraLata Markets*, Bonbright Center 16th Annual Telecommunications Conference, Atlanta, GA 3/96
- Incentive Design and Pricing Flexibility in Telecommunications*, 27th Annual Conference of the Institute of Public Utilities, Williamsburg, VA, 12/95
- Assessing The Workability Of Competition In Utility Industries*, NARUC Annual Regulatory Studies Program, East Lansing, MI, 8/95
- Utility Consolidation and Reorganization*, NARUC Annual Regulatory Studies Program, East Lansing, MI, 8/95
- Preparing for a Competitive Structure: Unbundling and Revaluing Utility Assets*, Current Issues Challenging the Regulatory Process, Center for Public Utilities, Santa Fe, NM, 3/95
- Experience and Implementation Issues of Incentive and Performance Based Regulation*, Commissioners' Policy Information Forum, NARUC Subcommittee on Commissioner Education, Washington, DC, 2/95
- Federal-State-Local Telecom Summit on Public Right of Way (NARUC representative)*, Annenberg Washington Program and the Department of Commerce, Washington, DC, 1/95
- Regulatory Challenges of Horizontal Restructuring*, 26th Annual Conference of the Institute of Public Utilities, Williamsburg, VA, 12/94
- Regulators on Retail Wheeling*, Fitch Research Special Report, Fitch Investors Service, Inc., New York, NY, 10/94
- What Its Like to be a Utility Regulatory Commissioner*, NARUC Biennial Regulatory Information Conference, Columbus, OH, 9/94
- Assessing The Workability Of Competition In Utility Industries*, NARUC Annual Regulatory Studies Program, East Lansing, MI, 8/94
- Telecommunications: The Next American Revolution*, Contributed to Chapter Seven (Universal Service) of the National Governors' Association Report, Washington, DC, 7/94
- Do We Need New or Different Regulatory Bodies? New Authorities?* KMB Video Conference - Reinventing State Regulatory Structures in the Convergence Era, St. Petersburg, FL, 5/94
- International Activities of Utility Affiliates - When and Where is Regulation Needed?* American Bar Association Seventh Annual Conference on Electricity Law and Regulation, San Antonio, TX, 3/94
- Presentation and Q and A Interview with Financial Analysts*, Regulatory Research Associates, Inc., New York, NY, 3/94
- Analyzing Mergers in Markets in Competitive Transition*, Annual Conference of the Southern Economic Association, Washington, DC, 11/92 (Published in NARUC Biennial Information Conference Proceedings, Columbus, OH, 12/92)
- Public Utility Regulation*, Annual Conference of the Southern Economic Association, Washington, DC, 11/92
- Developments in Transmission Access in Electricity Markets*, Southeastern Electric and Gas Utility Conference, University of Georgia, Atlanta, GA, 10/92
- Analyzing Market Power in Electric Utility Mergers*, NARUC Biennial Information Conference, Columbus, OH, 9/92
- Electricity Markets and All Resource Options: Beyond Integrated Resource Planning* EMA, EDF, NEES, PG&E, and SRC, sponsors, San Francisco, CA, 2/92
- Applying Antitrust Principles in the Electric Utility Industry: Market Definition in Utility Mergers* Advanced Workshop in Regulation and Public Utility Economics, Rutgers

University, San Diego, CA, 7/90

REGIONAL PRESENTATIONS OR PAPERS

- Analyzing Market Power*, Training Seminar for Commissioners and Staff, Public Utility Commission of Texas, Austin, TX 1/98
- An Economic Analysis of Issues to be Arbitrated Under Section 252 of the Telecommunications Act of 1996, An Economic White Paper on behalf of MCI Telecommunications Corp.* by August H. Ankum, PhD, Steve R. Brenner PhD, Richard Cabe PhD, Nina W. Cornell, PhD, Sarah Goodfriend PhD, A. Daniel Kelley PhD and Terry L. Murray, Washington, DC, August 28, 1996
- Yes, Regulators Are Still Out There - State Regulation*, Moderator, Texas Association of Long Distance Telephone Companies, Twelfth Annual Conference and Trade Exhibition, Austin, TX, 4/95
- Trends and Directions at the Public Utility Commission*, Texas Renewables 94 Conference, Austin, TX, 11/94
- Universal Service Fund*, Five State Regulatory Conference, Tulsa, OK, 10/94
- Telecommunications Planning Efforts in Texas*, UT System Office of Telecommunication Services, Telecommunication and Networking in Higher Education, Austin, TX, 10/94
- Regulatory Structure Roundtable*, Oklahoma Corporation Commission Telecommunications Symposium, Stillwater, OK, 7/94
- The Role of Regulators in an Increasingly Competitive Electric Industry*, Fall Conference of the Gulf Coast Cogeneration Association, Austin, TX, 9/94
- Public Utility Commission of Texas – Who We Are and What We Do*, University of Texas at Dallas, Richardson, TX, 5/94
- Regulatory Trends at the Public Utility Commission*, Texas Industrial Energy Consumers Annual Meeting, Houston, TX, 5/94
- The Information Economy and Global Competitiveness: Are We All (or Soon to be) Accountants Now?* Texas Society of Certified Public Accountants, Austin, TX, 4/94
- Update on the Public Utility Commission of Texas*, Senior Citizens Alliance, Ft. Worth, TX, 4/94
- Update on Public Utility Commission of Texas*, Travis County Bar Association's Administrative Law Section, Austin, TX, 3/94
- Interview - Goodfriend Speaks Out on Merits of Competition, Measured Phone Service, Special Interest Groups, Economic Development Rates, Other PUC Issues*, Texas State Agencies Newsletter, Vol. 2, No. 16, 2/26/94
- Energy Policy Act Implementation in Texas*, Fall Conference of the Gulf Coast Cogeneration Association, Austin, TX, 10/93

PROFESSIONAL ACTIVITIES

- National Regulatory Research Institute, Board of Directors 1993 - 1995
- National Association of Regulatory Utility Commissioners, Committee on Communications 1993 - 1995
- National Association of Regulatory Utility Commissioners, Chair, Staff Subcommittee on Strategic Electric Issues 1992 - 1993
- Center for Public Utilities, Advisory Council 1995
- American Economic Association
- American Bar Association (Associate)

PETITION ATTACHMENT 2

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

RECEIVED
OCT 15 1998
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In Re Applications of)
)
AMERITECH CORP.,)
Transferor,)
)
AND)
) CC Docket No. 98-141
SBC COMMUNICATIONS, 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 5, 22, 24, 63, 90, 95 and 101)
of the Commission's Rules)

AFFIDAVIT OF AUGUST H. ANKUM

ON BEHALF OF THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

October 14, 1998

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Regulatory and External Affairs Division. In this capacity, I testified on behalf of TCG in proceedings concerning local exchange competition issues, such as Ameritech's Customer First proceeding in Illinois. From 1986 until early 1994, I was employed as an economist by the Public Utility Commission of Texas ("PUCT") where I worked on a variety of electric power and telecommunications issues. During my last year at the PUCT, I held the position of chief economist. Prior to joining the PUCT, I taught undergraduate courses in economics as an Assistant Instructor at the University of Texas from 1984 to 1986.

4. A list of proceedings in which I have filed testimony is attached to this Affidavit.

II. SUMMARY

5. In this affidavit, I will demonstrate the following:

- SBC's proposed merger signifies a regulatory failure -- with SBC and Ameritech being the culprits here -- to fully implement the procompetitive provisions of the Telecommunications Act of 1996 (Act of 96). If competitors are truly offered non-discriminatory access to the ILECs facilities, then there should be only minimal advantage to owning or merging with an incumbent network and all carriers would be able to compete, not just SBC.
- SBC's market definition fails to distinguish between upstream and downstream markets, thus ignoring the damage the merger will do to competition in upstream markets.
- SBC and Ameritech are vertically integrated firms with wholesale and retail divisions. Privileged access by SBC's retail division to Ameritech's wholesale division after the merger extends the discriminatory advantages of incumbency to SBC. That is, it allows SBC to compete in Ameritech's serving area as an ILEC rather than as a CLEC, an advantage which may be decisive after derailment of the Act of 96.
- A merger between SBC and Ameritech will hamper competitive efforts to lower prices. For certain customers, the merger will actually raise prices.

- The alleged benefits of the merger are overstated and, possibly, may never materialize at all.
- The merger should be denied.

III. SBC'S NATIONAL/LOCAL STRATEGY REPRESENTS REGULATORY FAILURE TO IMPLEMENT THE PRO-COMPETITIVE PROVISIONS OF THE ACT OF 96

6. The Act of 96 was supposed to have opened local markets by providing competitors non-discriminatory access to the ILEC's networks and wholesale services. Ideally, such non-discriminatory access would permit efficient competitors to enter local markets with only minimal capital requirements and without the need to own a ubiquitous network. However, SBC's proposed merger is a clear demonstration that this policy objective has not been achieved. In its application, SBC demonstrates that the provisions of the Act of 96 -- as currently implemented -- do not allow carriers, not even powerful ones such as SBC and Ameritech, to enter out-of-region local markets viably.

7. SBC's stated motivation for the merger is an alleged need to offer nationwide service to all relevant customers:

Customers now see an opportunity to obtain what they want -- the option of having one principal source of service, one source of contact and consolidated lines across the nation and around the world. Telecommunications companies that are not satisfied with being regional and/or niche competitors are moving to obtain the capabilities necessary to provide such services around the world. (James Kahan, p. 10.)

8. In view of this need to offer services nationwide, SBC and Ameritech argue that they need to merge their operations. Only with an expanded joint territory and increased financial strength will they be able to operate viably outside their own regions. Without

the merger, SBC and Ameritech claim, they will be relegated to the sidelines as fringe players in the scrimmage to offer nationwide one-stop shopping.

9. To demonstrate their inability to viably offer service out of region, both SBC and Ameritech regale the Commission with the details of their failed business ventures. As if failure were a virtue, their affidavits state the following:

Our reason for electing not to pursue CAP opportunities at that time included such factors as the initial operating losses (Affidavit of Jason Weller on behalf of SBC, p. 15.)

Resale gross margins were too small (Affidavit of Jason Weller on behalf of SBC, p. 17.)

10. SBC's and Ameritech's experiences are, of course, not unique. The industry is painfully aware that it is nearly impossible to successfully break into local exchange markets *as a CLEC*. In fact, it is a source of great frustration for many market participants, especially the long distance carriers, which have yet to find a *profitable* venue for entry.

11. The FCC itself, in its BA/NYNEX Order, cites the dismal operating results for the former MFS and TCG, which thus far had been the two largest CLECs:

TCG had 1996 gross revenues of \$267.7 million and a net loss of \$114.9 million. MFS had 1996 revenues of \$4.49 billion and a net loss of \$2.2 billion. (BA/NYNEX Order, paragraph 88.)

12. Thus, SBC's and Ameritech's experience *vindicates* the long standing complaint of their competitors that the battle between ILECs and CLECs is unevenly matched. The ILECs, by virtue of their incumbency and control over the critical local loop facilities

have an inherent advantage over the CLEC that still has not been diminished by any meaningful degree. Neither the Act of 96, the FCC's Orders nor the State Commissions' efforts have succeeded in lessening the ILECs' grip on market power. Indeed, nearly a decade and a half after divestiture the jury is still out on the question of whether the term "local exchange competition" is an oxymoron.

13. Yet, the Act of 96 provides for all the necessary conditions to stimulate local exchange competition. To recapitulate briefly, the Act of 96 provides that the ILECs are required to offer to competitors: interconnection and the ability to lease unbundled network elements; retail services at wholesale rates; reciprocal compensation for transport and termination of local calls; collocation services to competitors. Under the Act of 96, ILECs are also required to implement number portability and dialing parity.

14. Of course, the passage of the Act of 96 did not in and of itself ensure the successful implementation of the Act's pro-competitive provisions. However, *if* the procompetitive provisions of the Act of 96 are appropriately implemented, *then* surely local exchange competition will flourish.

15. That the pro-competitive provisions of the Act of 96 *have not been implemented appropriately* is abundantly clear by now. AT&T, MCI and others have long complained that the resale discounts offered by the RBOCs and GTE are insufficient to enter local markets profitably. The prices for unbundled elements and the associated non-recurring charges continue to be too high to allow for viable margins. To make matters worse,

RBOCs continue to balk at the simple requirement to recombine network elements for dependent competitors. And, as if all of this were not bad enough, no RBOC has, as of yet, implemented operation support systems that allow non-discriminatory access to their networks and services on a wholesale basis.

16. Having tried unsuccessfully to enter out-of-region local markets by using the provisions of the Act of 96 themselves, SBC and Ameritech now *corroborate* the painful experience of the IXCs and other CLECs.

17. In short, SBC's proposed merger with Ameritech is a sobering confirmation of the failure of the Act of 96. Further, SBC's proposed merger with Ameritech is the clearest demonstration to date that the only economically viable means of entering out-of-region local markets on a wide scale basis is *not by using the provisions of the Act of 96* but by *merging with the out-of-region incumbent LEC*.

18. SBC and Ameritech have determined -- and rightly so -- that it is far easier to compete as an *ILEC* than it is to compete as a *CLEC*. SBC's proposed merger, therefore, should be viewed by policy makers as a well-reasoned strategy to secure for SBC and Ameritech the *continued advantages of incumbency*.

19. But, while SBC's proposed merger with Ameritech may represent a rational and commendable corporate maneuver, if approved, it would be deplorable as a matter of

public policy. To be sure, approval of this merger for the reasons stated by SBC concedes and ensures -- prematurely and unnecessarily -- the failure of the Act of 96.

20. The appropriate response is to deny SBC's merger proposal and to review the RBOCs tariffs and other terms and conditions under which resale and unbundled network elements are made available to competitors. *After all, if competitors are truly offered non-discriminatory access to the ILECs facilities, then there should be only minimal, if any, advantage to owning the incumbent network.* That is, if the provisions of the Act are implemented appropriately, SBC's proclaimed need to merge with Ameritech would be substantially diminished. SBC's predicament of how to serve customers nationwide would be largely resolved. The right public policy response, therefore, is not to approve the merger. Instead, the FCC should focus its efforts on salvaging and restoring the provisions of the Act of 96. In doing so, it would -- consistent with the Act of 96 -- create conditions under which *all carriers* are able to compete nationwide, and not just SBC. Merger approvals should not become a public policy substitute for implementing the pro-competitive provisions of the Act of 96.

IV. MARKET DEFINITION: SBC'S MARKET DEFINITION FAILS TO DISTINGUISH BETWEEN UPSTREAM AND DOWNSTREAM MARKETS

21. As discussed in the accompanying Affidavit of Dr. Shepherd on behalf of OPUC, an appropriate analysis of the effects of a proposed merger is critically dependent upon the proper identification of the relevant markets. I am not convinced, however, that the FCC in its analysis of the proposed SBC merger with Ameritech should follow the same

approach as it did in the BA/NYNEX case. Specifically, I believe that in the BA/NYNEX case, the FCC focused too much on the effects of the merger on *retail customers in downstream markets* and too little on the effects on BA's and NYNEX's *dependent competitors in the upstream markets*. In fact, I believe that the FCC largely and inappropriately ignored the effects of the merger on upstream markets.

22. In paragraph 50 of the BA/NYNEX Order, the FCC defined the relevant *product* markets for purposes of the proposed BA merger with NYNEX as follows: (1) local exchange and exchange access service; (2) long distance service; and (3) local exchange and exchange access service bundled with long distance service.

23. The FCC then went on to specify three customer groups with similar demand patterns: (1) residential and small business; (2) medium-sized business; and (3) large business/government users. It appears, therefore, that the FCC's market analysis has focused predominantly, if not exclusively, on the effect of the merger on retail services offered to end-users.

24. Specifically, the FCC noted:

For the purposes of this decision, however, we will focus on the competitive effects of the merger on local exchange and exchange access service in LATA 132/New York metropolitan area and on bundled local long distance services originating in LATA 132/New York metropolitan area ("the relevant markets") that are offered to residential and small business customers. (BA/NYNEX Order, paragraph 57.)

25. Clearly, therefore, the FCC's focus was on the effect of the merger on retail customers in downstream markets. *No attention was given to the effect of the merger on BA's and NYNEX's wholesale customers in the upstream markets that are also BA's and NYNEX's dependent competitors.*

26. Mirroring the FCC's approach to defining markets in the BA/NYNEX case, the SBC affiants state the following:

In the current case, the only geographic markets in which the merger could have any effect on actual or potential competition are the St. Louis and Chicago LATAs where SBC and Ameritech own competing cellular systems and are respectively the incumbent wireless carriers. (Schmalensee and Taylor Affidavit, p. 13.)

27. The SBC affiants then go on to conclude:

The merger of SBC and Ameritech will not combine any entities that compete to any meaningful extent with one another in any relevant geographic market for any product or service. (Schmalensee and Taylor Affidavit, p. 13.)

28. Thus, the FCC's focus on retail markets is gratefully adopted by SBC. As will be demonstrated shortly, SBC's focus on retail markets obscures the detrimental impact of the merger on SBC's and Ameritech's dependent competitors in the upstream markets.

V. THE FCC SHOULD SEPARATELY EVALUATE THE EFFECT OF THE MERGER IN UPSTREAM AND DOWNSTREAM MARKETS

29. In defining the appropriate markets for purposes of a market-power analysis, the FCC should recognize that SBC and Ameritech are *vertically integrated firms*. Each one of these two companies consists of a wholesale division and a retail division. The wholesale division installs and runs the actual network. It also provides wholesale services to its

own retail division and to *dependent* competitors. Under the Act of 96, the wholesale division must provide wholesale services to its own retail division and dependent competitors on a non-discriminatory basis.¹ (As is discussed elsewhere in this affidavit, dependent competitors do not receive non-discriminatory access.) The retail divisions of SBC and Ameritech offers products to retail customers, i.e., to end-users.

30. This conceptual framework which bifurcates the ILEC's operations into a wholesale division and a retail division is consistent with the FCC's findings in a number of proceedings. Most notably, in its Local Competition Order, CC Docket No. 96-98, the FCC explicitly recognizes that the ILECs are vertically integrated firms consisting of a wholesale division and a retail division.² Indeed, the bifurcation of the ILEC's operations into a wholesale and a retail operation underlies the FCC's TELRIC methodology and the avoided cost methodology for determining resale discounts. The same conceptual framework is pertinent in the current proceeding.

31. In analyzing the effect of the merger, the FCC should consider the following matrix of interactions:

¹ See FCC's interpretation of the pricing provisions of the Act of 96 as discussed of its TELRIC methodology in the vacated portions of the Local Competition Order, paragraphs 674 through 703. While the construction permeates the discussion, paragraph 691 provides a good example: "Retailing costs, such as marketing or consumer billing associated with retail services, are not attributable to the production of network elements that are offered to interconnecting carriers and must not be included in the forward-looking direct cost of an element."

² See FCC's discussion of its TELRIC methodology in the vacated portions of the Local Competition Order, paragraphs 674 through 703.

	SBC Retail Division	SBC Wholesale Division
Ameritech Retail Division	<i><u>Horizontal</u> merger</i>	<i>Merger represent <u>vertical</u> integration. Ameritech's retail division gains access to SBC's wholesale operations.</i>
Ameritech Wholesale Division	<i>Merger represents <u>vertical</u> integration. SBC's retail division gains access to Ameritech's wholesale division.</i>	<i><u>Horizontal</u> merger. Local networks do not compete with one another in geographically distinct regions.</i>

32. As the above matrix indicates, the FCC should separately analyze the effect of the merger for SBC's and Ameritech's wholesale and retail divisions.

33. In its BA/NYNEX Order, the FCC focused almost exclusively on only one cell in this matrix: the merger of the retail divisions. As discussed above, the FCC considered only the effect of the merger on retail markets and the degree of competition in those retail markets. The FCC did not consider the ramifications of permitting the mergers of the retail divisions with the out-of-region wholesale divisions.

34. In what follows, I will discuss the relevant markets in view of the above matrix of interactions.

The relevant market for analyzing the effect of a merger of SBC's retail division with Ameritech retail division is their combined serving areas

35. I disagree with SBC that the relevant markets for merger analysis are the St. Louis and Chicago areas. (See Joint Affidavit of Schmalensee and Taylor, pp. 11 - 13.)

36. For purposes of defining the relevant market, the Commission should note that if the customer has locations nationwide, then marketing managers will eventually define the relevant market as a national market. In fact, SBC's own affidavit speaks to the need to provide large customers with nationwide service. Again,

Customers now see an opportunity to obtain what they want -- the option of having one principal source of service, one source of contact and consolidated lines *across the nation* and around the world. (Emphasis added.) (James Kahan, p. 10.)

37. Thus, for the *retail divisions* of SBC and Ameritech, which provides products and services to end-users, the relevant product market is not Chicago and St. Louis, but their combined serving areas, with the possible exception of rural areas.

38. Further, SBC's and Ameritech's arguments (see affidavits of Kahan, Osland) that they did not have active plans to invade one another's regions (St. Louis and Chicago, respectively) are at odds with the remainder of their application. SBC's affiant, Kahan, notes that there will be "two types of firms." (Kahan, p. 9.) On the one hand there will be a large number of smaller niche players serving *distinct geographic areas or market segments*. On the other hand, there will be a "smaller number financially strong, technically capable, fully integrated national and global competitors." (Kahan, p. 10.) Stating the obvious, Kahan then observes "SBC and Ameritech have concluded that a regional or niche strategy is not in the best interest of their customers, employees and shareholders" (p. 10.) Clearly, the mandates of an evolving market place are that large companies such as SBC and Ameritech eventually would have to compete with one another.

39. In view of this, it is clear that SBC's and Ameritech's assertions, that they did not have active plans to compete in one another's territories, in no way demonstrates that the proposed merger is a horizontal merger with no overlapping markets. Rather, it is an indication that both companies recognize their predicament: (1) the marketplace requires that sooner rather than later, they will have to compete; (2) *de novo* entry is too expensive (Kahan, p. 5); and (3) SBC's and Ameritech's regulatory departments have done such a good job at defense that offense (market entry), by means of unbundled elements and resale, is not commercially viable. It is a stand-off between two Goliaths, each unwilling to approach the other for combat.

40. The relevant markets for analyzing the effect of merging SBC's and Ameritech's retail divisions is the combined serving areas of SBC and Ameritech, with the exception, perhaps, of more rural areas. Both companies are likely competitors of one another in the larger metropolitan areas. As demonstrated by SBC and Ameritech itself, this is particularly true for larger customers with locations in both SBC's and Ameritech's regions.

Under the vertical merger arrangements SBC's and Ameritech's retail divisions will gain access to formerly out-of-region wholesale operations

41. As indicated in the above matrix of interactions, the retail division of Ameritech will gain access to the wholesale division of SBC and, conversely, the retail division of SBC

will gain access to the wholesale division of Ameritech. As such, the proposed merger between SBC and Ameritech should be viewed also as a vertical merger.

42. Currently, SBC's and Ameritech's retail divisions are dependent on the provisions of the Act of 96 when they want to offer their large customers local service out-of-region. While today there may only be few instances in which SBC and Ameritech offer local service out-of-region, the need to accommodate large customers in this manner will become more common over time. SBC's own affidavits are replete with references to the growing need to offer one-stop shopping to larger customers. In fact, this perceived trend in the industry is put forth by SBC as the *raison d'être* for the merger. The ability of SBC's and Ameritech's retail divisions to access the formerly out-of-region wholesale divisions will become increasingly significant.

43. In view of this, the relevant market should again be defined as the combined serving areas of SBC and Ameritech, with the possible exception of the rural areas.

VI. MARKET PARTICIPANTS

44. In paragraph 71 of its BA/NYNEX Order, the FCC concluded that "five companies -- NYNEX, Bell Atlantic, AT&T, MCI, Sprint -- are the most significant market participants: that is, they are either in the market already or are the most likely to enter and to have an effect on the market for local exchange and exchange access services, and bundled local exchange, exchange access and long distance services to the mass market."

45. Presumably, the Commission will similarly identify the significant market participants in the current proceeding. This means that the significant market participants for purposes of the current proceeding are: SBC, Ameritech, AT&T, MCI/WorldCom and Sprint.

**VII. A MERGER BETWEEN SBC AND AMERITECH WILL HAMPER
COMPETITIVE EFFORTS TO LOWER PRICES AND, FOR CERTAIN
CUSTOMERS, WILL INCREASE PRICES**

46. In its application, SBC asserts that there is currently significant competition capable of constraining SBC and Ameritech and that this proposed merger will not adversely affect competition and the public interest. (See page 77 of the Description of Transaction.) This conclusion is wrong for a number of reasons. First, SBC overstates the degree to which local competition is currently an effective constraint on SBC. Second, SBC fails to discuss the adverse impact of the merger on the ability of CLECs to compete with SBC in the future. In what follows, I will discuss each of these reasons in more detail.

The current level of competition is minimal and will not constrain SBC's increased market power.

47. On page 77 of its application, SBC notes: "there is no reason to believe that the merger will remove current constraint on the competitive behavior of either of the merging parties, and it is clear that sufficient competition -- from the major IXCs as well as the myriad of CLECs, niche firms and others have been very successful at winning profitable business away from Ameritech and SBC -- will continue."

48. First, the FCC should observe the *inconsistency* between, on the one hand, SBC's assertions that competition is flourishing and constraining its market power and on the other hand, SBC's and Ameritech's accounts of their own dismal experience with out-of-region entry. If it is nearly impossible for established companies such as SBC and Ameritech to compete out-of-region, then how can competing be so easy for CLECs with far fewer resources, less expertise and, for the most part, little or no name recognition. Clearly, these two claims -- made throughout the SBC merger application -- cannot both be true.

49. Next, in evaluating similar claims, the FCC itself found in the BA/NYNEX Order that competitive access providers ("CAPs") do not pose significant competition for the ILECs. The FCC found: "Because of their relative limited access to capital and their low brand recognition among small business and residential customers, we are unpersuaded by the Applicants that CAPs are, either singularly or a class, likely to have significant competitive impact in the relevant markets." (Paragraph 88.) Surely, if the FCC found that CAPs pose no significant threat in LATA 132, which includes the bustling financial district of New York City, then they cannot not pose much of a threat in the far more sparsely populated markets of SBC.

50. The FCC's observations on the state of competition are echoed by that of state public utility commissions. Particularly relevant here are the observations of the Texas

commissioners in rejecting SBC's section 271 application for interLATA authority. The Chairman of the Texas PUC notes: "We personally presided over those lengthy arbitration hearings and their excruciating detail in order to resolve these issues once and for all, only to find that we have *minimal competition* in Texas today, two years later." (Emphasis added.) (Texas PUC Project No. 16251, Order No. 25, Comments Chairman Pat Wood, III, page 1.) Commissioner Judy Walsh, likewise, notes that there is only a "*minuscule* number of residential and business customers" being served by SBC's competitors. (Emphasis added.) (Texas PUC Project No. 16251, Order No. 25, Comments Commissioner Judy Walsh page 1.) And, Commissioner Patricia Curran notes: "Currently there are CLECs with *de minimus* customers -- and even those *de minimus* customers have been secured only with tremendous effort and with Bell resisting at every turn." (Emphasis added.) (Texas PUC Project No. 16251, Order No. 25, Comments Commissioner Patricia Curran, page 3.) The operative phrases here are: *minimal*, *minuscule*, and *de minimus*.

51. But, the numbers speak for themselves. SBC's affiants Schmalensee and Taylor proffer the following:

According to information provided by SBC and Ameritech, over 50 local exchange competitors have purchased more than 150,000 unbundled loops, 300 unbundled switch ports and 500,000 interconnection trunks. SBC and Ameritech have negotiated approximately 500 interconnection and resale agreements and currently have approximately 1000 collocation arrangements with an additional 700 pending. (Page 20 - 21.)

52. These numbers, though unimpressive at first sight, tell an interesting story once placed in a proper perspective. First, SBC and Ameritech combined serve over

53,000,000 access lines. Thus, the observation that cumulatively 150,000 of their unbundled loops have been ordered by CLECs demonstrates merely that, almost three years after the passage of the Act of 96, *only about 0.3% of SBC's and Ameritech's bottleneck local loop facilities are being used by competitors.*

53. The purchase of 300 unbundled switch ports is too small a number to be meaningfully expressed as a percentage of SBC's and Ameritech's total number of switch ports: the percentage is minuscule, less than a scintilla, negligible. Therefore, rather than demonstrating the vigor of competition under the Act of 96, the fact that only 300 unbundled ports have been ordered is evidence that the provisions of the Act of 96 have not yet been implemented: that is, CLECs do not yet have non-discriminatory access to the ILECs' network elements.

54. Further, it is unlikely that the 500,000 interconnection trunks serve just traffic between SBC, Ameritech and CLECs. Rather, it is more likely these trunks are used also for the much larger traffic flows between adjacent LECs, such as traffic exchanged between GTE, other independent LECs, and Ameritech and SBC. In any event, the 500,000 interconnection trunks are not for the paltry traffic volumes generated by the 150,000 unbundled loops and 300 switch ports purchased by CLECs.

55. Last, IXCs have always used collocation cages for their long distance traffic. Thus, that 1,000 collocation spaces are currently in use in Ameritech and SBC territory tells the FCC little about the state of competition in those regions.

56. In short, the evidence presented by SBC and Ameritech does not demonstrate that competition is flourishing in their territories. These data certainly do not merit the assertion that competition can be counted upon to curtail SBC's market power after the merger with Ameritech.

The vertical integration of SBC's and Ameritech's retail divisions with the formerly out-of-region wholesale divisions greatly increases SBC's market power and disadvantage dependent CLECs

57. In its BA/NYNEX Order, the FCC concluded that the merger between BA and NYNEX would harm competition. Specifically, the FCC noted that, among other harmful effects, "the merger is likely to strengthen NYNEX's market power against erosion from competition by removing one of the most significant market participants." (Paragraph 45.)

58. The FCC also noted in the BA/NYNEX Order (paragraph 11) that there are three possible means for a regulated firm to exercise market power. They are:

- (1) a price cap regulated firm that fails to lower prices;
- (2) when regulated and unregulated products are bundled, the price of the bundled product is in effect not price regulated; and
- (3) service quality is difficult to monitor and may deteriorate.

59. The FCC should make the same findings with respect to the SBC merger application. As discussed above, SBC and Ameritech are two obvious competitors. While it may be true that neither company has, at this point in time, any active plans to enter the other company's markets, the mandates of an evolving market place would sooner rather than

later have forced these companies into competitive strife. Thus, as with the BA/NYNEX merger, the current merger application diminishes the degree of potential and actual competition. As indicated in the matrix below, the harmful effect of eliminating significant competitors (i.e., the elimination of SBC as a competitor in Ameritech's region and *vice versa*) is a result of merging Ameritech's retail division with SBC's retail division.

60. An additional -- *and perhaps more insidious* -- effect on competition stems from the vertical integration of SBC's retail division with Ameritech's wholesale division, and *vice versa*.

	SBC Retail Division	SBC Wholesale Division
Ameritech Retail Division	<i>Impact of merger is to eliminate a potential and actual competitor.</i>	<i>Impact merger highly anti-competitive. There are few if any alternative providers of network facilities. Thus, Ameritech's retail division will obtain an <u>unacceptable</u> advantage over competitors.</i>
Ameritech Wholesale Division	<i>Impact merger highly anti-competitive. There are few if any alternative providers of network facilities. Thus, SBC's retail division will obtain an <u>unacceptable</u> advantage over competitors.</i>	<i>Little negative impact of merger since wholesale divisions that operate local networks in geographically distinct areas do not compete.</i>

61. To appreciate the potential competitive harm from allowing a vertical integration of SBC's retail division with Ameritech's wholesale division, and *vice versa*, the FCC

should consider, once again, the uneven battle between CLECs and ILECs. Once SBC's retail division has access to Ameritech's wholesale division, it can then operate as a fully integrated ILEC in the formerly out-of-region Ameritech serving area. Thus, after the merger, SBC will be greatly advantaged over CLECs in competing for certain contracts that require a presence in multiple locations, say, in Dallas and Chicago.

62. In the above situation, where SBC is competing with other carriers to serve a customer with multiple locations in both Dallas and Chicago, the gains in SBC's competitive position vis-à-vis CLECs may be summarized as follows:

	Before Merger		After Merger	
	Dallas	Chicago	Dallas	Chicago
SBC	<i>ILEC</i>	<i>CLEC</i>	<i>ILEC</i>	<i>ILEC</i>
AT&T, MCI, etc.	<i>CLEC</i>	<i>CLEC</i>	<i>CLEC</i>	<i>CLEC</i>

63. The change in status from CLEC to ILEC in Chicago will give SBC a critical advantage over *dependent* competitors. The Commission should consider that, while the Act of 96 mandates non-discriminatory access, CLECs face considerably higher costs for using network elements than SBC and Ameritech themselves. First, CLECs will incur the additional costs of collocation, required to aggregate unbundled loops at SBC's and Ameritech's central offices, and other non-recurring charges that often are artificially inflated. Further, both SBC and Ameritech have pricing flexibility for services offered to large customers. Thus, while CLECs face tariffed rates based on averages, both SBC and

Ameritech are able to price services for large customers at their incremental costs. The resulting competitive advantages to SBC and Ameritech in this case can be significant.

64. The increased advantage of incumbency for SBC as a result of the merger should be a cause for grave concern to the FCC. In general, efforts by companies to gain a competitive advantage over others enhance economic welfare; it is called competition. In this case, however, the competitive advantage is not achieved through the typical means of product innovation, increased responsiveness to customer needs, or an implementation of more efficient technologies. *Instead, the advantage is gained through gaming the regulatory process.*

65. The Act of 96 is intended to provide all competitors non-discriminatory access to the ILECs' network. In other words, all competitors, including the ILEC's own retail division, should be able to have access to the ILEC's wholesale division on terms and conditions that are non-discriminatory and do not favor one competitor over another.

66. However, as discussed at some length above, the pro-competitive provisions of the Act of 96 have not been fully implemented and, as a result, there remain substantial benefits to incumbency. The advantage that SBC's retail division gains over CLECs in bidding for customers with multiple locations in both Dallas and Chicago, therefore, stems entirely from an *intentional* failure on the part of SBC and Ameritech to implement the Act of 96. Surely, this type of effort to gain a competitive advantage is not what the

FCC ought to be encouraging and is, presumably, not what Congress had in mind when it passed the Act of 96.

67. Again, the proper response to SBC's proposed merger is to reject it and to re-examine why the provisions of the Act of 96 -- as currently implemented -- are not sufficient for SBC to implement its national/local strategies.

SBC's increased market power will, for certain types of customers, increase prices

As demonstrated in the previous section, a merger between SBC and Ameritech would seriously imperil the competitive process and diminishes the likelihood that current and future competitors will be able to lower prices. Equally, if not more, detrimental to the public interest is the possibility that the merger will *raise* prices for certain types of customers.

68. The possibility that price will be raised after the merger exists for larger customers that require service in multiple locations throughout the SBC and Ameritech serving areas. Currently, no carrier is likely to offer these types of customers service entirely on their own facilities. That is, these types of customers typically receive service over the facilities of a number of carriers, including local exchange carriers and long distance companies.

69. To see how prices may increase after the merger, the Commission should consider the following. In obtaining service from multiple carriers, a large customer may either contract with one of those carriers to put together a package, or the customer may place its own telecommunications department in charge of putting all the piece parts together. As part of this decision making process, price information will be exchanged between the carriers and the customer. Because the carriers are bidding against one another -- *while being dependent on one another in offering one-stop shopping solutions* -- carriers are forced to reveal to the potential customer their lowest possible price. This competitive bidding process is intensified because each carrier has a price advantage where it concerns the use of its own facilities but a disadvantage for that portion of the service for which it requires the facilities of other carriers. Specifically, to offset the price advantages of other carriers, *each carrier is forced to reveal how cheaply they are actually able to offer services on their own network*. As a result, the customer obtains price information that it will not receive if, after the merger, SBC is able to offer one-stop shopping largely or entirely over its own network.

70. To better understand how the merger may lead to higher prices, the Commission should consider the following simplified example. Consider a situation in which three carriers, say, SBC, Ameritech and AT&T are competing for a customer that has offices in both Dallas, Texas, and Chicago, Illinois. In this example, each of the carriers has an advantage with respect to its own network, but is handicapped to the extent that it needs to lease facilities from one or both of the other carriers.

71. Assume that SBC has facilities to serve the customer only in Dallas but would need to lease facilities from Ameritech to serve the customer in Chicago. Also, SBC would need to partner with AT&T to provide for interstate transport. Ameritech, in turn, can serve the customer in Chicago, but needs to lease facilities from SBC to serve the customer in Dallas. Just as SBC, Ameritech too would need to partner with AT&T for interstate transport. While AT&T has facilities for interstate transport of the customer's traffic, it needs to lease local network facilities from SBC and Ameritech to serve the customer's Dallas and Chicago offices, respectively.

72. Reflecting the fact that carriers will be able to offer service more cheaply on their own facilities than competitors can by leasing those facilities, the costs for use of the local and long distance networks are assumed as follows:

	Revealed Cost to Serve Dallas	Revealed Cost of Long Distance	Revealed Cost to Serve Chicago	Price Floor
SBC	\$20	\$30	\$30	\$80
AMERITECH	\$30	\$30	\$20	\$80
AT&T	\$30	\$20	\$30	\$80
<i>Lowest cost revealed to customer</i>	\$20	\$20	\$20	<i>Revealed Total Cost = \$60</i>

73. In this simplified example, each of the carriers puts in a bid that is no lower than \$80, the cost of serving the customer. However, as part of the competitive bidding process, the carriers have little choice but to reveal to the customer their competitive advantage -- i.e., *lowest price* -- for offering service on their *own* portion of the network. The

Commission should note here that each carrier is forced to reveal its lowest cost to the customer for use of its own facilities in order to *offset* the cost advantages of the other carriers. Thus, based on this price information the customer is now able to decide whether it should have one of the carriers provide it with the one stop shopping solution for a price of no less than \$80 or whether to have its own telecom department contract with each carrier individually for a cost of \$60, plus the cost of maintaining its own telecom department.

74. After the merger, the bidding process is simplified. As explained previously, SBC will gain privileged access to Ameritech's facilities in Chicago. This means that SBC's cost for serving the customer in Chicago will become as low as Ameritech's. *Most importantly, SBC no longer has to reveal a low cost in Dallas to offset Ameritech's cost advantage in Chicago.* That is, SBC is now bidding only against AT&T's cost advantage related to the interstate transport portion, but no longer against Ameritech. Thus the revealed cost structure available to the customer after the merger will look as follows:

	Revealed Cost to Serve Dallas	Revealed Cost of Long Distance	Revealed Cost to Serve Chicago	Price Floor
SBC	\$30 > Cost Dallas > \$20	\$30	\$30 - Cost Chicago > \$20	\$80 > total cost > \$70
AT&T	\$30	\$20	\$30	\$80
<i>Lowest cost revealed to customer</i>	\$30 > Cost Dallas > \$20	\$20	\$30 - Cost Chicago > \$20	<i>Revealed Total Cost > \$60</i>

Thus, as a result of the merger, SBC will no longer have to reveal to the customer how *cheaply* it could offer service in Dallas and Chicago. All SBC needs to do is to offer service at a price equal to or lower than AT&T, i.e., at a price equal to or less than \$80. Assuming that SBC needs to offer service at only \$1 less than AT&T to win the bid, SBC could reveal the following cost to the customer:

	Revealed Cost to Serve Dallas	Revealed Cost of Long Distance	Revealed Cost to Serve Chicago	Price Floor
SBC	\$24.50	\$30	\$24.50	\$79
AT&T	\$30	\$20	\$30	\$80
<i>Lowest cost revealed to customer</i>	\$24.50	\$20	\$24.50	<i>Revealed Total Cost=\$69</i>

Thus, while prior to the merger, the carriers revealed to the customer a lowest total cost (price floor) of \$60, after the merger, the revealed total cost (price floor) has gone up to \$69.

75. The above example serves to illustrate how after the merger, SBC no longer has to put forth its best prices in a bidding process for certain types of customers. As a result, customers may see increased prices if the proposed merger between SBC and Ameritech is approved.

76. To see that the above simplified example reveals realistic dynamics in the marketplace, the Commission should consider the following. SBC, like virtually all other ILECs, enjoys considerable pricing flexibility for larger contracts that are subject to

competition. In Texas, for example, SBC's price floor for large Centrex contracts, including the local loop facilities, is long run incremental costs plus 5% contribution.³ Indeed, in Texas, for larger Centrex type contracts, SBC has traditionally been allowed *to waive any capital related charges* where it concerns allegedly "stranded" facilities, giving SBC almost total pricing flexibility to give away facilities.⁴ Thus, while dependent competitors face SBC's averaged tariffed rates for unbundled elements (or similar prices agreed to in interconnection agreements), SBC is allowed to charge prices based on its incremental costs and lower if it alleges that facilities would be stranded if the contract is won by competitors. Further, dependent competitors incur the additional costs of SBC's collocation charges for aggregating the unbundled loops in SBC's central offices in addition to a host of other, often artificially inflated, non-recurring charges. In short, the costs to SBC for serving customers in its territory are considerably lower than the costs to any of its dependent competitors.

77. Like SBC, Ameritech too has pricing flexibility for larger customers. And, while the rates for unbundled elements are de-averaged in Illinois, unlike those of SBC in Texas, dependent competitors will still pay higher charges than the incremental costs that are the price floor for Ameritech. Also, CLECs that seek to use Ameritech's unbundled loop facilities will incur the additional costs of collocation and other non-recurring charges. Thus, the assumption in the above example, that SBC has significantly lower price floors

³ cite pura.

in Dallas and in Chicago, after the merger, than its dependent competitors, is entirely realistic.

VIII. THE ALLEGED BENEFITS OF MERGER ARE OVERSTATED AND POSSIBLY MAY NEVER MATERIALIZE AT ALL

78. Against the backdrop of the negative impact of the proposed merger on the development of competition, the social benefits of the merger appear meager at best. First, the Commission should note that the alleged benefits are not well documented and represent no more than the optimistic ruminations of SBC's and Ameritech's affiants. Be that as it may, the FCC should consider the following.

Absent robust local competition, price cap regulation funnels merger benefits to a select group: i.e., stockholders of SBC and Ameritech

79. If both SBC and Ameritech operate under price cap regulation, as they do, then only the stockholders will enjoy the merger benefits. To the extent that the merger is detrimental to the development of local exchange competition, a weighing of costs against benefits must necessarily pit the interest of stockholders against those of society at large. In this juggling of interests, the FCC should remember part of its mandate as defined in the Communications Act of 1934, Section 1, S.3285, Public No. 416:

to make available to all people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communications service with adequate facilities at reasonable charges,

⁴ This practice was sanctioned by the Texas PUC in PUCT Docket No. 6771, Inquiry into pricing practices of Southwestern Bell Telephone Company under the EXXS Custom Tariff, April 19, 1989.

Further, the FCC should note that any alleged gains here are a result of gaming the regulatory process, and do not stem from introducing true efficiencies. As such it would be inappropriate to have stockholders be the sole beneficiaries of the merger by considering 100% of the gains to be covered under the price cap plans.

The benefits of the merger are overstated and may never materialize at all

The Commission should also consider that the alleged benefits of the merger are either overstated or may never materialize at all. The reasons are the following:

- SBC's national/local strategy may be delayed or never be implemented. While SBC now touts its intent to become an aggressive competitor, after the merger the company may well decide that it is more profitable to take a defensive rather than an offensive posture. Thus far, SBC has impressed the world more with its ability to stifle competition in-region than by its ability to be a competitor out-of-region. Therefore, if past experience is a predictor for the future, then all indications are that SBC will simply seek to acquire more companies while doing everything in its power to prevent competitors from making inroads into its territory.
- The SBC affiants list various ways in which SBC and Ameritech will be able to generate more revenues from its existing customers. For example, the companies will be able to sell more second lines and vertical features to existing customers. Obviously, now that these potential sources for growth have been identified, the companies do not need to merge in order to pursue these types of revenue growth. Each company can grow the revenues from these types of services individually.
- Offsetting any possible benefits are the losses to society as a result of SBC and Ameritech individually developing specific expertise and efficiencies. In describing the alleged benefits of the merger, the SBC affiants refer repeatedly to the "best practices" of PacBell, SBC and Ameritech, to illustrate that a merger of these three companies can draw on the individual strength of these three companies. To the extent this argument has merit, the Commission should recognize that after the merger, society will lose the benefits of having separate firms developing individual strengths and approaches to offering telephony. This loss may be particularly large where it concerns regulatory practices. The Commission should consider that an unbundled loop from Ameritech in downtown Chicago costs competitors only \$2.59 while a similar strand of copper from SBC in downtown Dallas costs \$17.05, *no less than 6 times as much*. In fact, a high cost unbundled loop from Ameritech in rural Illinois is only \$11.40, which is still considerably cheaper than SBC's "low cost" loop in downtown

Dallas. Having been involved in the cost proceeding in which the rates for SBC's and Ameritech's loops were established, I can assure the Commission that this difference does not stem from legitimate cost differences but from the regulatory attitudes of the companies. *SBC is simply more hostile to competition.* Undoubtedly, after the merger, SBC will seek to increase the lower Ameritech prices for unbundled network elements.

Regional asymmetry in benefits

80. While the merger may strengthen SBC in competing out-of-region, it would clearly make it harder if not impossible for others to compete in SBC's region. This is particularly true when SBC obtains approval for its 271 application, after which SBC will be allowed to provide one-stop shopping. Specifically, SBC will be the *only* firm that, with almost one-half of the access lines in the country, can effortlessly provide one-stop shopping to *all* customers inside its serving area using its own facilities. If competing with SBC is already difficult, it will become near impossible after the merger.

IX. SUGGESTED CONDITIONS FOR MERGER APPROVAL

81. As demonstrated above, approving the merger as proposed by SBC is not in the public interest. In fact, the likelihood is great that a merger between SBC and Ameritech would seriously harm and perhaps permanently impede local exchange competition in the SBC and Ameritech serving areas. In view of the above, I therefore urge the Commission to reject the SBC's application.

82. However, if the FCC finds that SBC's proposed merger is in the public interest, then OPUC requests that, at a minimum, the FCC imposes a number of conditions upon

SBC's and Ameritech's merger to mitigate the anti-competitive impact of the merger. I recommend the following pre-conditions:

- Impose a provision for flowing through the estimated benefits of the merger to SBC's ratepayers.
- Order Divestiture of SBC's and Ameritech's wholesale operations. This is the only way to ensure that the retail operations of SBC and Ameritech, after the merger, will not receive preferential treatment from their wholesale divisions. That is, divestiture of SBC's and Ameritech's wholesale operations is the only means to ensure non-discriminatory access to the network for all local exchange competitors.
- Require voluntary compliance of SBC with the FCC rulings on the ILECs requirements to provide common transport to CLECs.
- Require voluntary compliance of SBC with the FCC's requirement to combine unbundled network facilities for CLECs.
- Require that SBC offer access to its unbundled network elements at terms and conditions more flexible and reasonable than standard collocation tariffs that have been constructed to frustrate competition.
- Both SBC and Ameritech must have met the conditions necessary for approval of a Section 271 Application. Only then can it be demonstrated that CLECs have non-discriminatory access to SBC's and Ameritech's wholesale divisions and will not be disadvantaged after the vertical merger of SBC's retail division with Ameritech's wholesale division and *vice versa*.

X. SUMMARY

83. In this affidavit I have demonstrated that SBC's proposed merger with Ameritech is not in the public interest. The merger will stifle competition, generate limited benefits only for SBC's stockholders and raise prices for select customers. In view of these considerations, the Commission should deny the merger application.

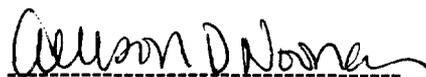
The information contained in this affidavit is true and correct to the best of my knowledge and belief.

Signed on October 7, 1998.

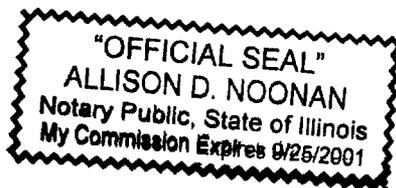


August H. Ankum

SWORN TO AND SUBSCRIBED BEFORE ME on October 7, 1998 by August H. Ankum.



Notary Public, State of Illinois



ATTACHMENT 1

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I am an economist and consultant, specializing in public utility regulation. In this capacity, I have provided consulting services for firms in most major telecommunications markets of the United States, such as New York, Texas, California, Illinois, Michigan and in a variety of smaller states. Specifically, I have worked for large corporate clients, such as MCI, AT&T, AT&T Wireless, CellularOne and smaller clients, such as Brooks Fiber (now WorldCom) and PCS providers. I have also represented many of these clients before state and federal regulatory agencies in various administrative law proceedings concerning the introduction of competition in telecommunications markets. Where necessary, I provide expert witness testimony. Recently, these proceedings have often focused on the implementation of the pro-competition provisions of Telecommunications Act of 1996. On behalf of my clients, I have had the opportunity to analyze, within the context of legal proceedings and subject to proprietary agreements, the operations and networks of SBC, NYNEX, Bell Atlantic, US West, Bell South, Ameritech, Pacific Bell and GTE.

REGULATORY PROCEEDINGS AND OTHER PROJECTS IN WHICH DR. ANKUM HAS PARTICIPATED AND/OR FILED EXPERT WITNESS TESTIMONY:

New York

Commission Investigation into Resale, Universal Service and Link and Port Pricing, New York Public Service Commission, Case Nos. 95-C-0657, 94-C-0095, and 91-C-1174, July 4, 1996. On behalf of MCI Telecommunications Corporation.

Texas

Petition of The General Counsel for an Evidentiary Proceeding to Determine Market Dominance, PUC of Texas, Docket No. 7790, Direct Testimony, June 1988. On behalf of the Public Utility Commission of Texas.

Application of Southwestern Bell Telephone Company for Revisions to the Customer Specific Pricing Plan Tariff, PUC of Texas, Docket No. 8665, Direct Testimony, July 1989. On behalf of the Public Utility Commission of Texas.

Application of Southwestern Bell Telephone Company to Amend its Existing Customer Specific Pricing Plan Tariff: As it Relates to Local Exchange Access through Integrated Voice/Data Multiplexers, PUC of Texas, Docket No. 8478, Direct Testimony, August 1989. On behalf of the Public Utility Commission of Texas.

Application of Southwestern Bell Telephone Company to Provide Custom Service to Specific Customers, PUC of Texas, Docket No. 8672, Direct Testimony, September 1989. On behalf of the Public Utility Commission of Texas.

Inquiry of the General Counsel into the Reasonableness of the Rates and Services of Southwestern Bell Telephone Company, PUC of Texas, Docket No. 8585, Direct Testimony, November 1989. On behalf of the Public Utility Commission of Texas.

Southwestern Bell Telephone Company Application to Declare the Service Market for CO LAN Service to be Subject to Significant Competition, PUC of Texas, Docket No. 9301, Direct Testimony, June 1990. On behalf of the Public Utility Commission of Texas.

Petition of Southwestern Bell Telephone Company for Authority to Change Rates, PUC of Texas, Docket No. 10382, Direct Testimony, September 1991. On behalf of the Public Utility Commission of Texas.

Application of Southwestern Bell Telephone Company, GTE Southwest, Inc., and Contel of Texas, Inc. For Approval of Flat-rated Local Exchange Resale Tariffs Pursuant to PURA 1995 Section

3.2532, Public Utility Commission of Texas, Docket No. 14658, January 24, 1996. On behalf of Office of Public Utility Counsel of Texas.

Application of Southwestern Bell Telephone Company, GTE Southwest, Inc., and Contel of Texas, Inc. For Interim Number Portability Pursuant to Section 3.455 of the Public Utility Regulatory Act, Public Utility Commission of Texas, Docket No. 14658, March 22, 1996. On behalf of Office of Public Utility Counsel of Texas.

Application of AT&T Communications for Compulsory Arbitration to Establish an Interconnection Agreement Between AT&T and Southwestern Bell Telephone Company, and Petition of MCI for Arbitration under the FTA96, Public Utility Commission of Texas, Consl. Docket Nos. 16226 and 16285. September 15, 1997. On behalf of AT&T and MCI.

Petition by Waller Creek Communications, Inc. For Arbitration with Southwestern Bell Telephone Company, Public Utility Commission of Texas, Docket No. 17922. November 1997. On behalf of Waller Creek Communications, Inc.

Illinois

Adoption of Rules on Line-Side Interconnection and Reciprocal Interconnection, Illinois Commerce Commission, Docket No. 94-0048. September 30, 1994. On behalf of Teleport Communications Group, Inc.

Proposed Introduction of a Trial of Ameritech's Customer First Plan in Illinois, Illinois Commerce Commission, Docket No. 94-0096. September 30, 1994. On behalf of Teleport Communications Group, Inc.

Addendum to Proposed Introduction of a Trial of Ameritech's Customer First Plan in Illinois, Illinois Commerce Commission, Docket No. 94-0117. September 30, 1994. On behalf of Teleport Communications Group, Inc.

AT&T's Petition for an Investigation and Order Establishing Conditions Necessary to Permit Effective Exchange Competition to the Extent Feasible in Areas Served by Illinois Bell Telephone Company, Illinois Commerce Commission, Docket No. 94-0146. September 30, 1994. On behalf of Teleport Communications Group, Inc.

Proposed Reclassification of Bands B and C Business Usage and Business Operator Assistance/Credit Surcharges to Competitive Status, Illinois Commerce Commission, Docket No. 95-0315, May 19, 1995. On behalf of MCI Telecommunications Corporation.

Investigation Into Amending the Physical Collocation Requirements of 83 Ill. Adm. Code 790, Illinois Commerce Commission, Docket 94-480, July 13, 1995. On behalf of MCI Telecommunications Corporation.

Petition for a Total Local Exchange Wholesale Tariff from Illinois Bell Telephone Company d/b/a Ameritech Illinois and Central Telephone Company Pursuant to Section 13-505.5 of the Illinois Public Utilities Act, Illinois Commerce Commission, Docket No. 95-0458, December 1995. On behalf of MCI Telecommunications Corporation.

Citation to Investigate Illinois Bell Telephone Company's Rates, Rules and regulations For its Unbundled Network Component Elements, Local Transport Facilities, and End office Integration Services, Illinois Commerce Commission, Docket No. 95-0296, January 4, 1996. On behalf of MCI Telecommunications Corporation.

In the Matter of MCI Telecommunications Corporation Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish and Interconnection Agreement with Illinois Bell Telephone Company d/b/a Ameritech Illinois, Illinois Commerce Commission, Docket No. 96-AB-006, October, 1996. On behalf of MCI Telecommunications Corporation.

In the Matter of MCI Telecommunications Corporation Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish and Interconnection Agreement with Central Telephone Company of Illinois ("Sprint"), Illinois Commerce Commission, Docket No. 96-AB-007, January, 1997. On behalf of MCI Telecommunications Corporation.

Investigation into forward looking cost studies and rates of Ameritech Illinois for interconnection, network elements, transport and termination of traffic. Illinois Commerce Commission, Docket No. 96-0486, February, 1997. On behalf of MCI Telecommunications Corporation

Investigation into the forward-looking economic cost studies for non-rural local exchange carriers, Illinois Commerce Commission, Docket 97-0515, March 1998. On behalf of MCI Telecommunications Corporation.

Massachusetts

NYNEX/MCI Arbitration, Common Wealth of Massachusetts, Department of Public Utilities, D.P.U. 96-83, October 1996. On behalf of MCI Telecommunications Corporation.

New Mexico

Brooks Fiber Communications of New Mexico, Inc. Petition for Arbitration, New Mexico State Corporation Commission, Docket No. 96-307-TC, December, 1996. On behalf of Brooks Fiber Communications of New Mexico, Inc.

Michigan

In the Matter of the Application of City Signal, Inc. for an Order Establishing and Approving Interconnection Arrangements with Michigan Bell Telephone Company, Michigan Public Service Commission, Case No. U-10647, October 12, 1994. On behalf of Teleport Communications Group, Inc.

In the Matter, on the Commission's Own Motion, to Establish Permanent Interconnection Arrangements Between Basic Local Exchange Providers, Michigan Public Service Commission, Case No. U-10860, July 24, 1995. On behalf of MCI Telecommunications Corporation.

In the Matter, on the Commission's Own Motion, to consider the total service long run incremental costs and to determine the prices for unbundled network elements, interconnection services, resold services, and basic local exchange services for Ameritech Michigan, Michigan Public Service Commission, Case No. U-11280, March 31, 1997. On behalf of MCI Telecommunications Corporation.

In the matter of the application under Section 310(2) and 204, and the complaint under Section 205(2) and 203, of MCI Telecommunications Corporation against AMERITECH requesting a reduction in intrastate switched access charges, Case No. U-11366. April, 1997. On behalf of MCI Telecommunications Corporation.

In the matter of the application of Ameritech Michigan for approval of its forward-looking economic cost study for use in determining Federal Universal Service Support, Michigan Public Service Commission, Case No. U-11635. March 1998. On behalf of MCI Telecommunications Corporation.

Ohio

In the Matter of MCI Telecommunications Corporation Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish and Interconnection Agreement with Ameritech Ohio, The Public Utilities Commission of Ohio, Case No. 96-888-TP-ARB, October, 1996. On behalf of MCI Telecommunications Corporation.

In the matter of the review of Ameritech Ohio's economic costs for interconnection, unbundled network elements, and reciprocal compensation for transport and termination of local telecommunications traffic, The Public Utilities Commission of Ohio, Case No. 96-922-TP-UNC, Jan 17, 1997. On behalf of MCI Telecommunications Corporation.

Indiana

In the matter of the Petition of MCI Telecommunications Corporation for the Commission to Modify its Existing Certificate of Public Convenience and Necessity and to Authorize the Petitioner to Provide certain Centrex-like Intra-Exchange Services in the Indianapolis LATA Pursuant to I.C. 8-1-2-88, and to Decline the Exercise in Part of its Jurisdiction over Petitioner's Provision of such Service, Pursuant to I.C. 8-1-2.6., Indiana Regulatory Commission, Cause No. 39948, March 20, 1995. On behalf of MCI Telecommunications Corporation.

In the matter of the Petition of Indiana Bell Telephone company, Inc. For Authorization to Apply a Customer Specific Offering Tariff to Provide the Business Exchange Services Portion of Centrex and PBX Trunking Services and for the Commission to Decline to Exercise in Part Jurisdiction over the Petitioner's Provision of such Services, Pursuant to I.C. 8-1-2.6, Indiana regulatory Commission, Cause No. 40178, October 1995. On behalf of MCI Telecommunications Corporation.

MCI Telecommunications Corporation Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish and Interconnection Agreement with Indiana Bell Telephone Company d/b/a Ameritech Indiana, Indiana Public Utility Regulatory Commission, Cause No. 40603-INT-01, October 1996. On behalf of MCI Telecommunications Corporation.

In the matter of the Commission Investigation and Generic Proceeding on Ameritech Indiana's Rates for Interconnection Service, Unbundled Elements and Transport and Termination under the Telecommunications Act of 1996 and Related Indiana Statutes, Indiana Public Utility Regulatory Commission, Cause No. 40611. April 18, 1997. On behalf of MCI Telecommunications Corporation.

In the Matter of the Commission Investigation and Generic Proceeding on GTE's Rates for Interconnection, Service, Unbundled Elements, and Transport under the FTA 96 and related Indiana Statutes, Indiana Public Utility Regulatory Commission, Cause No. 40618. October 10, 1997. On behalf of MCI Telecommunication Corporation.

Rhode Island

Comprehensive Review of Intrastate Telecommunications Competition, State of Rhode Island and Providence Plantations Public Utilities Commission, Docket No. 2252, November, 1995. On behalf of MCI Telecommunications Corporation.

Wisconsin

Investigation of the Appropriate Standards to Promote Effective Competition in the Local Exchange Telecommunications Market in Wisconsin, Public Service Commission of Wisconsin, Cause No. 05-TI-138, November, 1995. On behalf of MCI Telecommunications Corporation.

Matters relating to the satisfaction of conditions for offering interLATA services (Wisconsin Bell, Inc. d/b/a Ameritech Wisconsin) Wisconsin Public Service Commission, 670-TI-120, March 25, 1997. On behalf of MCI Telecommunications Corporation.

In the Matter of MCI Telecommunications Corporation Petition for Arbitration Pursuant to Section 252(b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Wisconsin Bell, Inc. d/b/a Ameritech Wisconsin, Wisconsin Public Service Commission, Docket Nos. 6720-MA-104 and 3258-MA-101. On behalf of MCI Telecommunications Corporation.

Investigation of cost study methodologies for determining universal service subsidies for non-rural local exchange carriers, Wisconsin Public Service Commission, Cause No. 05-TI-160. March, 1998. On behalf of MCI Telecommunications Corporation.

Vermont

Investigation into NET's tariff filing re: Open Network Architecture, including the Unbundling of NET's Network, Expanded Interconnection, and Intelligent Networks, Vermont Public Service Board, Docket No. 5713, June 8, 1995. On behalf of MCI Telecommunications Corporation.

Pennsylvania

In Re: Formal Investigation to Examine Updated Universal Service Principles and Policies for telecommunications Services in the Commonwealth Interlocutory order, Initiation of Oral Hearing Phase, Pennsylvania Public Utility Commission, Docket No. I-00940035, February 28, 1996. On behalf of MCI Telecommunications Corporation.

Georgia

AT&T Petition for the Commission to Establish Resale Rules, Rates and terms and Conditions and the Initial Unbundling of Services, Georgia Public Service Commission, Docket No. 6352-U, March 22, 1996. On behalf of MCI Telecommunications Corporation.

Tennessee

Avoidable Costs of Providing Bundled Services for Resale by Local Exchange Telephone Companies, Tennessee Public Service Commission, Docket No. 96-00067, May 31, 1996. On behalf of MCI Telecommunications Corporation.

Commonwealth of Puerto Rico

Petition for Arbitration Pursuant to 47 U.S.C. & (b) and the Puerto Rico Telecommunications Act of 1996, regarding Interconnection Rates Terms and Conditions with Puerto Rico Telephone Company, Puerto Rico Telecommunications Regulatory Board, Docket No. 97-0034-AR, April 15, 1997. On behalf of Cellular Communications of Puerto Rico, Inc.
Cellular Communications of Puerto Rico, Inc.

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October 7, 1998

Dear Rick,

Here's the signature page to my Affidavit. Also, enclosed are some signed contracts with OPUC. Could you please give those to Brenda Sevier for me.

Thanks,

Gus

PETITION ATTACHMENT 3

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION

RECEIVED
OCT 15 1998
FCC MAIL ROOM

In Re Applications of)
)
AMERITECH CORP.,)
Transferor,)
)
AND)
)
SBC COMMUNICATIONS, 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 5, 22, 24,)
63, 90, 95 and 101 of the Commission's)
Rules)

CC Docket No. 98-141

AFFIDAVIT OF CAROL A. SZERSZEN

ON BEHALF OF THE TEXAS OFFICE OF PUBLIC UTILITY COUNSEL

October 14, 1998

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	U.S. Telecommunication Company Financial Data	Exhibit 2

AFFIDAVIT OF CAROL A. SZERSZEN

STATE OF TEXAS §
 §
COUNTY OF TRAVIS §

Carol A. Szerszen, being duly sworn, deposes and says:

I. BACKGROUND AND QUALIFICATIONS

1. My name is Dr. Carol A. Szerszen. I am an economist with the Texas Office of Public Utility Counsel. My business address is 1701 N. Congress, Suite 9-180, Austin, Texas 78701.

 I received a Ph.D. in Economics from the University of Illinois at Champaign – Urbana in 1979, an M.S. in Economics in 1975, and a Bachelor of Urban Planning in 1971, both from the University of Illinois (Champaign – Urbana).

2. My work as a regulatory economist has included research in health care issues as well as electric, gas, and telephone issues. I have testified in over 50 cases before the Texas Public Utility Commission. My areas of regulatory expertise include cost of capital and other financial issues, diversification, affiliate transactions and affiliate allocations, deferred accounting, merger analyses, various competitive issues, as well as electric tariff review and design. A complete summary of my educational and professional background is attached to this affidavit as Exhibit 1.

II. SUMMARY

3. In this affidavit, I will show that the consumer benefits ensuing from the proposed merger are not significant enough to mitigate the merger’s anti-competitive effects. I will also show that current competition in telecom markets is characterized by the presence of

numerous small, financially weak competitors whose assets, revenues and income are dwarfed by those of SBC and Ameritech.

4. The large acquisition premium being paid by SBC is indicative of expectations that the combined entity will continue to exercise monopoly power in the local service telephone markets.

5. The merger will make it increasingly more difficult for existing competitors to thrive, possibly leading to even more mergers and increasing concentration in telecom markets.

III. CONSUMER BENEFITS OF MERGER

6. The applicants allege that there are numerous pro-competitive economic benefits that result from the merger. Drs. Schmalensee and Taylor claim these benefits are significant enough to mitigate any potential competitive harm that may ensue from the merger (p. 2). However, many of the claimed benefits are vague and speculative, and the applicants have not shown that a merger is necessary for the achievement of many of these benefits.

7. The primary consumer benefits ensuing from the merger are discussed in the affidavits of Drs. Robert Harris and Richard Gilbert. The affiants state that the merger will enhance consumer welfare in several significant ways. These include: a) the speedier introduction of new services and technologies; b) lower telecom prices for consumers due to merger-related economies of scale and economies of scope, as well as the adoption of best practices; c) the increased market penetration of existing services; d) the avoidance or lessening of stranded asset exposure; e) increased competition through the applicants plan to enter 30 out-of-region telecom markets.

8. The applicants allege that the merger will allow the adoption of “best practices,” leading to improved operating performance and lower costs for consumers. However, it is unclear whether a merger is necessary to implement the best practice procedures described in the applicants’ affidavits. Mr. Wharton Rivers provides several instances whereby performance-enhancing information was obtained by Ameritech in the normal course of business. (Rivers, pp. 7-9) For example, in 1995, Ameritech was able to assimilate some of Southwestern Bell Telephone Company’s best practice procedures through an on-site visit to the company’s facilities. Mr. Rivers also notes that Ameritech relies heavily on its system and technology vendors to provide performance-enhancing insights. Finally, Mr. Rivers states that competitive considerations compel telephone companies to purchase and utilize the best available technology and business practices.

9. The applicants have not demonstrated that the merger is necessary for either company to improve its productivity and customer satisfaction levels. I strongly agree with Mr. Rivers that all companies operating in a competitive environment would be expected to adopt the most efficient managerial practices. While a merger may make adoption of best practices easier, it does not follow that a merger is a necessary condition for productivity or performance improvements. Such improvements should be not considered a significant or compelling justification for a merger.

10. The applicants have not sufficiently demonstrated that all of its claimed merger savings are achievable, or that merger savings could not, at least in part, be achieved through individual company cost cutting programs. The affiants calculate that the total merger savings will be approximately \$2.5 billion, consisting of \$778 million in revenue synergies, \$1.43 million in cost savings, and \$300 million in savings from jointly entering

out-of-region long distance markets. While I do not dispute the possibility that the combination of two extremely large telecommunications companies may result in efficiencies (particularly in administrative and general functions), it is unclear whether the actual level of merger savings is sufficient to compensate for the potential anti-competitive effects of this merger.

11. The \$778 million in revenue synergies appear to stem primarily from more effective marketing and sales techniques. According to Mr. Martin Kaplan, the companies have been unequally successful in marketing certain ancillary services in their service territory, primarily caller ID, call waiting, call return, voice mail, additional telephone lines, directory publishing, data services and Centrex. (Kaplan, pp. 4-9) Kaplan alleges that SBC's marketing expertise is needed to obtain increased sales for services in Ameritech areas where these services have not been as heavily subscribed to. However, SBC has not provided any evidence that its marketing skills are superior to Ameritech's, and one would expect some existing regional differences in telephone service usage due to variations in income and consumer preferences. More importantly, the applicants have not demonstrated that consumer welfare will be enhanced by the increased consumption of telephone services. While revenue synergies will undoubtedly benefit the Company's shareholders, the benefits to ratepayers are uncertain.

12. In the Bell Atlantic-NYNEX merger, the FCC found that the applicants had not demonstrated that a merger is necessary to create an effective long distance competitor.¹ The same reasoning should apply to this merger. SBC and Ameritech claim that \$300 million will be saved in the joint deployment of out-of-region long distance services

¹ Federal Communications Commission. Memorandum Opinion and Order, FCC 97-286, August 14, 1997, Paragraph 168, p. 80.

(Kaplan, p. 17 and Schmalensee and Taylor, p. 6). Neither company has claimed or provided evidence that it is currently successfully offering or will be successful in offering out-of-region long distance service, and a discussion of synergy savings in providing this service on a joint basis is premature. There is no reason to believe a merger will make them any more successful in offering long distance than they would be on a stand-alone basis.

13. Mr. Kaplan and Drs. Gilbert and Harris provide various details regarding merger savings estimates in their affidavits. However, there has been no public information provided in this merger regarding the proposed methods and calculations used in deriving the applicants' merger savings estimates.² I have been involved in several electric utility merger proceedings before the Texas Public Utility Commission, and am generally quite familiar with the level of detail and analyses required to promulgate merger savings estimates. Additionally, there are usually several significant areas in merger savings analyses that are heavily contested. Merger savings are inherently difficult to measure because of uncertainties encountered in forecasting budget and staffing needs for a business combination that has not yet occurred. In my past reviews of merger savings, it has not been unusual to find significant cost savings that are achievable on a stand-alone basis. It is also not unusual to find that these estimates do not accurately account for various operating cost increases that may occur in combining two companies. The lack of detail (or publicly available detail) supporting the company's merger savings estimates is troubling, and reduces the validity of the claimed efficiencies and revenue synergies.

² Confidential information may have been provided to the FCC. However, OPC has not been able to review any confidential information to date.

14. The most significant problem with the applicants' synergy analysis is that there are no estimates or discussions of the costs associated with this merger. Merger costs typically include acquisition premiums, severance, retraining and relocation payments, golden parachute payments, as well as the general expenses that will be incurred in integrating the merging companies' operations. Merger costs are likely to be substantial, and may even exceed merger savings for years after the merger is consummated. The applicants' failure to discuss the costs associated with the proposed merger is a serious omission.

15. Without some level of detailed merger savings analysis, it is impossible to determine whether some of the claimed savings could be achieved on a stand-alone basis. In the Bell Atlantic-NYNEX merger, the Commission found that merger benefits would be considered pro-competitive only if such efficiencies are achievable as a result of the merger, and the savings are sufficiently likely and verifiable.³ The same conclusion should apply to the SBC-Ameritech merger. The applicants have not shown that the efficiencies are merger-specific, and have not shown that the savings are likely and verifiable. Indeed, the only evidence offered by the applicants regarding the achievability of merger savings consists of references to alleged actual cost savings in the SBC-Pacific Telesis merger. This evidence, however, is itself unverifiable and certainly not sufficient to support the merger savings analyses for the SBC-Ameritech merger.

16. The applicants claim that the merger will enhance consumer welfare by accelerating the introduction of new services and new technologies. The applicants allege that they will be able to share research efforts, knowledge and test markets, and be

³ Bell Atlantic-NYNEX Merger Order ¶ 157, p. 77.

more effective in rolling out new products because there will be a larger customer base to spread costly and risky development and product introductions (Gilbert and Harris, p. 16).

17. In the Bell Atlantic-NYNEX merger, the Commission expressed concern about the effect the merger would have on research and development efforts. The Commission found that R&D is a means through which firms engage in non-price competition, and the Bell Atlantic-NYNEX merger would eliminate this form of competition by the elimination of parallel research and development efforts.⁴ SBC and Ameritech assert that these concerns are not applicable here because SBC has a research subsidiary (Technology Resources, Inc.). Ameritech has no equivalent organization, and the firms, therefore, do not compete through research and development efforts (Schmalensee, p. 10). However, this information does not present an accurate picture of the individual firms' research efforts or activities. Ameritech's 1997 10-K states clearly that the Company is involved in research activities, albeit not necessarily by way of a separate subsidiary.⁵ Furthermore, neither SBC nor Ameritech has provided any evidence that they do not compete in their research and development efforts. Even if R&D competition did not exist, there is no guarantee that the combination of these two companies will lead to the faster introduction of a greater number of products. For instance, despite the existence of SBC's Technology Resources, Inc. subsidiary, I was not able to find a reference to one new innovative product or service that this subsidiary has singularly

⁴ Id. ¶ 171, p. 81.

⁵ For instance, Ameritech is involved in a joint cable TV research venture with several other firms. SBC is also part of this venture.

introduced to the market.⁶ In fact, several of the newest telecom technologies have been developed and introduced by small business ventures, as opposed to the large global telecommunications companies like SBC.

18. The applicants contend that consumers will benefit from the 30 city national/local market strategy. This business strategy is also discussed in the affidavits of Drs. Shepherd and Ankum. While SBC and Ameritech promise to promptly devote significant capital, technical and managerial resources to these 30 MSA markets, there is no guarantee that the merged companies will be successful in any or all of the 30 markets. As Dr. Ankum discusses, the Companies have had dismal experiences to date entering out-of-region local service telecom markets. This fact does not engender confidence that an ambitious, expensive market expansion plan by the applicants will be successful. Most notably, it is incorrect for the applicants to claim that a merger is necessary to implement an out-of-region entry strategy. As I will discuss in the next section, there are numerous telecommunications firms that have entered and are entering diverse geographic markets with overwhelmingly fewer technical, managerial, and financial resources than either SBC or Ameritech. As a group, the companies typically incur substantially higher capital, start up, and marketing costs in their telecom ventures than either SBC or Ameritech. From a financial perspective, these companies are at a distinct disadvantage compared to any one of the regional BOCs.

⁶ Drs. Gilbert and Harris cite DSL service as an example of a service for which Technology Resources has provided deployment assistance. However, Ameritech is also deploying DSL technology. Until 1997, much of the RBOC's research and development was conducted by Bellcore. In November, 1997, Bellcore was sold and the RBOC's have only retained the Bellcore activities that coordinate telecom requirements for national security and emergency preparedness.

19. The 30 market entry plan is part of SBC and Ameritech's more ambitious strategy to eventually offer point-to-point communications services for business customers. The applicants, in fact, complain that their businesses have and will continue to suffer because of their current inability to offer ubiquitous telecom services. If permission to enter in-region long distance markets is delayed for a significant period of time, it is unlikely that the applicants will be willing to devote the enormous amount of resources that they allege are necessary to deploy the 30 city expansion plan.

20. The applicants contend that the combination of merger synergies, technology deployment, best practices and the 30 market entry strategy will lead to lower prices for telecommunication services. This promise of future lower prices is extremely vague and at best, highly speculative. In refusing to order Bell Atlantic or NYNEX to lower prices as a condition for approval of their 1997 merger, the FCC found that the fostering of a competitive environment was the preferred method of insuring that consumers benefited from cost efficiencies.⁷ Drs. Shepherd and Ankum have in their affidavits demonstrated that this merger will substantially harm competition in the provision of local telephone service, further moving the FCC away from its stated goal. It is ironic that the applicants devote much of their affidavits to imparting the idea that current "competitive" pressures make the proposed merger necessary, and at the same time claim that the merger will bring "competitively" induced price decreases some day in the future.

21. Concerning the applicants' discussion of stranded assets, there is no evidence that SBC or Ameritech have any significant amounts of stranded assets. Furthermore, even if stranded assets did exist, SBC and/or Ameritech would likely carry significant burdens of

⁷ Bell Atlantic-NYNEX Merger Order ¶ 207, p. 95.

proof in showing that consumers, particularly residential, should be responsible for any negative financial consequences that may result from stranded asset exposure. There are many effective ways to reduce stranded asset exposure, and it is likely that the applicants' revenue and customer growth can minimize such exposure in the future. At this point in time, any discussion of stranded asset exposure is premature, and consideration of stranded assets should not be considered a legitimate benefit to the proposed merger.

IV. ACQUISITION PREMIUM

22. The merger agreement contemplates that Ameritech shareholders will receive 1.316 shares of SBC common stock for each share of Ameritech stock. Based on May 8, 1998 pre-merger announcement closing stock prices and April, 1998 common stock share numbers, the potential acquisition premium paid by SBC is approximately \$13,085,440,000. Based on September 30, 1998 common closing stock prices, the acquisition premium is \$11,992,650,000.⁸ These are both substantial purchase premiums, and exceed the 1997 total book value of Ameritech's stock at year-end 1997.⁹

23. A substantial possibility exists that SBT may attempt to recover all or some of this acquisition premium from its ratepayers, either on an intrastate or interstate basis. For instance, Southwestern Bell Telephone is currently under incentive plan regulation in most of its states. Such plans allow the company some flexibility to raise prices for "non-essential services." In Texas, the company has recently requested a \$30 - \$40 million increase to basic local rates. The company's incentive plans in Missouri and

⁸ The May 8th price of SBC and Ameritech stock was \$42 3/8 and \$43 7/8, respectively. Stock prices on September 30, 1998, were \$44 3/8 and \$47.5, respectively. Ameritech had 1,100,496,190 common shares outstanding as of June 1998. The exact amount of the acquisition premium will, of course, depend on the relative prices of the Companies' stock at the time of the merger.

⁹ Total book value was about \$8.3 billion at the end of 1997.

Oklahoma will expire in 2000 and 2001, respectively, leaving open the possibility of future price increases in those states. In addition to Southwestern Bell's plan to raise basic local rates in Texas, the company has also applied to the Texas Commission to increase rates for certain discretionary services (e.g., call waiting, caller ID and call forwarding) for business and residential customers. Southwestern Bell has asserted that after 1999, several of its services should be subject to substantially less regulation in Texas, even though this would create the potential for even more rate increases after the time period for incentive regulation has expired. At least for residential customers, alternative local service facilities are extremely limited, if available at all. Thus, until local competition develops, residential ratepayers may well bear the brunt of any attempt by SBC and Southwestern Bell to recover the acquisition premium from its customers.

24. In addition to price increases for various services, SBC might attempt to recover the acquisition premium through a reduction in operating expenses, and a consequent reduction in service quality. This would be particularly the case for non-competitive services.

25. The substantial current market premium that SBC is paying for Ameritech indicates the expectation that above-normal profits will continue to be earned by the combined entity. This expectation implies a continuation of the basic local monopoly, continued high revenue growth and continued high profits.

26. The acquisition premium paid by SBC is also indicative of the substantial economic value associated with eliminating a significant potential future competitor (i.e., Ameritech). The entry of Ameritech and SBC into other local markets is discussed in more detail by Dr. Augustus Ankum.

V. FINANCIAL PROFILE OF THE TELECOMMUNICATIONS INDUSTRY

27. The applicants contend that the merger is necessary to provide them with the financial resources and technical capability to compete as a “global telecommunications” company. SBC and Ameritech have concluded that the changing telecommunications markets and the emergence of other telecommunications competitors is no longer conducive to the existence of regional-based telecommunications providers. The applicants claim that the merger is absolutely essential to meet the demands of their customers for single source telecommunication services. The Companies also claim that customer loss and revenue erosion will be the end result of a business strategy that only focuses on regional, as opposed to global, marketplaces.

28. Drs. Schmalensee and Taylor state that Ameritech and SBC face “formidable” competitors in local exchange markets. They contend that these competitors have “clear” competitive advantages compared to the applicants, including existing wireline networks, customer relationships, and brand recognition (p. 22). Schmalensee and Taylor also claim that the more efficient service deployment program associated with the merger will enable SBC to make a more effective challenge to the market dominance and high profit margins of the big three long distance carriers (p. 10).

29. Mr. Weller states that local and intraLATA toll competitors have grown substantially, operating with “huge” financial backing from the capital markets (p. 3). Furthermore, Mr. Weller alleges that the recent wave of mergers and joint ventures in the telecom industry are creating a collection of “super carriers” that SBC or Ameritech cannot compete with on a stand-alone basis.

30. SBC's affiants have grossly exaggerated and overestimated the extent of the competitive challenges it faces in the telecommunications market. Most notably, there are only a few firms in the telecommunications marketplace that currently exceed SBC in revenues and assets. If the merger is approved, SBC's and Ameritech's combined revenues and assets will be exceeded only by AT&T, assuming that the proposed AT&T-TCG merger is successfully completed.

31. In Exhibit 2, I have shown several financial statistics for virtually all U.S. based telecom or cable companies that are referenced or cited in the applicant's affidavits.¹⁰ Although there are many more telecom companies offering service throughout the U.S., the companies cited by the Applicants and shown in the Exhibit are certainly among the largest and most well known. Many of the smaller telecom companies operating today are privately held concerns, with no public debt or equity holdings.

32. Although other RBOC companies were not specifically cited as competing companies, they are included in Exhibit 2 to provide perspective on the financial strength of a combined Ameritech/SBC vis-à-vis other RBOC's.

33. The telecommunications industry can be best characterized as an industry with a few very large firms with substantial assets, income, and revenues, and a multitude of small firms with virtually insignificant assets, revenues and income compared to the largest firms. The majority of the competitors that the applicants refer to would not be considered financially sound, according to common evaluative criteria used by bond and common stock investment analysts. These competitors either have negative common equity balances, negative net income, high debt ratios, high debt costs, low interest

¹⁰ Financial information was not available for Covad Communication or for Focal Communications, which appear to be privately held businesses.

coverage ratios, or a combination of all these factors. Many of these firms are attracting capital at extremely high cost rates. Teligent, E.spire, Hyperion and Allegiance, for instance, incur 11.5% - 15% coupon rates on their debt, which for all practical purposes is not considered investment grade. SBC and Ameritech, on the other hand, incur coupon rates of under 10%. The vast majority of SBC's and Ameritech's debt issuances are the 5% - 7% coupon range.¹¹

34. The majority of the smaller telecom companies in Exhibit 2 that are rated by Moody's have been assigned non-investment bond ratings (double B or below).¹² Debt issuances with double B or single B ratings are considered to have speculative elements, and the future payment of principle and interest is not well assured. Companies with C bond ratings are likely to be arrears in payments, and such issues are often in default or in danger with respect to principal or interest payments.

35. While Mr. Weller may be correct in his belief that competing telecom firms have been successful in obtaining access to capital, he fails to recognize the extremely high debt and equity costs these firms encounter. In fact, access to the capital markets at extraordinary high return requirements puts the competitors at a distinct cost disadvantage in starting up and expanding their operations. Approval of the merger would make this disparity even greater.

36. The applicants state that they do not have the financial resources to engage in an out-of-region expansion strategy on a stand-alone basis. WorldCom, a company that is

¹¹ Data on debt cost rates is obtained from the companies' Annual Reports to Shareholders.

¹² The only companies with investment grade ratings are Ameritech, AT&T, Cox, MCI, SNET, Sprint, TCI Communications, WorldCom, and the RBOCs. SBC, SNET, Bell Atlantic and AT&T have double A ratings, whereas Bell South's rating is triple A. U.S. West and Ameritech have a mix of double AA and single A rated debt. Cox, MCI, Sprint, TCI Communications and WorldCom have triple B ratings.

repeatedly cited in the applicants' affidavits as a most ubiquitous, powerful competitor, is not nearly as large or as financially successful as SBC alone, let alone the telephone behemoth that would result from a combined SBC/Ameritech. WorldCom's 1997 revenues are only 30% of SBC's, and it has only about 53% of SBC's assets. WorldCom's return on equity is also substantially lower than either Ameritech's or SBC's, and the company has never paid dividends to its shareholders. Even after the merger of MCI and WorldCom, the assets and revenues of the combined company will still be considerably smaller than a combined SBC/Ameritech.

37. The only non-RBOC telecom competitor that currently exceeds SBC in revenue and assets is AT&T. However, AT&T is still primarily a long distance service company, which accounted for 90% of the company's 1997 revenues. AT&T's local, wireless and other initiatives (primarily online services) are currently operating at a loss.¹³

38. It is abundantly clear that individually SBC and Ameritech already have access to the financial resources needed to expand their operations. For the non-RBOC group of competitors cited by SBC in its application, Ameritech on a stand-alone basis is exceeded in size and revenues only by AT&T and MCI.¹⁴ Ameritech also had the second highest 1997 return on equity for all the telecommunications firms listed in Exhibit 2.

39. Contrary to the statements of Drs. Schmalensee and Taylor (p. 10), the long distance carriers cannot be characterized as having unilaterally high profit margins. MCI has had quite modest returns on equity and returns on total capital for the past four years, ranging from 1.7% to 11%. The same is true of WorldCom, whose returns have ranged

¹³ See AT&T 1997 Annual Report to Shareholders, pp. 28 and pp. 33-34.

¹⁴ While Ameritech is the second smallest RBOC, this fact does not diminish Ameritech's leading financial position among the competitors cited in the affidavits. U.S. West is the only RBOC smaller than Ameritech.

from 1% to 12%. Sprint has had quite high equity returns ranging from 10.5% to 19%, and its returns on capital have been about 8% to 13.5%. Sprint, however, is both a long distance and local service company. The Company's local service operations operate with substantially higher operating margins than do its long distance operations.¹⁵ SBC, on the other hand, has experienced returns on equity ranging from 19% to 34% in the last four years, and returns on capital have ranged from 13% to 18.5%. Ameritech's equity returns have ranged from 18.5% to 28%, and its returns on total capital have been about 18%.¹⁶

40. The smaller, non-RBOC competitors' equity returns have been dismal. As shown in Exhibit 2, the vast majority of telecom companies had negative equity returns in 1997 and many of the companies have negative common equity balances. The negative common equity balances are indications that in prior years, net income to common was also negative.

41. Undoubtedly, some of the competitors currently offering services in telephony markets may be highly successful in expanding their businesses, and may become significant providers of telecommunication services in the future. The relatively poor financial condition of other telecommunications providers (relative to SBC and Ameritech) does not necessarily mean that they cannot compete now or in the future. Thus, the one year's worth of financial comparisons I have shown in Exhibit 2 should not be considered an indication of future profitability and growth prospects. However, the

¹⁵ See Sprint Corporation's 1997 SEC 10-K, pp. F-29 and F-31.

¹⁶ Data for returns of capital and equity are from the July 10, 1998 edition of the Value Line Investment Survey. Value Line typically excludes nonrecurring losses and nonrecurring gains from its reported earnings. As a result, Value Line's calculated returns on equity and returns on capital may be different from those reported by the companies.

current financial positions of the competitors does illustrate the singular position of SBC and Ameritech, and offers strong contrary evidence to the companies' claims that their stand-alone size and financial resources are not adequate to compete in a global telecommunications market. These companies certainly have a leading competitive edge in many markets that can serve as strong impetuses to future global growth. For instance, Mr. Weller discusses the extensive international holdings by Ameritech and SBC (p. 6), and the companies' continuing dominance in local exchange markets is uncontroverted.¹⁷ The unfortunate result of this merger, if approved, is that other smaller competitors may find it increasingly difficult to survive, leading to additional business combinations among the various telecom companies.

42. Finally, Mr. Weller discusses the reasons that Ameritech has not pursued an expansion strategy through acquisitions, as opposed to merging with SBC. Mr. Weller opines that Ameritech shareholders would be unfairly penalized if the company engaged in an acquisition strategy because, unlike other telecom providers, Ameritech is largely valued on the basis of earnings growth and the ability to meet analysts' earnings estimates (p. 17). Since acquisitions would tend to dilute earnings in the short run and negatively impact stock prices, Mr. Weller concludes that a merger would be more favorable from the stockholders' point of view.

Mr. Weller's opinions are nonsense. First of all, his discussion does not explain why Ameritech's acquisition of another firm is any different than SBC's acquisition of Ameritech. SBC expects some earnings dilution to occur as a result of this merger, and this is exactly what Ameritech claims should be avoided. Second, it is simply not true

¹⁷ For instance, both the FCC and various state commissions have found that SBC and Ameritech face little competition in the provision of local service. This issue is discussed in more detail by Drs. Ankum and

that companies with long histories of positive earnings results are valued any differently than newer companies that have not established such records (e.g., WorldCom, many CLEC's, and Internet Services). All firms are valued on their long-term earnings and dividend prospects, and there is no difference in the asset valuation models used in valuing the RBOCs and the new telecom competitors. If any difference does exist, it is that the newer competitors are generally expected to have higher future earnings growth prospect than the RBOCs. However, this factor must be weighed against the substantial dividend payments paid to RBOC shareholders, and the fact that the RBOCs have long histories of yearly dividend increases.

VI. COMPETITION IN THE TELECOMMUNICATIONS INDUSTRY

43. The applicants have not presented a very accurate picture of the competitive status or competitive activities of alternative telecom providers. In the telecommunications company annual SEC 10-K reports, each company's management is required to provide an accurate assessment of the nature and extent of competition faced in the marketplace. These comments offer an interesting alternative view of the problems and concerns faced by the "competitors" cited in SBC's and Ameritech's affidavits.

44. The applicants claim that entry into the local service market is easier than in the past, and that resale is a particularly attractive strategy because of the retail service discounts provided to resellers (Schmalensee and Taylor, pp. 19 – 20). However, contrary to SBC's opinion, at least two of the CLEC carriers claim that entry into the local resale market is extremely difficult, requiring considerable time, effort and expense.¹⁸ Also, contrary to assertions by Drs. Schmalensee and Taylor (p. 23), the

Shepherd.

¹⁸ Allegiance Telecom, 1997 10-K, p. 17; Hyperion Telecommunications, 1997 10-K, p. 21.

competitive carriers express concern that the RBOC's and ILEC's long standing relationships with their customers, their greater financial, technical and market resources, and the incumbent local carriers' ability to engage in cross-subsidization of competitive services put the competitors at a distinct disadvantage in the marketplace.¹⁹

45. Even AT&T, which is currently the largest telecommunications carrier in the U.S., has experienced considerable difficulty in entering local markets. Drs. Schmalensee and Taylor express their opinion that AT&T has experience comparable to that of SBC or Ameritech in providing local service telecom networks, and has the additional advantage of being able to sell any ILEC product that might give the ILEC a competitive advantage (p. 26). AT&T does not quite view the situation in the same positive light as Drs. Schmalensee and Taylor. The company states that it has actually experienced considerable difficulty in penetrating local markets due to regulatory and judicial actions, as well as a lack of technical and operational interfaces necessary to order network elements from ILECs. AT&T adds that in spite of strong demand, the company actively stopped marketing resold local service to residential and small business customers in most service areas in the fourth quarter of 1997. The reasons for these actions include limitations on ILEC's ability to handle anticipated demand, and the fact that AT&T did not receive a large enough discount from the ILECs to make resale a viable, long-term method of offering service.²⁰

46. Several of the competitive carriers claim that the ability to offer local telephone

¹⁹ Allegiance Telecom, 1997 10-K, pp. 19 & 23; USN Communications, 1997 10-K, p. 7; GST Telecommunications, 1997 10-K, pp. 16 & 17; ICG Communications, 1997 10-K, p. 12; Hyperion Telecommunications, 1997 10-K, p. 18; Intermedia Communications, 1997 10-K, pp. 13 & 23; Winstar Communications, 1997 10-K, p. 11.

²⁰ AT&T Corp., 1997 SEC Form 10-K, p. 5.

services packaged with point-to-point long distance service may be their primary competitive advantage compared to the ILEC and RBOC operations. These carriers assert that if in-region long distance entry is provided to the RBOCs, the competitor's operations may or will be adversely affected.²¹ Many CLEC carriers cite the loss of access revenues from IXCs and the ability to offer competitively priced local and long distance service as specific concerns associated with RBOC long distance entry.²²

47. The competitive carriers also express concern that the current merger trend among telecommunications companies is making it increasingly difficult for them to compete and remain in business.²³ A few carriers are actively searching for merger possibilities.

48. Because of the ILEC's and RBOC's overwhelming dominant market position in local service provision, the competitive carriers have also expressed concern about the increased pricing flexibility that may be allowed by FCC and state regulators. As the telecommunication market becomes more competitive, RBOC and ILEC pricing flexibility, along with their ability to engage in cross-subsidization, may have or will have a material adverse effect on smaller competitor operations.²⁴

49. The difficulties faced by the alternative telecom carriers in entering and growing their markets are not to be construed as an indication that they cannot or will not be able to effectively function in the marketplace. To date, however, the CLEC carriers have not

²¹ USN Communications, 1997 10-K, p. 9; GST Telecommunications, 1997 10-K, p. 18; ICG Communications, 1997 10-K, p. 13; Hyperion Telecommunications, 1997 10-K, p. 24; Intermedia Communications, 1997 10-K, p. 12; Teligent, Inc. 1997 10-K, p. 15; McLeodUSA, 1997 10-K, p. 23; American Communications Services (predecessor to E-Spire), 1997 10-K, p. 12.

²² GST Communications, 1997 10-K, p. 18; ICG Communications, 1997 10-K, p. 13; Hyperion Telecommunications, 1997 10-K, p. 24.

²³ McLeodUSA, 1997 10-K, p. 17; USN Communications, 1997 10-K, p. 10; Intermedia Communications, 1997 10-K, p. 23.

²⁴ Intermedia Communications, 1997 10-K, pp. 12 & 17; Teligent, Inc., 1997 10-K, p. 12; Electric Lightwave, 1997 10-K, p. 11; American Communication Services (predecessor to e.spire), 1997 10-K, pp. 10 & 11; Allegiance Telecom, 1997 10-K, pp. 19 & 20; Winstar Communications, 1997 10-K, p. 16.

made any significant inroads into Ameritech's and SBC's service territories. In SBC territory, only 650,000 access lines are currently being resold, comprising less than 2% of the company's total access lines. In Ameritech territory, about 635,000 lines are being resold, which is about 3% of the company's total access lines.

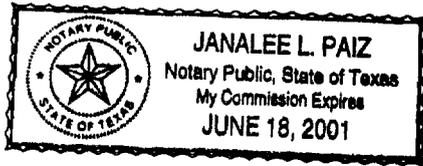
These relatively bleak statistics have been manifested in both state regulatory commission and FCC refusals to grant the RBOC's permission to enter local markets, and additionally confirmed by the competitive carriers' assessments of their own market positions.

The information contained in this affidavit is true and correct to the best of my knowledge and belief.

Signed on October 13, 1998.

Carol A. Szerszen
Carol A. Szerszen

SWORN TO AND SUBSCRIBED BEFORE ME on October 13, 1998 by
Carol A. Szerszen.



Janalee L. Paiz
Notary Public, State of Texas

EXHIBIT 1

EDUCATIONAL AND EMPLOYMENT HISTORY

CAROL A. SZERSZEN

EDUCATION

Ph.D., Economics, 1979 University of Illinois (Urbana)

Ph.D. Fields: Labor Economics
Public Finance
Industrial Organization

M.S., Economics, 1975 University of Illinois (Urbana)

B.U.P., Urban Planning University of Illinois (Urbana)

EMPLOYMENT HISTORY

Economist
Office of Public Utility Counsel
State of Texas
January 1984 - present

Utility Specialist
Iowa State Commerce Commission
State of Iowa
October 1981 - January 1984

Research Associate
American Medical Association
Health Care Research and Policy
August 1980 - June 1981

Assistant Professor
Introductory Economics and Transportation Regulation
University of Wisconsin
August 1979 - August 1980

Instructor
Introductory Economics
Illinois State University
August 1978 - 1979

Research Grant
University of Illinois Research Board
Fall 1977 - August 1978

Teaching Assistant
Introductory Economics
University of Illinois
Fall 1974 - Spring 1977

Testimony presented before the Iowa State Commerce Commission:

<u>Style</u>	<u>Subject</u>
RPU 83-24 Iowa Power & Light	Cost of Capital
RPU 82-12 Iowa Power & Light	Cost of Capital
RPU 82-49 Northwestern Bell	Labor Costs
RPU 83-14 Union Electric	Cost of Capital
RPU 84-7 Northwestern Bell	Labor Costs
Independent Commission Studies:	
INU 82-3	Iowa Utility Executive Compensation
INU 82-1	Northwestern Bell Salary and Wages

Testimony presented before the Texas Railroad Commission:

No. 5207 Lone Star Gas Company	Cost of Capital and Financial Integrity
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Testimony presented before the Federal Energy Regulatory Commission:

EC94-7-000 & EC94-7-898-000 El Paso Electric Company and Central and South West Services, Inc.	Merger Savings
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Testimony presented before the Texas Public Utility Commission:

No. 5560 Gulf States Utilities Company	Cost of Capital and Financial Integrity
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No. 5640 Texas Utilities Electric Co.	Same as above
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No. 5779 Houston Lighting & Power Company	Same as above
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No. 6027 Lower Colorado River Authority	Same as above
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No. 6200 Southwestern Bell Telephone Co.	Same as above
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No. 6375 Central Power and Light Company	Same as above
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No. 6525 Gulf States Utilities Company	Same as above
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No. 6588 Southwestern Bell Telephone Co.	Declassification of Confidential Documents
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Nos. 6765 and 6766 Houston Lighting & Power Company	Cost of Capital and Financial Integrity Executive Bonus Plan
Nos. 7195 and 6755 Gulf States Utilities Company	Interim Rate Relief
Nos. 7195 and 6755 Gulf States Utilities Company	Cost of Capital and Financial Integrity
No. 7289 West Texas Utilities Company	Deferral Accounting
No. 7375 Houston Lighting & Power Company	Deferral Accounting
No. 7510 West Texas Utilities Company	Cost of Capital and Financial Integrity
No. 8032 Lower Colorado River Authority	Debt Service Coverage Requirements
No. 7790 AT&T Communications	Determination of Market Dominance in Texas Inter-exchange Telecommunication Market
No. 8095 Texas-New Mexico Power Company	Cost of Capital
No. 7560 Central Power and Light Company	Deferral Accounting
No. 5610 GTE Southwest Incorporated	Cost of Capital
No. 8230 Houston Lighting & Power Company	Deferral Accounting

No. 8218 Inquiry of the General Counsel Into the WATS Prorate Credit	Effect of the WATS Prorate Elimination
No. 8363 El Paso Electric Company	Cost of Capital Diversification Program
No. 8425 Houston Lighting & Power Company	Cost of Capital Diversification, Economic Development Program and ERS Tariff
No. 8646 Central Power and Light Company	Cost of Capital Economic Development Tariff
No. 8928 Texas-New Mexico Power Company	Cost of Capital
Nos. 8585 and 8218 Southwestern Bell Telephone Co.	Cost of Capital and Incentive Regulation Proposed Stipulation
Nos. 8892, 9069, 9165 El Paso Electric Company	Deferral Accounting
No. 9300 Texas Utilities Electric Co.	Cost of Capital
No. 9561 Central Power and Light Company	Cost of Capital
No. 9850 Houston Lighting & Power Company	Cost of Capital
No. 9945 El Paso Electric Company	Cost of Capital and Rate Moderation
No. 9981 Central Telephone Company	Cost of Capital
No. 10200	Cost of Capital

Texas-New Mexico Power Company

No. 11229 Economic Development Tariff

West Texas Utilities Company

No. 11371 Economic Development Tariff

Central Power & Light Company

No. 11292

Entergy Corporation and Gulf
States Utilities Company Merger-Related
Acquisition Adjustment and
Amortization Plan

No. 11735

Texas Utilities Electric
Company Cost of Capital
Affiliate Transactions
Purchased Power Risk

No. 11892

General Counsel Original
Petition for Generic Proceeding
Regarding Purchased Power Purchased Power Risk

No. 11999

Houston Lighting & Power Company Economic Development Tariff

No. 12700

El Paso Electric Company Post-Bankruptcy
Capitalization
Merger Savings
Investor Losses
Lease Rejection Damages

No. 12957

Houston Lighting & Power Company Load Retention Customer
Specific Pricing Tariff

No. 12820

Central Power and Light Company Cost of Capital
Affiliate Transactions
Economic Development Tariff

No. 12065

Houston Lighting & Power Company Cost of Capital
Affiliate Transactions

No. 13943

Transmission Line CCN

Gulf Coast Power Connect

No. 13369
West Texas Utilities Company

Cost of Capital
Affiliate Transactions
Deferred Accounting
Cost of Capital
Affiliate Transactions
Deferred Accounting
Competitive Issues
Remand

No. 14965
Central Power and Light Company

Merger Savings Analysis

No. 14980
Southwestern Public Service Company

No. 16800
Sprint Communications Company, L.P.

COA Application

No. 16705
Entergy Gulf States

Cost of Capital
Affiliate Transactions
Competitive Issues

No. 17751
Texas-New Mexico Power Company

Cost of Equity
Competitive Transition Plan

EXHIBIT 2

U.S. Telecommunication Company Financial Data

COMPANY	TOTAL REVENUES	NET INCOME TO COMMON	TOTAL ASSETS	COMMON EQUITY	LONG TERM DEBT	ROE
Allegiance (1)	\$1,414,900	-\$34,549,700	\$302,271,700	-\$39,473,000	\$254,883,200	Note 6
Ameritech	\$15,998,000,000	\$2,296,000,000	\$25,339,000,000	\$8,308,000,000	\$4,610,000,000	28.71%
AT&T	\$51,319,000,000	\$4,638,000,000	\$58,635,000,000	\$22,647,000,000	\$6,826,000,000	21.61%
Bell Atlantic	\$30,193,900,000	\$2,454,900,000	\$53,964,100,000	\$12,789,100,000	\$13,265,200,000	19.01%
Bell South	\$20,561,000,000	\$3,261,000,000	\$36,301,000,000	\$15,165,000,000	\$7,348,000,000	22.96%
Cox Communications	\$1,610,364,000	-\$136,492,000	\$6,556,601,000	\$2,357,312,000	\$84,179,000	5.91%
Electric Lightwave	\$61,084,000	-\$33,945,000	\$359,962,000	\$213,314,000	\$60,000,000	-30.50%
E-spire	\$59,000,450	-\$126,646,139	\$638,895,372	-\$65,355,847	\$461,321,370	Note 6
Frontier	\$2,352,886,000	\$53,543,000	\$2,475,150,000	\$950,233,000	\$930,467,000	5.39%
GST Communications (2)	\$105,967,000	-\$113,338,000	\$728,405,000	-\$39,791,000	\$612,703,000	Note 6
Hyperion (3)	\$13,510,000	-\$81,491,000	\$634,893,000	-\$118,991,000	\$528,776,000	Note 6
ICG Communications	\$273,354,000	-\$327,643,000	\$1,107,664,000	-\$369,318,000	\$890,568,000	Note 6
Intermedia	\$247,899,000	-\$284,865,000	\$1,874,970,000	-\$140,009,000	\$1,224,455,000	Note 6
Level 3 Com (4)	\$332,000,000	\$248,000,000	\$2,779,000,000	\$2,230,000,000	\$137,000,000	12.25%
MCI	\$19,653,000,000	\$149,000,000	\$25,510,000,000	\$11,311,000,000	\$3,276,000,000	1.36%
McLeodUSA	\$267,886,000	-\$79,910,000	\$1,345,652,000	\$559,379,000	\$613,384,000	-16.60%
Nextlink	\$57,579,000	-\$168,324,000	\$1,217,153,000	\$68,460,000	\$750,000,000	-676.00%
Qwest	\$696,703,000	\$14,523,000	\$1,398,105,000	\$381,744,000	\$630,463,000	7.43%
SNET	\$1,543,500,000	\$191,700,000	\$1,953,500,000	\$659,400,000	\$667,100,000	29.88%
Sprint	\$14,873,900,000	\$951,500,000	\$18,184,800,000	\$9,025,200,000	\$3,748,600,000	10.85%
SBC (5)	\$24,856,000,000	\$1,474,000,000	\$42,132,000,000	\$9,892,000,000	\$12,019,000,000	15.09%
Teleport Communications	\$494,304,000	-\$222,667,000	\$2,456,301,000	\$1,031,616,000	\$1,034,984,000	-24.36%
TCI Communications	\$6,167,000,000	-\$70,000,000	\$21,858,000,000	-\$801,000,000	\$13,528,000,000	Note 6
Teligent	\$3,310,999	-\$138,054,155	\$596,380,268	\$274,146,222	\$300,000,000	-102.00%
Time Warner	\$13,294,000,000	-\$73,000,000	\$34,163,000,000	\$9,352,000,000	\$11,833,000,000	-0.78%
USN Communications	\$47,200,433	-\$112,103,294	\$171,200,246	-\$86,999,959	\$172,144,136	Note 6
U.S. West	\$10,083,000,000	\$1,252,000,000	\$17,008,000,000	\$4,400,000,000	\$5,019,000,000	29.60%
Winstar	\$79,631,000	-\$255,363,000	\$976,401,000	-\$118,431,000	\$768,469,000	Note 6
World Com	\$7,351,354,000	\$357,219,000	\$22,389,553,000	\$13,509,740,000	\$6,527,207,000	2.70%
Ameritech+SBC+SNET (7):	\$42,397,500,000	\$3,961,700,000	\$69,424,500,000	\$18,859,400,000	\$17,296,100,000	21.52%

Notes:

ROE = Return of Average Common Equity.

(1) Data for six months ending March 1998. Allegiance started operations in April 1997.

(2) For year ending September 30, 1997.

(3) For year ending March 31, 1998.

(4) Level 3 Com owned by Peter Kiewit Sons' Inc. Financial data includes results of construction business, information services, telecommunications, and coal mining business.

(5) 1996 ROE was 35.265%.

(6) ROE could not be calculated because the common equity balance is negative.

(7) Combined Ameritech, SBC, and SNET numbers are derived by adding the individual company financial statistics. These numbers do not necessarily reflect actual post merger, pro forma financial statistics.

Sources:

Securities and Exchange Commission 10K's and Annual Reports to Shareholders.

PETITION ATTACHMENT 4

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PUC PROJECT NO. 16251

93-11-1 P. 12:44
PUBLIC UTILITY COMMISSION
OF TEXAS

INVESTIGATION OF §
SOUTHWESTERN BELL TELEPHONE §
COMPANY'S ENTRY INTO THE §
TEXAS INTERLATA §
TELECOMMUNICATIONS MARKET §

**ORDER NO. 25
ADOPTING STAFF RECOMMENDATIONS;
DIRECTING STAFF TO ESTABLISH COLLABORATIVE PROCESS**

Comments and Recommendations

At the May 21, 1998 open meeting, the Commission discussed staff's recommendations on Southwestern Bell Telephone Company's (SWBT's) notice of intent to file section 271 application for interLATA authority in Texas. The Commission adopted, as modified, staff's recommendations. Attachment 1 contains the recommendations adopted by the Commission.

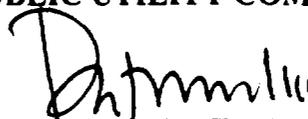
Collaborative Process

Also at the May 21, 1998 open meeting, the Commission directed the staff to establish a collaborative process to address all the issues outlined by Commissioners and staff, as contained in the attached recommendation. The goal of the collaborative process shall be to institute workable solutions to the issues outlined by Commissioners and staff, including a series of specific commitments and obligations by SWBT, and to review data obtained during the process. At the conclusion of the collaborative process, SWBT shall supplement the record to show its compliance with the requirements of section 271. The successful conclusion of the collaborative process and supplementation of the record would allow the Commission to reach a positive recommendation to the FCC on SWBT's application.

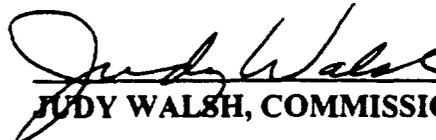
A subsequent order shall detail the specific procedures and schedule for the collaborative process.

SIGNED AT AUSTIN, TEXAS the 1st day of June 1998.

PUBLIC UTILITY COMMISSION OF TEXAS



PAT WOOD, III, CHAIRMAN



JUDY WALSH, COMMISSIONER



PATRICIA A. CURRAN, COMMISSIONER

PUC PROJECT NO. 16251

INVESTIGATION OF	§	
SOUTHWESTERN BELL TELEPHONE	§	PUBLIC UTILITY COMMISSION
COMPANY'S ENTRY INTO THE	§	
TEXAS INTERLATA	§	OF TEXAS
TELECOMMUNICATIONS MARKET	§	

COMMISSION RECOMMENDATION

The Texas Public Utility Commission (the Commission) and the telecommunications industry have worked steadily since the passage of the federal Telecommunications Act of 1996¹ (FTA96) to negotiate and arbitrate interconnection agreements that will facilitate local competition in Texas. Pursuant to FTA96, new entrants have the legal authority to enter the local market in Texas through resale, unbundled network elements (UNEs), and interconnection. FTA96 § 251 (47 U.S.C. § 251).

In order to provide in-region interLATA services, Southwestern Bell Telephone Company (SWBT), a Bell Operating Company (BOC), must establish that the local telecommunications market is irreversibly open to competition.² Specifically, Section 271 of FTA96 requires SWBT to establish that

- it satisfies the requirements of either Section 271(c)(1)(A), known as "Track A," or Section 271(c)(1)(B), known as "Track B";
- it is providing the 14 checklist items listed in Section 271(c)(2)(B) pursuant to either a Track A state-approved interconnection agreement or a Track B statement of generally available terms (SGAT);
- the requested authorization will be carried out in accordance with the requirements of Section 272; and
- SWBT's entry into the in-region interLATA market is "consistent with the public interest, convenience, and necessity." Section 271(d)(3)(C).

Although the Federal Communications Commission (FCC) ultimately determines whether SWBT has established its entitlement to enter the interLATA market pursuant to Section 271, the statute directs the FCC to consult with state commissions. The FCC relies upon state commissions to develop a complete factual record.³

¹ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (codified as amended in scattered sections of 15 and 47 U.S.C.) (FTA96).

² See e.g., Memorandum Opinion and Order, Docket No. 97-137, In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as Amended, to Provide In-region, InterLATA Services in Michigan (August 19, 1997) (Ameritech Michigan Order).

³ Ameritech Michigan Order at ¶ 30.

SWBT filed its application to provide in-region interLATA service in Texas on March 2, 1998 with the Commission. On April 7, 1998, the Commission held an open meeting at SWBT's Local Service Center (LSC) in the Dallas-Ft. Worth area and on April 21st through the 25th, the Commission held an extensive hearing on SWBT's application. Many competitive local exchange companies (CLECs) and other parties participated in the Commission's 271 proceeding.

SWBT has done much in Texas to open the local market to competition. Notwithstanding that fact, if the Commission were asked to give a recommendation to the FCC today, it regrettably would be required on the record before it to say "not yet." The Commission files this Recommendation in an effort to provide SWBT with guidance on what the Commission believes SWBT will need to do in order for this Commission to say that the local market is irreversibly open and SWBT should be allowed to provide in-region interLATA service. The Commission files this Recommendation in the spirit of cooperation and in the hope that SWBT will work with the 271 participants and this Commission to get SWBT to "yes."

Participants presented evidence throughout this Section 271 proceeding that indicated their difficulty in working with SWBT to interconnect, purchase UNEs, and provide resale. Although the Commission believes the evidence may indicate that SWBT needs to change its corporate attitude and view the participants as wholesale customers, the Commission also believes many of the problems may be attributable to lack of communication within SWBT and between SWBT and the participants. The Commission believes that SWBT attempted to address many of the problems raised by the participants during the course of the 271 hearing itself. The Commission hopes that this response by SWBT indicates a willingness to address the issues that will get SWBT to "yes."

Public Interest

With regard to the public interest aspect of Section 271 (including the "ease of doing business with SWBT") the Commission makes the following recommendations:

1. The Commission shall establish a collaborative process whereby SWBT, Commission staff, and participants to this project establish a working system that addresses all of the issues raised in this recommendation;
2. SWBT needs to show this Commission and participants during the collaborative process by its actions that its corporate attitude has changed and that it has begun to treat CLECs like its customers;
3. SWBT needs to establish better communication between its upper management, including its policy group, and its account representatives. As a first step, SWBT shall develop policy manuals for its account representatives and put in place a system, such as email notifications, to communicate decisions by the policy group to account representatives and questions or comments back to the policy group;

4. SWBT needs to establish consistent policies used by all SWBT employees in responding to issues raised by CLECs. Toward that end, SWBT shall establish an interdepartmental group whose responsibility is trouble-shooting for CLECs engaged in interconnection, purchase of UNEs, and resale. This group shall be headed by an executive of SWBT with the final decision making power;
5. SWBT needs to establish a system for providing financial or other incentives to LSC personnel based upon CLEC satisfaction;
6. SWBT needs to commit to resolving problem issues with CLECs in a manner that will give CLECs a meaningful opportunity to compete;
7. SWBT shall draft a comprehensive manual for CLECs to ensure the timely provision of all aspects of interconnection, provision of UNEs and resale. The manual shall be written in a fashion that clearly delineates parties' responsibilities, the procedures for obtaining technical and other practical information, and the timelines for accomplishing the various steps in interconnection, purchase of UNEs and resale. The manual should also set forth SWBT's policy with regard to a CLEC's ability to adopt an approved interconnection agreement pursuant to Section 252(i) (this process will be referred to as the "MFN" process);
8. SWBT needs to treat CLECs at parity with the way it treats itself or its unregulated affiliates;
9. SWBT needs to show proof that it has made all the changes it agreed to make during the process of the Commission's 271 hearing, all of which have been detailed in the record;
10. SWBT needs to establish that its interconnection agreements are binding and are available on a nondiscriminatory basis to all CLECs;
11. To the extent SWBT chooses to establish 271 requirements by relying upon interconnection agreements it has appealed, SWBT should consider adopting a statement of generally available terms and conditions;
12. SWBT needs to establish that it is following all Commission orders referenced in this recommendation and that it intends to follow future directives of the Commission;
13. SWBT needs to establish its commitment to offering the terms of current interconnection agreements during any period of renegotiation, even if the negotiations extend beyond the original term of the interconnection agreements;
14. Commission staff, SWBT, and the participants need to establish adequate performance monitoring (including performance standards, reporting requirements, and enforcement mechanisms) during the collaborative process that will allow self-policing of the interconnection agreements after SWBT has been allowed to enter the long distance market;
15. SWBT shall not use customer proprietary network information to "winback" customers lost to competitors.

Checklist Items

ITEM ONE: Has SWBT provided interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1), pursuant to 271(c)(2)(B)(i) and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall investigate and implement measures to expedite construction and installation activities both at tandem and end office locations and, in order to provide for a reasonably foreseeable demand, SWBT shall engage in cooperative planning of trunking facilities with a view toward providing parity for CLECs;
2. The physical collocation tariff should be amended to be made available to any CLEC that wants to physically collocate in SWBT's facilities. A CLEC should be allowed to use the tariff without going through the MFN process in Section 252(i) of FTA96;
3. SWBT shall implement a cost-based virtual collocation tariff available to all CLECs;
4. SWBT shall allow CLECs to buy equipment from non-SWBT entities, and in turn, sell the equipment to SWBT in order to reduce the CLECs' costs.

ITEM TWO: Has SWBT provided nondiscriminatory access to network elements in accordance with the requirements of section 251(c)(3) and 252(d)(1) of FTA, pursuant to 271(c)(2)(B)(ii) and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall offer at least the following three methods to allow CLECs to recombine UNEs. These three methods attempt to balance SWBT's security concerns with the desire of CLECs to combine UNEs:
 - virtual collocation of cross-connects at cost-based rates,
 - access to recent change capability of the switch to combine loop port combinations, and
 - electronic access such as Digital Cross Connect (DCS) for combining loop and port at cost based rates, where available;

2. SWBT, Commission Staff, and the participants to this proceeding shall explore the following issues during the collaborative process:
 - additional methods for recombining UNEs or for allowing CLECs to combine UNEs and the costs associated with such methods;
 - whether SWBT is providing any and all individual UNEs required by FTA96;
3. Concerning virtual collocation of cross connects, the Commission recommends that CLECs be able to provide incumbent local exchange companies (ILECs) with rolls of their own wire. When a customer changes carriers from the ILEC to a CLEC, the ILEC would take out a wire from the CLEC's inventory, untie and remove the ILEC's wire, and insert and tie the CLEC's wire. Similarly, if a customer returns to the ILEC, the ILEC must remove the CLECs wire, insert its wire, and return the CLEC's wire to the CLEC's inventory. SWBT, under this scenario, would be able to recover its forward-looking, economic costs and insure the security of the network;
4. Concerns have been raised about the Commission requiring CLECs to obtain right to use licenses, where necessary, when leasing UNEs.⁴ Under the current UNE rates, the Commission believes the right to use decision made in the mega-arbitration⁵ is appropriate. However, the Commission invites CLECs to seek a UNE-Right to Use adder. This adder would compensate SWBT for costs associated with right to use arrangements. For CLECs choosing to pay the cost-based adder, SWBT would agree to provide the right to use arrangements as a wholesale function. For CLECs choosing not to pay the adder, the Commission's position in the mega-arbitration would apply. The parameters of this issue shall be negotiated in the collaborative process.

ITEM THREE: Has SWBT provided nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by SWBT at just and reasonable rates in accordance with the requirements of section 224 of the Communications Act of 1934 as amended by the FTA96 pursuant to 271(c)(2)(B)(iii), and applicable rules promulgated by the FCC?

RECOMMENDATION: If SWBT implements the Commission's recommendations in the **public interest** section above, and the **OSS** and **performance standard** sections addressed below, the Commission believes SWBT will meet this checklist item.

ITEM FOUR: Does the access and interconnection provided by SWBT include local loop transmission from the central office to the customer's premises, unbundled from local switching or other services in accordance with the requirements of section 271(c)(2)(B)(iv) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, Staff

⁴ The issue of the rights of third party vendors is currently pending before the FCC.

⁵ "Mega-arbitration" is the term used to refer to several arbitration dockets, specifically Nos. 16189, 16196, 16226, 16285, 16290, 16455, 17065, 17579, 17587, and 17781, all of which were consolidated into one docket.

recommends the following, the details of which could be established in the collaborative process. Staff believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall publish a technical manual showing CLECs how to use the unbundled loops to provide Asymmetric Digital Subscriber Line (ADSL) and High-Speed Digital Subscriber Line (HDSL) services. Spectrum management of available cable space shall be conducted by SWBT in an expedited manner, upon request from a CLEC who intends to use the unbundled loop for high speed ADSL and/or HDSL services;
2. SWBT shall also allow 4-wire HDSL service on an unbundled loop, provided the subscriber to such service has adequate cable or channel capacity or other means to place 911 calls from the same location;
3. SWBT must demonstrate it is complying with its development/reporting obligations for digital subscriber loops and that CLECs using recombined UNEs will have access to mechanized line testing (MLT) at parity with SWBT before the Commission can recommend that SWBT be found to have met this checklist item. Moreover, to the extent SWBT provides virtual collocation of the cross-connect and/or disconnection by recent change order, the MLT issue may be resolved.

ITEM FIVE: Does the access and interconnection provided by SWBT include local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services in accordance with the requirements of section 271(c)(2)(B)(v) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the public interest section, and the OSS and performance standard sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall be required to provide the multiplexar and the unbundled dedicated transport (UDT) as a UNE;
2. SWBT shall be required to demonstrate that it is complying with the order in Docket No. 18117 and that it is providing two-way trunks upon request to CLECs. Although the Commission concurs with SWBT that the mere existence of a past dispute that has been resolved by the Commission does not disqualify SWBT from satisfying a check list requirement, it is necessary for SWBT to demonstrate that it is, in fact, complying with the Commission's orders.

ITEM SIX: Does the access and interconnection provided by SWBT include local switching unbundled from transport, local loop transmission, or other services in accordance with the requirements of section 271(c)(2)(B)(vi) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall be required to expedite the design process to implement measurement capability in its switching and billing systems for terminating access/originating 800 usage data for the unbundled switch or provide sufficient evidence to demonstrate why expediting this development is not feasible. The Commission further recommends that this issue, including interim compensation solutions, be explored in more detail during the collaborative process among SWBT, the participants, and Commission staff;
2. As an alternative recommendation, in the event SWBT is allowed to provide in-region interLATA service before providing a technical solution to this problem, the Commission could recommend to the FCC that SWBT interLATA relief be limited to originating, non-800 type interLATA service until SWBT has demonstrated that it provides CLECs usage data for these type of calls;
3. If a party wishes to obtain customized routing by using line-class codes, SWBT shall be required to provide such option. The appropriate rates for such service shall be based on forward looking costs. To the extent that no CLEC is interested in obtaining customized routing by using line-class codes at cost-based rates, SWBT may still be considered as "providing" such customized routing in compliance with this checklist item.

ITEM SEVEN: Has SWBT provided nondiscriminatory access to the following, pursuant to section 271(c)(2)(vii) and applicable rules promulgated by the FCC: (a) 911 and E911 services; (b) directory assistance services to allow the other telecommunications carrier's customers to obtain telephone numbers; and, (c) operator call completion services?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall provide a compare file to each CLEC so the CLEC can verify the accuracy of 911 database information it has submitted with the actual entry by SWBT. Additionally, SWBT shall include a parity performance measure that would indicate the number of records that were entered incorrectly for its own customers, each CLEC's customers, and all CLEC

- customers. SWBT shall file these reports for a minimum of three months with the parties and the Commission staff to determine if parity performance violations have occurred. Until such determination is made SWBT has not met the burden of proof that it is indeed providing parity performance;
2. Pursuant to the Mega-Arbs, SWBT shall not remove customer data from the directory assistance (LIDB) database when a new customer is served through UNEs;
 3. SWBT shall collaborate with the CLECs and Commission staff to create a procedure to establish non-discriminatory procedures for customers that have been won back;
 4. In addition, SWBT has denied access to ILEC directory assistance listings claiming that the ILECs have not given SWBT permission to release their customer's information. At the hearing, SWBT stated that these listings would be released as soon as that permission was received. Tr. at 1055. SWBT and the participants shall coordinate their efforts to acquire the ILECs' permission through the use of a standard release.

ITEM EIGHT: Has SWBT provided white pages directory listings of customers of other telecommunications carrier's telephone exchange service, pursuant to section 271(c)(2)(B)(viii) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall be required to provide CLEC resellers with the opportunity to review and correct white pages directory listings prior to the date white pages directory listings are published in telephone directories to sustain its burden of proof with regards to the nondiscriminatory access standard between and among carriers;
2. SWBT shall allow CLECs to choose whether their white page listings are interspersed with SWBT listings or whether they are separate from SWBT's listings;
3. SWBT shall allow CLEC resellers the same options as facilities-based CLECs for distribution of white page telephone directories;
4. SWBT shall institute a procedure to permit CLECs to adhere advertisements to the white pages directory.

ITEM NINE: Has SWBT provided nondiscriminatory access to telephone numbers for assignment to the other telecommunications carrier's telephone exchange service customers, pursuant to section 271(c)(2)(B)(ix) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATION: The Commission concludes that SWBT has satisfied the requirements of this checklist item with no further action.

ITEM TEN: Has SWBT provided nondiscriminatory access to databases and associated signaling necessary for call routing and completion, pursuant to section 271(c)(2)(B)(x) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATION: The Commission concludes that SWBT has satisfied the requirements of this checklist item with no further action.

ITEM ELEVEN: Has SWBT provided number portability, pursuant to section 271(c)(2)(B)(xi) of FTA96 and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall take corrective measures to minimize the manual intervention of its mechanized process in the provision of interim number portability (INP). SWBT shall provide at least three months of data beginning May 15, 1998, to this Commission and to the participants to ensure that CLEC customers do not lose service during the INP process;
2. The Commission has concerns relating to SWBT's delayed implementation of permanent number portability (PNP) as well. Delays in the implementation of PNP place competitors at a disadvantage, because interim solutions do not provide parity; staff, therefore, recommends that some measure be taken to address the potential for further delays in PNP implementation and the consequent detrimental effect on competition and that this issue be explored in more detail in the collaborative process;
3. SWBT shall set forth its policy on route indexing and other forms of INP, including the terms and conditions upon which it is offered;
4. SWBT shall demonstrate that it has an approved tariff providing for PNP.

ITEM TWELVE: Has SWBT provided nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3) of FTA96, pursuant to section 271(c)(2)(B)(xii) and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. In areas where SWBT offers optional two-way extended area service (EAS) arrangements, CLECs should have the opportunity to negotiate the interconnection rates, terms, and conditions for similar two-way arrangements with SWBT. SWBT shall be required to complete calls placed by its customers to a CLEC's two-way EAS customers as local calls provided SWBT and the CLEC have negotiated appropriate compensation for such traffic;
2. In SWBT's intraLATA dialing parity docket, Commission staff had requested that SWBT be required to file "written procedures regarding carrier-neutral, administrative and other processes it will use to implement customer selection of another intraLATA toll carrier and to provide intraLATA toll dialing parity." At this time, however, SWBT has not yet provided the Commission with any guidelines or scripts SWBT plans to use for intraLATA PIC (primary interexchange carrier) selection. SWBT has merely stated that it plans to use the same processes that have been in place for interLATA PICs, and that it has no additional details of its carrier selection process for intraLATA PIC. This issue needs to be resolved before SWBT can satisfy this checklist item.

ITEM THIRTEEN: Has SWBT provided reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2) of FTA96 pursuant to section 271(c)(2)(B)(xiii), and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS and performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall be required to abide by the Commission's ruling on compensation for internet service provider (ISP) traffic in Docket No. 18082 with respect to other CLECs. ISP traffic shall be classified as local traffic and compensated at the local interconnection rates contained in the specific SWBT-CLEC agreement, unless the agreement specifically classifies ISP traffic as non-local traffic. SWBT's obligation to pay reciprocal compensation should not be conditioned on any terms, nor should the CLECs be required to seek arbitration to receive such compensation;
2. Appropriate traffic records shall be exchanged between SWBT and CLECs to facilitate the payment of mutual compensation for calls;
3. Compensation for expanded local calling service (ELCS) traffic shall be consistent with the Commission's decision in the mega-arbitration. EAS traffic, including ELCS traffic, shall be subject to the lesser of the cost-based interconnection rates or the interconnection rates in effect between SWBT and other incumbent LECs for such traffic.

ITEM FOURTEEN: Has SWBT provided telecommunications services available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3) of FTA96, pursuant to 271(c)(2)(B)(xiv) and applicable rules promulgated by the FCC?

RECOMMENDATIONS: In addition to the recommendations addressed above in the **public interest** section, and the **OSS** and **performance standard** sections addressed below, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to an affirmative answer on this checklist issue.

1. SWBT shall develop procedures to assure that the provision of voice mail and other unregulated services provided by a SWBT affiliate will continue uninterrupted during the transition from one local telephone provider to another. This process will necessitate coordination with SWBT's voice mail subsidiary to assure that voice mail is not disconnected, unless a CLEC or customer requests disconnection of the voice mail service. Should the voice mail subsidiary find this process unreasonable, the subsidiary can always verify with the customer or CLEC the need to continue the provision of voice mail, without undue harm to the subsidiary;
2. SWBT shall revise its procedures to ensure that all promotions of its telecommunications services are done only after adequate notification has been provided to CLECs. Adequate notification includes the provision of notice, at least thirty days in advance of the proposed implementation date for any promotion. Additionally, SWBT shall communicate with all its CLEC customers to obtain information indicating which department or principal should receive promotional material. This would ensure the timely receipt of information provided by SWBT to the department that is required to act on behalf of the CLEC for such promotions. Finally, SWBT shall provide promotional material to all CLECs in a consistent matter, regardless of whether they are purchasing resold services as a result of an interconnection agreement or tariff;
3. The Commission agrees that most of the rulings related to customer specific contracts must be decided during the docketed proceeding. However, the FCC determined in its decision in BellSouth/South Carolina, that an RBOC must provide customer specific contracts for resale at a wholesale discount in order to meet this checklist item. To the extent SWBT wants to provide proof that it is meeting this checklist item, SWBT shall change its policy to reflect compliance with the FCC's decision;
4. At the hearing, SWBT indicated it would provide a discount on ALL promotions, regardless of duration, e.g., 30-day promotions. SWBT shall provide documentation of such.

Performance Measures

RECOMMENDATIONS: In addition to the recommendations addressed above in the public interest and checklist item sections, and the OSS sections addressed below, the Commission recommends the following measures and requirements as a beginning point, the details of which could be established in the collaborative process.

1. The Commission recommends that the concept of broad, outcome-based performance measures be explored for interconnection, UNEs, and resale;
2. The Commission shall consider the appropriateness of monetary penalties, including discounts to rates, as a sanction for nonperformance to the extent SWBT misses due dates in the future. The monetary penalties shall be set a level sufficient to discipline non-compliance and to insure self-enforcement;
3. SWBT shall establish that it has a consistent policy and time deadlines in responding to CLEC inquiries, as well as trouble and repair reports, and should design performance monitoring to measure its responsiveness to CLECs;
4. The Commission concurs with SWBT that the required measurement for E911 is the length of time required to clear an error; however, the definition and details of the measure should be established during the collaborative process;
5. SWBT shall provide measurements with regard to the timeliness of E911 database updates to establish that the 911 service provided to the CLECs is equivalent to that which SWBT provides to itself;
6. Benchmarks shall be established and reports made on performance measurement for a period of three months that demonstrate the timeliness of the E911 database updates for the CLECs and for SWBT. Specifically, a measurement shall be developed quantifying the amount of time that elapses between the time a CLEC's customer records are received by SWBT until the time these records have been accepted or rejected from the E911 database. A corresponding analogous measurement showing the timeliness of SWBT's own updates shall be reported for the same three month period;
7. SWBT shall initiate a policy to conduct traffic studies by obtaining busy hour data to know how a trunk group is performing and to know whether that trunk group needs augmenting. As a part of the traffic study, SWBT shall obtain peg overflow and usage counts, to determine the amount of lost traffic into a CLEC's switch from both tandems and end offices. These studies shall be made available to all interconnecting CLECs;
8. SWBT shall provide at least three months of data on all performance measures;
9. SWBT shall establish an Internet site where it will post all of its historical performance measurement reports for non-restricted use by interested parties on a monthly basis;
10. The Commission generally agrees with the supplementation as recommended by the Department of Justice (DOJ). SWBT shall provide those additional performance measures to CLECs, as well as additional measures established by the Commission, FCC, or the DOJ.

Once established, all CLECs shall be allowed to amend or MFN into the supplemented performance measures;

11. The following specific measures shall be established: (1) performance measures related to the access to be offered by SWBT to enable CLECs to combine UNEs; (2) speed of processing requests to accessing poles, conduits, and rights-of-way; and (3) number of days to complete physical collocation facilities;
12. SWBT should establish the following measures: (1) a measurement which would include the average delay days for all SWBT caused missed due dates; and (2) the percentage of all SWBT caused missed due dates greater than 30 days. The Commission also believes that a measure reflecting coordinated conversions should be developed. SWBT shall discuss with CLECs the development of performance measurements that relate to premature disconnect and the coordinated customer conversion process and jointly develop measurements that would enable both parties to track parity in the process;
13. Because the current process for updating directory listings activity for CLECs and independent companies are manual, the Commission concludes that SWBT add the following measures: (1) directory listings database update completion interval; (2) directory listings database update interval; and (3) directory listings electronic interface availability;
14. Because the process employed by SWBT for Operator Services (OS) and Directory Assistance (DA) is the same as that used by CLECs and other independent companies, the measurements proposed by SWBT for OS/DA should provide adequate information making the additional measures unnecessary to ensure parity for this category. The measurements provided in this category shall include: (1) Grade of Service; and (2) Average Speed of Answer. Furthermore, the measures shall be reported aggregated for SWBT and for CLECs;
15. Measures shall be established to assure parity in the provision of interim number portability;
16. The Commission finds that SWBT must provide measurements for interconnection trunks for all CLECs to assure nondiscriminatory treatment. The measurements shall include: (1) Percent Trunk Blockage; (2) Common Transport Trunk Blockage; (3) Distribution of Common Transport Trunk Groups Exceeding 2%; (4) Percent Missed Due Dates; and (5) Average Trunk Restoration Interval along with the standard deviation. The measurements provided shall include data for individual CLECs, all CLECs, and SWBT;
17. SWBT is contractually required to file performance measures for different types of unbundled loops and resale services in the approved AT&T and MCI interconnection agreements. As an additional requirement, the performance measures related to DS-1, DS-3 and higher capacity loops and dedicated transport should be tracked separately;
18. "Average Time to Return Firm Order Commitment" shall also include SWBT's own internal performance in order to compare it with its performance provided to CLEC;
19. SWBT shall provide a measurement of the performance it provides to its own customers as related to "percentage of Trouble Reports Within 10 days of Installation" and "Percentage of Trouble Reports Within 30 Days of Installation;"

20. SWBT shall include an additional measure "Delayed Orders Cleared After 30 Days." This measurement shall be reported for loop by separate capacity category;
21. SWBT shall report comparative data on NXX loaded and tested prior to local exchange routing guide (LERG) effective date, and Mean Time to Repair for NXX Troubles;
22. SWBT's Network Performance measures shall include Ratio of Calls Blocked to Calls Attempted;
23. SWBT should develop a process for simulation modeling for those measures for which actual results are not available or are so limited that a statistical comparison is not feasible;
24. SWBT shall implement TCG's suggestions as far as the kinds of benchmarks to establish to measure SWBT's performance in the area of directory assistance and operator call completion;
25. SWBT's performance data shall be further disaggregated, consistent with the discussions of the Office of Public Utility Counsel (OPC) and the testimony of SWBT witness Dysart;
26. The Commission recommends that a measure reflecting coordinated conversions should be developed. SWBT shall work with the CLECs and Commission Staff to develop measures relating to premature disconnect and the coordinated customer conversion process and develop measurements that would enable all parties to track parity;
27. The issue of auditing shall be addressed further in the collaborative process between SWBT, the participants, and Commission Staff. SWBT must allow CLECs to audit the underlying performance data used in calculating the required measure to provide CLECs the ability to satisfy any concerns that the performance measures "mask" discriminatory treatment, *i.e.*, disparate treatment in a particular exchange. As an initial matter, the Commission believes it is appropriate for the requesting CLEC to bear the costs associated with such an audit. However, if the CLEC demonstrates that SWBT has consistently provided discriminatory and/or lower grade service than it provides to itself, SWBT is required to refund such fees. If necessary, the post-interconnection dispute process may be used to resolve disputes regarding the payment of such fees. In such a process, it may be appropriate to consider attorneys' fees and litigation costs to be part of the overall audit costs;
28. Performance penalty issues need to be resolved. Issues for the collaborative process include the type of penalty, level of penalty, and the appropriateness of any necessary safeguards to protect CLECs from sporadic performance and SWBT from random fluctuations. For any measure, when SWBT's performance substantially deviates from parity, *e.g.*, more than one standard deviation for three consecutive months, the Commission recommends that a root cause analysis be performed to determine the cause of the disparity. In other words, SWBT must investigate exceptionally good and exceptionally bad performance results;
29. In recognition of the New York Public Service Commission's ruling in Bell Atlantic's Section 271 docket and the concerns raised by participants in this docket, the Commission believes that the performance penalty structure in the AT&T and MCI interconnection agreements with SWBT, which was largely negotiated, may not be adequate to assure nondiscriminatory treatment. Instead, during the collaborative process, proposals relating to a reduction in resale/UNE/interconnection rates should be considered if, prospectively, the

Commission determines that SWBT has failed to meet the performance requirements, or engaged in discriminatory practices against CLECs;

30. The Commission recommends that additional safeguards be considered if performance penalties are determined to be insufficient to restrain anticompetitive behavior after SWBT obtains § 271 relief. Such a procedure may allow the Commission to issue a cease and desist order affecting SWBT's ability to accept new in-region interLATA customers if the Commission determines that SWBT has provided sub-standard and/or discriminatory service to CLECs, such that CLECs do not have a meaningful opportunity to compete in local markets. This issue is more broadly discussed in the public interest section;
31. SWBT shall be required to allow a CLEC that was not a party to the mega-arbitration to include those performance measures while allowing the CLEC to raise new issues that were not arbitrated or negotiated during the mega-arbitration hearing through further negotiation or arbitration and shall explore development of a tariff containing performance measures and public availability of performance measure data;
32. Consistent with the attachment-by-attachment MFN philosophy, SWBT shall allow a CLEC that was not a party to the mega-arbitration to adopt the performance measures without having to adopt the separate and distinct provision on performance penalties;
33. SWBT shall provide all the performance data required by its interconnection agreements with AT&T and MCI, including the average response time for preorder interfaces, provisioning accuracy, average time to return firm order commitments (FOCs), mean time to return service, order process percent flow-through, LSC speed of answer, billing accuracy, billing timeliness, or any measures with respect to UNEs or design services.

Operations Support Systems (OSS)

RECOMMENDATIONS: In addition to the recommendations addressed above in the public interest, checklist item, and the performance standard sections above, the Commission recommends the following, the details of which could be established in the collaborative process. The Commission also includes a brief discussion relating to the relationship between interim and permanent interfaces to provide some context for the specific recommendations.

Relationship between interim and permanent interfaces:

There are a number of interim and permanent OSS interfaces discussed in these comments. In particular, at least for CLECs willing to move to an EDI (Electronic Data Interexchange solution), EASE (Easy Access Sales Environment) is an interim interface for resale and UNE switch/port combinations, LEX (Local Service Request Exchange System) is an interim solution for resale and UNE orders, VERIGATE (Verification Gateway) and DataGate are interim measures for preordering functions. SWBT's ultimate obligation is to develop a real-time, interactive, EDI gateway based on national standards.

As the final stages of EDI development are in progress, SWBT's § 271 relief should not be rejected on this issue if certain conditions are met indicating that the OSS systems in place meet the requirements set out by the Commission and the FCC. These conditions include the following:

1. SWBT's interim measures provide flow-through and are modified as discussed in the specific recommendations contained herein;
2. SWBT continues to develop its EDI interface in good faith; this issue should be explored in more detail during the collaborative process. (Some form of adjustment may be necessary to offset the necessity of CLECs to undertake dual entry prior to EDI development being completed to the Commission's satisfaction, if SWBT does not meet its implementation dates for EDI development. Potentially, an interim discount on SWBT's electronic service order charge may be appropriate.); and
3. Sufficient procedures are in place to transition from interim measures to permanent solutions.

Specific Recommendations:

1. OSS shall be addressed in the collaborative process. The Commission believes implementation of both the spirit and letter of these recommendations would lead to an affirmative answer on OSS:
2. SWBT shall establish that all of its OSS systems for pre-ordering, ordering, provisioning, maintenance and repair, and billing are at parity;
3. SWBT shall establish that all of its electronic OSS systems for pre-ordering, ordering, provisioning, maintenance and repair, and billing are at parity and provide flow-through without the necessity of manual intervention;
4. SWBT shall conform its technical documents to meet the LEX and EDI interfaces. SWBT's LEX and EDI interface, at the time of the hearing, did not sufficiently follow the technical documentation provided by SWBT to CLECs;
5. SWBT shall modify LEX to better integrate LEX with VERIGATE, a pre-ordering apparatus. SWBT should develop the capability necessary to allow more efficient order preparation, beyond "Cut and Paste" functionality, in order to prevent a CLEC's sales representative from re-keying certain information multiple times when it is not necessary. SWBT's LEX system, at the time of the hearing, could not be used in a manner reasonably comparable to the EASE interface used by SWBT for its retail operations;
6. SWBT shall undertake further development of LEX and EDI to achieve the flow through capabilities for both UNE and Resale orders. LEX and EDI's electronic flow through, at the time of the OSS demonstration, was not sufficiently comparable to that of SWBT's EASE

system to provide nondiscriminatory access to CLECs. Further flow through capability is necessary. SWBT shall provide data on the rejection rate for orders processed to demonstrate the new flow through capability achieved through Phase I implementation;

7. SWBT shall demonstrate that improved flow through capability enables SWBT's OSS to handle commercial volumes;
8. SWBT shall provide further explanation regarding the disparity in EASE flow through rates in order to ascertain whether EASE is provided in a nondiscriminatory manner;
9. SWBT shall complete the development of EASE for UNE switch/port combinations;
10. Further review of SWBT's OSS training is necessary to determine whether SWBT is providing sufficient training for CLECs to effectively use the interfaces provided by SWBT;
11. Delays relating to LEX and EDI batch processes need to be reduced and transitioned to real time. SWBT shall demonstrate that such delays have been reduced;
12. SWBT needs to develop the procedures to provide timely, accurate information regarding order errors, jeopardies, and CLECs' access order status information;
13. SWBT needs to implement adequate safeguards to assure timely, efficient, parity performance for the manual orders processed by the LSC and CLEC questions directed to LSC. The Commission, therefore, recommends that this issue be explored in more detail during the collaborative process among SWBT, the participants, and Commission Staff. Further review of performance measures may be necessary to provide such a safeguard;
14. SWBT shall either improve the preordering interfaces available to CLECs to provide sufficient access to customer information and/or clarify the record to show that CLECs have parity access to customer service records, *e.g.*, ISDN, complex services and design services;
15. To the extent SWBT's access to the PREMIS database is at the customer service representative level, SWBT shall provide sufficient access to that database system's information and functionality in order to provide parity access;
16. SWBT shall provide access to SORD (Service Order Retrieval Distribution) and LFACS (Local Facilities Access System) at cost-based rates, terms, and conditions. As discussed previously, SWBT would have to provide training necessary to allow CLECs obtain parity access to SORD and LFACS;
17. SWBT shall be required to demonstrate, by providing at least three months of data, that it is providing CLECs with service that meets the performance standards established in this proceeding and in its interconnection agreements;
18. The Commission finds that SWBT does not make available the ability for a facilities-based CLEC to supplement pending service orders or receive timely jeopardy notifications, error notifications, or workflow confirmations. SWBT must either make this capability available to CLECs electronically or demonstrate that SWBT's customer service representatives do not have such access;

19. To provide necessary notifications, SWBT shall fully develop the jeopardy notification function into its EDI interface. This development should also be incorporated into the Order Status Toolbar function;
20. Although fax rejects may be appropriate when a CLEC provides its orders via fax, SWBT shall provide an electronic means for such notification when a CLEC uses an electronic means to place its orders with SWBT;
21. SWBT does not provide data as to the amount of time it takes SWBT to process and transmit reject notifications to CLECs. Moreover, SWBT could not provide specific goals and procedures in response to questioning from the Commissioners so actual performance could be measured against a benchmark. SWBT shall implement such goals and procedures so CLECs can regularly receive this information timely enough to correct such errors without affecting customer service. Such goals and procedures provide a CLEC with the ability to smoothly convert a customer to its service;
22. SWBT must make clear to CLECs the effect of the various stages of an order's "completion" to avoid confusion. To the extent this issue is one of communication, this issue can be addressed in the policy manual discussed in the public interest section of these comments;
23. The Commission, like the FCC, believes that actual commercial usage is the most probative evidence concerning a system's ability to handle large commercial volumes. The Commission recommends, to the extent there is no actual commercial usage or third party testing, alternative means for assessing system performance be developed in the collaborative process. For example, as greater flow-through is developed, commercial volume concerns may be eased as the representative hours necessary to input orders directly into SORD will be lessened. However, even after the potential manual "bottleneck" issue is resolved, there may remain a need to stress test SWBT's OSS systems before an affirmative recommendation is made on this issue;
24. A record on billing issues should be developed further during the collaborative process. The FCC determined that this information is necessary because "competing carriers that use the incumbent's resale services and unbundled network elements must rely on the incumbent LEC for billing and usage information. The incumbent's obligation to provide timely and accurate information is particularly important to a competing carrier's ability to serve its customers and compete effectively." A BOC must also provide detailed evidence to support its claim that it is providing billing on terms and conditions that are nondiscriminatory, just and reasonable. This information should include measures that compare the BOCs performance in delivering daily usage information for customer billing to both its own retail operation and that of competing carriers;
25. SWBT must resolve the double-billing and other billing issues raised during this proceeding and bring forth proof that such problems have been adequately addressed;
26. SWBT shall either limit requirement that a single CLEC obtain multiple OCNs (operating company numbers) or AECNs (alternate exchange company number) or demonstrate a necessity for such requirement;

27. SWBT shall provide CLECs with sufficient definition or information to decipher the downloads of information that a CLEC needs to validate addresses, determine calling scope, and determine feature availability without having to access SWBT's systems;
28. SWBT shall provide parity access to consolidated CSRs for business customers that have more than 30 lines or that have any design services such as Centrex. SWBT must enhance the ability of its interfaces to handle these order types or demonstrate that parity is provided at this time;
29. SWBT shall demonstrate that its back-end systems are operationally ready, to assure performance parity between CLECs and SWBT's retail operations for POTS (plain old telephone service) order completion, FOCs, installation intervals, trouble reports, design services, billing accuracy, or billing timeliness.

Section 272 Compliance

SECTION 272 COMPLIANCE: Pursuant to section 271(d)(3)(B), has SWBT demonstrated that the requested authorization will be carried out in accordance with the requirements of section 272?

RECOMMENDATIONS: The Commission recommends the following, the details of which could be established in the collaborative process. The Commission believes implementation of both the spirit and the letter of these recommendations would lead to compliance with Section 272.

1. Although SWBT has established a separate affiliate to provide interLATA services in Texas, the actual corporate structure must be clarified. The Commission cannot determine from the record which SBC subsidiary and/or d/b/a will be used to provide interLATA services in Texas. SWBT shall supplement the record with the necessary information;
2. It is the Commission's position that the independence and separation of the SBLD board and officers from SWBT is not absolutely clear in the record. The record on this issue shall be further developed and clarified so that a determination can be made as to whether SBLD's officers, directors, and employees are separate from SWBT and its corporate chain of command;
3. SWBT's postings on the internet do not clearly delineate the services which are provided by SWBT to SBLD, the identified interLATA affiliate. The internet postings shall clearly identify this information. Additionally, the internet postings shall be revised to indicate which of the services are provided by SWBT to SBLD for Texas, for Oklahoma, or any other state served by the three SBC BOCs, or services provided by SWBT to support SBCS in its other activities outside the SWBT service areas;
4. SWBT shall make available public access to information on transactions between the BOC and the interLATA affiliate at the BOC's headquarters. After the hearing, SWBT in an affidavit reported it would move the records to San Antonio, Texas during the month of June

1998. SWBT should file a follow-up affidavit once the records are available in San Antonio. The Commission must have proof that the records will remain available in San Antonio pursuant to the FCC's order;
5. SWBT shall post on the internet a written description of the asset or service transferred along with the terms and conditions;
 6. There is insufficient information to evaluate if transactions are fairly and accurately valued. SWBT shall provide such additional information, so the Commission can determine which of the posted services and assets would be available on an equal pricing basis to a competitor of SBLD:
 7. Transactions between February 1996 and the date of approval to initiate interLATA services shall be disclosed and made subject to "true-up;"
 8. SWBT shall provide additional information to enable the Commission to evaluate if transactions are arms-length between the affiliates;
 9. SWBT shall limit its use of "CONFIDENTIAL" and "PROPRIETARY" classifications to those transactions that meet the FCC guidelines for such protections;
 10. The record shall be developed further as to SWBT's practices regarding the use of "CONFIDENTIAL" and "PROPRIETARY" restrictions on documents. If contracts between SWBT and its interLATA affiliate are improperly so marked, then, the Commission's position is that SWBT does not meet the public disclosure requirements of Section 272;
 11. The audit report to Texas must report on transactions from all three SBC BOCs, summarizing the total support services from each BOC, reporting the specific services received by the long distance affiliate from each BOC, and reporting on the allocation of expenses within the SBCS organization by subsidiary and by d/b/a title;
 12. The Commission has concerns regarding marketing, but recognizes the FCC's decision in BellSouth/South Carolina. The Commission, nonetheless, has concerns that the strong recommendation of its affiliate by SWBT and the warm-hand-off to the affiliate would not pass any arms-length test. If a customer truly does not readily state a long distance company choice, then random assignment of a carrier is preferable.

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SWBT §271

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As of today, the answer to the core question -- are SWBT's local markets open to irreversible competition? -- is "not yet". We still have some work to do here. I would recommend that the company not file at the FCC for inter-LATA authority until we work further with them and the parties to solve the concerns we will be laying out this afternoon. In that regard, I would propose that we keep the record open over the coming few months, work in a collaborative process to flesh out and address the issues we outline today, institute solutions, review the data from the revised processes and supplement the record when SWBT has made the necessary changes.

In my mind, there are some major issues -- rebundling, OSS, performance measures, ease of doing business, the overhang from SWBT's litigation -- that we must resolve. In the end, though, there is the big issue: how do we develop a performance measure to guarantee cooperation?

I have read Bell Atlantic-New York's April 6th pre-filing statement laying out a series of specific commitments and obligations they made to the New York Commission in the context of its §271 review. There is a lot in that document. If we were to get a similar commitment from SWBT on all of the various issues -- big and small -- that we will lay out today, I am concerned about having the next two years play out like the last two years. We personally presided over those lengthy arbitration hearings and their excruciating detail in order to resolve these issues once and for all, only to find that we have minimal competition in Texas today, two years later.

If I felt the lack of competition were from a lack of interest or commitment on the part of the new entrants, it would be easy to dismiss their concerns, but for most of the participants in this hearing, that is not the case. This is potentially the richest telecom market in the country. Legal and regulatory barriers to local market entry have been eliminated and we have approved countless applications for new authority and interconnection agreements. But a piece of paper doesn't mean much if the incumbent really isn't interested in making this work.

I found Bell Atlantic's "wholesale customer" Web Page yesterday. [www.bell-atl.com/tis] This Web Site included downloadable handbooks for every aspect of doing business and interconnection, copies of all correspondence from the Wholesale Center to the CLECs, resellers, wireless carriers, etc. But what got me is this statement on the introductory page:

We view this [wholesale customer] relationship not only as supplier to customer but also as peer to peer. The fact is, we are truly in partnership with you, as co-providers of telecommunications services. In fact, we depend on you for our success.

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Talk's cheap, I know. But it's a good first step. That's why I want to get the whole process of doing business addressed ASAP, so we can make sure that it actually works.

We were reminded two weekends ago in Beaumont by a customer of Entergy's to "trust but verify". And that's what we need to do here. The company has repeatedly committed to fulfill its responsibilities under the Act, but I want to see the data showing that it is working. So, an important part of the further work over the coming months will be to look at the actual performance.

5/21/98

16251



COMMENTS OF COMMISSIONER JUDY WALSH
REGARDING SOUTHWESTERN BELL'S § 271 REQUEST
TO ENTER LONG DISTANCE MARKET

MAY 21, 1998

I find that SWB has not yet met the requirements for in region interlata authority under Sec. 271.

Track A:

Whether there is a competing facilities based provider to satisfy Track A is debatable - given the miniscule number of residential and business customers served. The de minimis rule becomes an issue. So does whether any of these providers is or can become a true competitive alternative to SWB, in light of SWB's lack of cooperation and efforts to frustrate the CLEC's efforts to enter the market.

Public Interest:

The last issue- whether SWB's entry into long distance is in the public interest is to be determined after the 14 points are met. The record is replete with examples of SWB's failure to meaningfully negotiate, reluctance to implement the terms of the arbitrated agreements, lack of cooperation with customers, and evidence of behavior which obstructs competitive entry.

As a result, we do not have an open market today, with Sec. 271 as an incentive. The very real danger is that if SWB were granted 271 relief now, they would have no incentive to cooperate with CLECS and the local market in Texas might never be competitive.

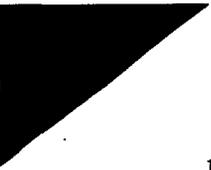
I could not find it in the public interest to support the 271 application today.

But I do not believe we need to reach the Track A or public interest issues today, because the 14 points have not been met, and if we work on curing those deficiencies, then there will be competitive alternatives, and Track A will also likely be satisfied.

If the 14 points are ultimately met, and if SWB is able to adjust its corporate culture to treat the CLECs as valued customers rather than annoying competitors, then the reservations concerning the public interest may also be removed.

So I would propose that we focus on the steps necessary to meet the checklist, but the evidence of uncooperative behavior to date, and the difficulty CLECs have had in establishing a competitive foothold as reflected in the dearth of facilities based customers,

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has influenced my judgment about what standards we should apply, and what evidence we should require before I can say the market is open, and more importantly that it will stay open and that competition is irreversible.

We indicated that we would give SWB guidelines about what needs to be done to get a recommendation from us. I think we should go over staff recommendations on each point in detail but recognize that any future process will be a dynamic one and details of these general requirements will develop throughout the process.

I would like to discuss more general, larger concerns that would have to be satisfied for me to vote yes.

Interconnection:

To satisfy the checklist, SWB is relying on the arbitrated interconnection agreements and compliance with their terms and conditions to support compliance with checklist Item 1, 2 and others.

At the same time, I would take note of appeals of these agreements in both federal and state court. These lawsuits indicate that the so called "agreements" were forced on SWB and challenge the very validity of the agreements.

The FTA requires that agreements be final and binding. CLECS cannot implement their business plans while the appeals create so much uncertainty.

I would not rely on the terms of these agreements to support 271 until all appeals are decided.

Another major issue has been whether competition is irreversible and whether the checklist will continue to be met. There was considerable discussion about what happens when the agreements resulting from the mega arbitrations expire. This issue also creates serious uncertainty which will inhibit market entry. The record suggests that another reluctant negotiation and contentious arbitration is likely.

To ensure that competition is irreversible, SWB needs to commit to extending the effective dates of the mega arbitration contracts for the statutory time required to negotiate and arbitrate new agreements, assuming notice of intent to negotiate occurs nine months prior to contract expiration.

The MFN policy must be spelled out in complete detail.

Non-Discriminatory Access to Network Elements:

Ultimately, SWB must provide UNE's at cost based rates in a manner which allows any CLEC to combine them and provide a competitive telecommunication service at parity with SWB. The five methods proposed by SWB do not appear to meet the requirements of the FTA.

A satisfactory method should be addressed in the collaborative process with the following options (and others) to be explored.

- Virtual collocation of cross connects.
- Access to recent change capability.
- Electronic access (DCS) where available.

In the interim, SWB must offer to recombine all UNE's for any requesting CLEC at a cost based recombination charge. The commitment to recombine would continue until acceptable terms and conditions exist for CLECS to do the combing themselves.

Parity must be measured against the manner in which SWB uses these same elements to provide their retail service.

OSS:

SWB must meet the schedule for making available EASE for UNE-P ordering and it must remain available until EDI is fully functional and commercially operational. UNE's ordered with specificity through EASE should not require reentry of data when EDI is functional. EASE should run in parallel with EDI until EDI is processing actual traffic in commercial volumes.

All systems, EDI, LEX, EASE must flow through electronically at parity with SWB's own use in providing retail service.

Problems of multiple entry of data, disconnect between pre-ordering and ordering, ability to process a change order, the high fall out rates, access to numbers, and availability of timely and complete bill information must be resolved.

Performance Measures:

Must adopt a complete set of performance measures to address all parity issues.

They must be available to all CLECS and provide aggregate and individual CLEC comparisons.



There must be a sufficient period of actual measurement of data to ensure measures are effective and to establish whether SWB is in compliance. The measurement period should be at least three months.

There must be self implementing penalties that do not allow for selective discrimination and which are large enough to be a deterrent.

To mitigate against deterioration after 271 relief is granted, a serious failure to continuously meet the performance measures should result in a freeze of the right to solicit in region interlata customers.

Section 272 Affiliate Transaction Issue:

I am concerned about competitive affiliates like Call Notes not providing the same service to customers who are served by CLECS as they do to SWB customers. There is a significant barrier to entry otherwise.

I am also concerned about the level of detail of data required to meet the reporting requirement for SBLD.

Reports must be readily available and capture relevant data to identify cross subsidies and anti-competitive activity.

When BOC and LD choose a simple structure, the reporting can be more straightforward. But if the corporate structure is complicated as this one is, and with three separate BOCS conducting transactions with one or more LD subsidiaries doing business in and out of the region, following the flow of transactions becomes more complex.

Doing Business with SWB and the Public Interest:

To date, SWB has been a reluctant participant in opening the local telecommunication market to competitors.

I fully support the development of an instruction manual that gives CLECS complete information on the steps necessary to accomplish all required transactions with SWB.

I would also require SWB to come up with concrete steps for changing its corporate culture to treat CLECS as valued customers. Any such change must be embraced from the top of the organization, acted upon, and communicated downward throughout the entire organization to account reps, repairmen and employees in the LSC.



Particular areas to be addressed would be:

- 1) Training for all employees who deal with retail customers and CLECS;
- 2) Develop protocols of what service reps can say and do in contacts with customers;
- 3) Structure information flow from the policy groups to account reps and to CLECS so policy decisions are universally known;
- 4) Establish incentives for employees based on CLEC satisfaction;
and
- 5) Develop an appeals process or ombudsman with SWB for CLECS to appeal decisions made by the account reps.

At the end of the collaborative process, a new survey of CLEC satisfaction should be taken and the hearing should be reconvened to take supplemental testimony on CLEC experiences to evaluate the real world experience with the 14 points and the public interest.

16251

Opening Statement of Commissioner Patricia A Curran, Public Utility Commission of Texas, Docket No. 16251, Investigation into Southwestern Bell Telephone Company's Entry into In-Region InterLATA Service Under Section 271 of the Telecommunications Act of 1996, May 21, 1998

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General Comments on Overall Process

The focus in this proceeding and in the staff's comments we will hear today may be directed at the things that SWB has either not done or has done well. That is due in large part to the nature of this proceeding. However, there is also evidence in this record that SWB is complying with a majority of the provisions of most interconnection agreements. In addition, during this investigation process SWB has agreed to a number of suggestions and recommendations. While competition is not as robust as perhaps it should be by this point in time, it is evident that SWB has come along way since the first arbitration. While I do not believe that competition is at a sufficient level to allow SWB to enter the long distance market today, the hope is that the comments we and the staff will provide as a result of our investigation will provide the roadmap for a truly competitive market and for SWB's eventual entry into the long distance market.

Comments on 271 Application

Even when SWB meets the "checklist" there are still some concerns which lead me to the conclusion that Bell still has not met its burden necessary to recommend that it be allowed to enter the long distance market. Those concerns arise under the "Track A" requirement and the question of whether SWB's application is in the public interest.

Thoughts on Track A

I have two major problems with any conclusion that Bell has met the Track A requirements: First is the issue of whether it has entered into BINDING AGREEMENTS. Secondly is my conclusion that the cumulative number of access lines served by Bell's competitors is insufficient to establish them as COMPETING PROVIDERS.

Binding Agreements:

Track A requires that SWB have entered into one or more binding agreements that have been approved specifying the terms and condition under which it is providing access and interconnection. While SWB has entered scores of agreements, certain of SWB's actions indicate that SWB doesn't consistently view all agreements as binding in nature. SWB has challenged a number of terms of arbitrated agreements in court proceedings. These legal challenges indicate that SWB is not committed to perform under the disputed terms of the agreement if it can prevail. Its legal challenges if successful, may render some or all of the disputed terms of the executed agreements void or voidable. These are not characteristics of what is generally understood to be a "binding" agreement. They also cast serious doubt about the future performance under these agreements.

Certainly SWB has a legal right to exhaust its remedies in court. The problem such appeals create, however, is the uncertainty in the business arrangement and the impression it is using the legal process, not to protect its rights, but to thwart the process. While the Commission cannot deny SWB its legal remedies SWB might consider withdrawing some of its pending lawsuits involving disputed interconnection agreements. Such a voluntary offer would alleviate the uncertainty in the business arrangements and would assure the binding nature of existing contracts and would be one indication of SWB's commitment to the competitive market place.

Another example of what I consider to be SWB's lack of commitment to the binding nature of certain arbitrated agreements it has executed is SWB's refusal to apply the Commission's rulings in one agreement to all similarly situated agreements. - For Example, we learned in this hearing that, despite the Commission's clear interpretation that reciprocal compensation provision apply to ISP traffic, SWB failed to apply the ruling to identical provision in other existing contracts. I understand that SWB has now agreed to abide by the Commission's ruling in the Time Warner and Waller Creek proceedings and to apply that ruling to all current contracts involving ISP traffic. Nevertheless, until SWB shows a consistent policy of applying Commission rulings across the board and a commitment to perform in accordance with the terms of all agreements, without constant Commission supervision, I cannot reach the conclusion that "binding" agreements have been entered.

Competing Providers:

Track A also requires that these binding agreements be with one or more unaffiliated competing providers of telephone exchange service. The question is, therefore, what constitutes a "competing provider". Neither the Act, nor the FCC, require a showing that a competitor or competitors have secured any minimum percentage of market share away from Bell. However, it stands to reason that to meet this requirement other providers must have secured more than a *de minimis* number of customers.

Here we have a situation where potential competitors have spent enormous effort and time, and probably money, attempting to gain a foothold in the local telephone market. The regulatory agency has spent untold hours in an effort to establish mechanisms under which the phone customers of Texas will have choice in their local phone service. And this enormous effort has resulted in a movement of just 1% of phone customers to competitors. I don't believe the record supports the explanation that this is the result of a lack of interest either on the part of consumers or on the part of potential competitors.

The 15 CLEC's relied upon by Bell to demonstrate there are competing providers, I believe, simply do not yet rise to the level of providing real competition to Bell or true commercial alternatives to a sufficient number of phone subscribers in the State.

On this issue, however, I would be willing to set forth the record evidence and let the FCC decide if it believes a *de minimis* number of lines in competitors hands is sufficient to meet this requirement.

Public Interest

This brings me to the question of whether I believe Bell's application is in the public interest. At this time I do not believe it is. With the facts before us, I do not believe there is any way to conclude that in Texas there is a situation of irreversible local competition.

Currently there are CLEC's with *de minimis* customers -- and even those *de minimis* customers have been secured only with tremendous effort and with Bell resisting at every turn. Will these CLEC's and other CLEC's be able to retain even this level of customer base into the future, much less to provide a

real competitive option to additional subscribers? Under current practice it is highly doubtful.

A critical factor is the term of the contracts. The terms of both arbitrated and negotiated contracts are for relatively short periods i.e. 2 years. CLECs who have MFNed into existing contracts appear to be forced to adopt the agreement with whatever remaining term exists in the original contract rather than being able to secure the same terms as the original contract, (a fact I find troubling). At the end of the term it is unclear what if any right the CLEC will have to expect a continuation of service from SWB pending the execution of a new agreement. Presumably, once the contract expires SWB has no obligation to continue providing service, until a new contract is executed. This potential termination or disruption in service has obvious business implications for competitors. In order to achieve a truly competitive marketplace there must be some assurance from SWB that as these interconnection agreements expire, that it will continue to operate under the terms of those agreements until new contracts are in place. And, to the extent that these agreements require arbitration, the period between the expiration of the current contract and subsequent contracts could be significant. Moreover, if SWB is already in the long distance market, it will have far less incentive to complete subsequent contract negotiations in a timely manner.

DEFAULT AGREEMENT

In order to expedite future contract negotiations, we could consider the development and adoption of "default" contracts for various types of interconnection agreements i.e. resale or UNE agreements. These default agreements would be available to CLECs without the necessity of any additional negotiations. The provisions of these agreements could be developed through the collaborative process and could be based on sections of agreements that SWB has already agreed to provide on an MFN basis. For instance, these agreements could include the performance measures attachment as well as provisions of the physical collocation tariff. Parties selecting a default agreement could always negotiate additional terms, but any CLEC, entering into an agreement with SWB for the first time or for a subsequent contract period could take advantage of these basic *minimum* terms. These default agreements could be considered a substitute for SWB's generic contracts which they now use to start the negotiation process.

It has been suggested that we could recommend to the FCC that conditions be placed on SWB's entry into the interLATA market. That is all fine and good. However, from a real-life point of view perhaps not realistic. Once SWB is in the market, there may be enormous pressures from all sorts of sources, including the consuming public, to allow SWB to remain in the long distance market without restriction, even at the expense of competition. A preferable approach is to assure that robust competition exists before SWB enters the market. Hopefully that is what a collaborative approach can achieve. By being as specific as possible in providing SWB a roadmap or outline of what is necessary to obtain a positive recommendation from this Commission, such conditional entry will not be necessary.

Finally, with regard to public interest, no matter what safeguards and protective measures we recommend, we cannot be assured that competition will become irreversible in Texas until SWB is committed to treating CLECs as customers rather than as competitors. This change in business attitude is entirely within SWB's power. This Commission cannot order SWB to change its attitude. We can, however, provide concrete action steps which we believe will result in an open market. But SWB can change its attitude and it can do that by demonstrating good faith in its negotiations and dealings with CLECs on a going forward basis. It can demonstrate this good faith by removing barriers that it has put in place and by its commitment to institutionalize clear and nondiscriminatory procedures to allow CLEC's entry into the market and to sustain new customer relationships.

In addition, SWB can demonstrate its change in attitude by participating in good faith, in the collaborative process we are recommending. This process will remedy the deficiencies we have noted in SWB's application and put into place a mechanism that will assure a truly competitive market in Texas.