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

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 Inc., Transferee	)))))	CC Docket No. 98-141

DECLARATION OF KENNETH C. BASEMAN AND A. DANIEL KELLEY

I. INTRODUCTION

1. MCI Worldcom has asked us to prepare this economic analysis of issues raised by the proposed merger between SBC Communications Inc. ("SBC") and Ameritech Corporation.

2. Kenneth Baseman is a Principal with MiCRA, an economic consulting firm in Washington, D.C. He received his graduate training in economics at Stanford University. He served as a senior economist in the Economic Policy Office of the Antitrust Division of the Department of Justice where, for over two years, he was a member of the Division's trial staff in U.S. v. AT&T. He has been an economic consultant for thirteen years. His consulting assignments have focused primarily on competitive issues, both in antitrust and regulatory proceedings. His earlier professional papers dealt with entry and competition in a regulated industry with natural monopoly characteristics and were published in the *American Economic Review,* and by the

National Bureau of Economic Research and the MIT Press. His more recent publications have focused on the use of non-linear pricing and technical incompatibility by dominant firms to preserve market power in the face of developing competition. He has consulted on telecommunications issues with the Department of Justice, MCI, AT&T, the National Cable Television Association, and WebCel Communications, and he has testified on competitive issues relating to telephony before state commissions in Ohio, Wisconsin, Texas, Georgia and Kansas. A copy of his vita is attached to this Declaration.

3. Daniel Kelley is Senior Vice President of HAI Consulting, Inc., of Boulder Colorado. He received a Bachelor of Arts degree in Economics from the University of Colorado in 1969, a Master of Arts degree in Economics from the University of Oregon in 1971 and a Ph.D. in Economics from the University of Oregon in 1976. His professional experience began in 1972 at the Antitrust Division of the U.S. Department of Justice where he analyzed mergers, acquisitions and business practices in a number of industries, including telecommunications. While at the Department of Justice, he was a member of the U.S. v. AT&T economics staff. In 1979, he moved to the Federal Communications Commission ("FCC") where he held positions as Senior Economist in the Common Carrier Bureau and the Office of Plans and Policy, and also served as Special Assistant to the Chairman. After leaving the FCC, he was a Project Manager and Senior Economist at ICF, Incorporated, a public policy consulting firm. From September 1984 through July of 1990, he was employed by MCI Communications Corporation as its Director of Regulatory Policy. He conducts economic and policy studies on a wide variety of telecommunications issues, including local exchange competition, dominant firm regulation, and

the cost of local service. He has advised foreign government officials on telecommunications policy matters and has taught seminars in regulatory economics in a number of countries. He has testified on telecommunications issues before this Commission, the California, Colorado, Connecticut, Florida, Georgia, Hawaii, Maryland, Massachusetts, Michigan, New York, Oregon, Pennsylvania and Utah Commissions, as well as the Federal-State Joint Board investigating universal service reform. His resume is attached

4. This paper concludes that the consolidation of SBC and Ameritech raises substantial competitive risks without countervailing public interest benefits. In approving the acquisition of NYNEX by Bell Atlantic, the Commission found that there were substantial anticompetitive effects flowing from the merger.[1/] This merger is also anticompetitive.

5. The Commission concluded that the public interest benefits of the BA-NYNEX merger exceeded the potential costs because Bell Atlantic committed to take a number of steps to open its local markets to competition.[2/] SBC and Ameritech attempt to justify this merger with a promise to enter local markets outside their regions through their "national-local plan," a plan to

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1/ In re the Application of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries, File No. NSD-L-96-10, released August 14, 1997. ("BA-NYNEX Order")

2/ The merger conditions agreed to by Bell Atlantic include preparation of service monitoring reports, uniform interfaces to Operations Support Systems ("OSS"), operational testing of interfaces, options for payment of non-recurring charges, a shared transport unbundled network element, as well as performance standards and enforcement mechanisms. See BA-NYNEX Order, Appendix C.

provide facilities-based local service to all or most of the locations of large, multi-location business customers headquartered in SBC's or Ameritech's region. There is no reason to believe that the the national-local plan will be any more effective in improving consumer welfare than the BA-NYNEX undertakings.

6. By claiming that they cannot enter profitably unless they merge SBC and Ameritech concede that entry into local markets is extremely difficult.[3] Moreover, they assert that post-merger out of region entry will have to be based on a critical mass of the company's own facilities -- even in the BA/NYNEX region.[4] This latter point implies that they believe that even in the purportedly more favorable entry environment in the BA territory, the existing actual and potential entrants cannot build a viable business based on UNEs. The National/Local plan seems to recognize that SBC and Ameritech cannot enter profitably out-of-region local service without a substantial investment in facilities. In other words, they do not believe they can enter profitably by relying primarily on UNEs.[5]

3/ See Kahan Aff. at para. 11 (on a stand-alone basis neither company has the critical mass necessary to support a viable out of region entry strategy), and paragraph 19 ("SBC analyzed various ways of achieving the needed critical mass and rejected both de novo entry and joint venture as both insufficient and unworkable") .

4/ Kahan at paragraph 30 argues that SBC's "...large customers seek services... that can only be provided by a company that has facilities-based capabilities across the United States...". Kahan describes the extensive investment the merged SBC/Ameritech says it will undertake in switching and fiber facilities at paragraphs 37-39, as well as SBC's plans to buy local transport where there are competitive alternatives. The purchase of UNEs will be limited to local loops, and apparently will not be generally contemplated for the major business customers. SBC/Ameritech will place fiber rings so as to reach these customers directly as often as it can.

5/ SBC and Ameritech say they have examined out-of-region local entry and concluded that the potential rewards do not justify the investment. Either this examination included consideration

7. This market environment leads to the following major conclusions. First, as the Commission found in the BA-NYNEX Order, there are only a limited number of firms capable of challenging incumbent local exchange carriers ("ILECs") for mass market customers. Experience in the past year shows that the prospects for widespread entry in the short term by competitive local exchange carriers ("CLECs") are actually lower now than they were perceived to be a year ago. Both AT&T and MCI have virtually abandoned resale as an entry vehicle because the discount levels set in state arbitrations are too small, ILEC Operations Support Systems for provisioning resold lines do not work, and resale limits the ability of firms to differentiate their services.

8. CLECs continue to be frustrated by the high price of, and difficulty in procuring, unbundled network elements ("UNEs"). AT&T appears to have embarked in a new direction with the proposed acquisition of TCI. Whether cable assets can be used as a basis for entry into mass market telephony remains to be seen, but the result will not be known until at least several years and many billions of dollars are spent. Wireless alternatives are unlikely to fare much better. As a result, *de novo* out of territory entry by an existing ILEC willing to break from the cartel remains a key competitive entry mechanism.

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of UNE-based entry strategies or it did not. We assume that SBC's application compares the prospects for largely facilities-based out-of-region entry with and without the merger because those are the relevant alternatives; i.e., that the economics of facilities-based entry are more favorable than UNE-based entry.

9. ILECs have provided local telephone service for over a century, they own and know how to operate necessary support systems, they are extremely profitable, and judging by their international investments, they have the capital and the ability to invest outside their traditional geographic markets. Moreover, ILECs are uniquely situated to challenge the discriminatory interconnection and pricing policies that are slowing entry by other carriers. State Commissions ruling in arbitration proceedings face a significant information asymmetry problem. An out of region ILEC would be an extremely credible participant in an arbitration proceeding. Thus far, no ILEC has attempted to enter local markets out-of-region on any significant scale. However, the more ILECs there are, the more likely it is that one of them will break from the cartel.

10. The merger will cause direct competitive harm in several significant ways. First, benchmarking ILECs is an important regulatory tool, and one that RBOCs relied upon to justify their requests for eliminating MFJ line of business restrictions. Second, if RBOCs receive 271 authority prematurely, their ability to harm competition is enhanced to the extent their territories are larger. This is because more calls will originate and terminate in their territory, thus increasing the return to discrimination. Third, the combined firm's share of total lines in the U.S. is too large -- leading to nationwide network dominance at least for the class of predominantly in-region business customers who, according to SBC-Ameritech, prefer either a one-stop shop for their telecommunications requirements, or that local service be procured as much as possible from the same vendor nationwide. Fourth, the merger will have a negative impact on the development of both narrowband and broadband local competition. Finally, the merger places at risk the continued evolution of the Internet on a competitive basis.

11. The potential negative impact on Internet competition is particularly significant. The Internet has developed under a competitive environment, with no single firm dominating its evolution. If this merger, and others like it that the Commission may soon consider, are approved, then the last mile between Internet providers and their customers will come to be dominated by a small handful of firms. If this control over the last mile is leveraged into control over access to and from Internet service providers ("ISPs"), the most technologically vibrant and fastest growing segment of the economy could be damaged.

12. The out-of-region entry proposed by SBC-Ameritech does not compensate for these anticompetitive effects. First, there is no real assurance that this "commitment" is any more credible than the BA-NYNEX "commitment" to open their markets.[6]

13. Second, although SBC-Ameritech give lip service to the notion of competing in the mass market, their primary strategy is to provide facilities based competition in competition with the existing CLECS.[7] Competition for the business of major corporate customers in central business

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6/ We would note that BA is still doling out commitments in hoped for exchange of regulatory favors. See *In the matter of Petition of New York Telephone Company for Approval of its Statement of Generally Available Terms and Conditions Pursuant to Section 252 of the Telecommunications Act of 1996 and Draft Filing of Petition for InterLATA Entry Pursuant to Section 271 of the Telecommunications Act of 1996*, Pre-filing Statement of Bell Atlantic New York, Case 97-C-021 (New York Public Service Commission, April 6, 1998) (A copy of Bell Atlantic's filing is available at http://www.dps.state.ny.us). Instead of actually opening local markets to competition, the '96 Act merely opened up an extending bargaining session between CLECs and ILECs, with ILECs still holding most of the chips and the CLECs relying on regulatory intervention to enforce the Act.

7/ Given the price and terms of wholesale services and unbundled network elements, there is no reason to believe that entry by an ILEC in the mass market will be any more profitable than districts is further advanced than mass market competition, at least as measured by installed capacity, but is still very limited.[8] There is no reason to believe that SBC-Ameritech will be any more able to leverage their CLEC business to mass markets, if they actually enter, than existing CLECS, including AT&T and MCI Worldcom.[9]

14. Section II below discusses the evolving structure of the local exchange business in the U.S. Section III discusses the loss of benchmark and likely competitive harms in the long distance market that will be caused by the merger. Section IV addresses the supposed major public interest benefit of the merger -- out of region entry by the combined SBC-Ameritech. With this background, the effect of the merger on local markets is also discussed in Section IV.

II. POST MERGER INDUSTRY STRUCTURE

15. This Section discusses developments in local competition and the nationwide structure of the local service business. Section A shows that competition for the business of large customers is progressing, but mass market competition has yet to get off the ground. Section B describes

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entry by AT&T or MCI Worldcom.

8/ See, e.g., Jonathan Kraushauer, Fiber Deployment Update, End of Year 1997, Common Carrier Bureau, FCC. pp. 34-35 for a description of CLEC fiber investments.

9/ All carriers without market power would have financial incentives to expand from business to mass markets if warranted by market conditions. See SBC, "Description of the Transaction, Public Interest Showing and Related Demonstration," July 24, 1998 at p. 75 ("... in a market with a large incumbent, all of the other market participants have a powerful incentive to compete and expand output.")

the evolving structure of the local exchange business, demonstrating that if all planned mergers are allowed, the nationwide structure of the local exchange industry will be heavily concentrated.

A. Local Markets Are Not Competitive

16. Although the ILECs have been predicting that local competition is "just around the corner" for more than a decade, the reality is quite different. The high expectations for the development of competition at the time of the passage of the 1996 Act have not been realized. Demonstrating that the local exchange is still a monopoly, and is likely to remain so for the foreseeable future, does not require an extensive *de novo* antitrust market analysis. The Commission concluded such an analysis just over a year ago when it approved the Bell Atlantic-NYNEX merger with conditions. In the Bell Atlantic/NYNEX Order, the Commission concluded that in New York City LATA 132, arguably the market where local competition is the most developed:

> neither the firms remaining in the market nor other telecommunications firms not currently in the market appear able to quickly and effectively increase their presence in response to any exercise of market power in the relevant market.[10/]

Unfortunately, the commitments made by Bell Atlantic in exchange for approval of the merger have not changed this conclusion. As the extensive documentation in the ALTS 706 Petition and MCI's May 1998 Access Charge Report show, CLECs are still having difficulty procuring essential network elements at reasonable prices. As a result, the ILECs retain substantial market share and monopoly control over the local exchange.

10/ BA-NYNEX Order, para. 143

17. The conclusion that ILECs retain monopoly control over the local exchange is also consistent with empirical analysis by HAI. In The Enduring Local Bottleneck II, HAI analyzed the business case for competition for residential and small business customers from cable and wireless operators.[11/] ELB II concluded that widespread deployment of the competitive technologies is not likely in the near term.[12/] ELB II analyzed the business case for providing cable telephony over hybrid fiber coax ("HFC") networks. There have been no changes in technology or costs sufficiently dramatic to change the results of that analysis. Cable companies have been attempting since the beginning of the 1990s to provide telephony over the HFC with virtually no penetration of the residential and small business marketplace.

18. ELB II noted the potential development of cable modem service as an entry point for cable provision of cable telephony services. Developments with Internet voice technology and the recent announcement of the acquisition of TCI by AT&T provide some hope that this technology will help break the bottleneck. However, even assuming that Internet voice will be a reasonably priced and high quality substitute for the current circuit switched service, billions of dollars in investment and a substantial amount of time are required to implement this strategy.[13/] Internet telephony ("I-tel") quality problems are likely to be solved in time, but cable companies must upgrade their networks, install the necessary electronics, and market the service (together with a

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11/ Hatfield Associates, Inc., April 30, 1997. ("ELB II")

12/ ELB II, p. 73. The Sigman Affidavit describes SBC's failed attempt to enter the local business in Rochester by leveraging its wireless assets.

13/ See Mike Mills, "AT&T: No changes in TCI Deal," Washington Post, July 8, 1998, p. C11.

substantial investment in premises hardware) to consumers. As a result, it will likely be some time before that service is widely available.

19. Wireless competition presents similar problems. Fixed wireless solutions may well provide competition for local exchange service in rural areas. However, ELB II concluded that the traffic loads imposed by fixed service make wireless technology impractical as a substitute for local exchange service in more densely populated areas. Broadband wireless also faces significant hurdles before it can become a serious contender for fixed wireline service in the foreseeable future. Although the technology exists, it suffers from coverage problems due to signal attenuation and the need to provide a line of sight connection to customers. It is certainly far from clear now that broadband wireless will overcome these problems.

20. It is also useful to assess local exchange competitiveness with the traditional Industrial Organization tool of structure, conduct and performance analysis.[14/] The CLECs are growing rapidly through substantial investments in broadband technology. However, today, CLECs primarily provide services for large businesses and IXCs in mostly business sections of large cities. As a result, they often report their progress in terms of markets or cities served. CLEC market penetration gains are also usefully measured on a building-by-building basis. In 1997, CLECs had only 15,667 buildings located on their networks, representing less than 0.31 percent of

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14/ F.M. Scherer and David Ross, Industrial Market Structure and Economic Performance (1990). The U.S. Department of Justice Merger Guidelines are based on this paradigm.

commercial buildings, and less than 0.012 percent of households and commercial buildings.[15/] In terms of total national market penetration, the CLECs are today approximately where the competitive long distance providers were twenty years ago when they received authority to provide switched services. They are providing some dedicated services, and are only in the early stages of providing switched services. The percentage of residential and small business customers served by competitors is, of course, even smaller. That number likely rounds to zero percent.

21. Viewing the market from the perspective of conduct and performance confirms that the monopoly structure leads to monopoly results. Unlike customers and suppliers in competitive markets, access providers and their long distance customers frequently find themselves in adversarial relationships. For example, ILECs seldom cooperate with their CLEC or IXC customers when requests are made for new or more efficient forms of interconnection.[16/] If the ILECs were facing imminent widespread facilities-based competition, they would be more than willing to make unbundled network elements available to firms that would otherwise construct competing facilities.

15/ See, *ex parte* Letter from Mary L. Brown, MCI, to Richard Metzger, FCC, CC Docket No. 96-262, RM 9210, May 7, 1998, p. 27, fn. 59. ("MCI Access Report")

16/ The failure of ILECs to cooperate on interconnection issues is detailed in Petition of the Association for Local Telecommunications Services (ALTS) for a Declaratory Ruling Establishing Conditions Necessary to Promote Deployment of Advanced Telecommunications Capability Under Section 706 of the Telecommunications Act of 1996, CC Docket No. 98-78 (filed May 27, 1998) ("ALTS Petition"). Also see Affidavits submitted with MCI Access Report.

22. The ILECs do not voluntarily reduce prices when their costs fall. Regulators must order reductions. This is demonstrated by the fact that access charges are typically set at the maximums allowed by price cap plans. Productivity adjustments under price cap regimes are insufficient to prevent the inexorable climb of profits towards full unconstrained monopoly levels.

23. ILEC profits dramatically exceed any reasonable estimate of a competitive cost of capital. The most recently prescribed interstate rate of return was 11.25 percent.[17/] A study completed in 1996 shows that the appropriate return then was less than 10 percent.[18/] Interest rates have declined dramatically since that time. The most recent reports filed with the Commission show that the price cap carriers are earning 15.52 percent.

24. The ILECs might argue that this profit performance is due to the fact that price caps provide incentives for cost reductions. It is true that price caps are a contributing factor to the enormous returns. But other factors that may be just as significant as, or more significant than, price caps contribute to the excessive ILEC returns. For instance, access demand is growing due to the per minute access charge reductions the Commission has imposed in the past, and due to

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17/ See FCC Seeks Comment on Changes to Local Telephone Companies' Rate of Return to Reflect Marketplace Conditions (CC Docket No. 98-166), Report No. CC 98-33, October 5, 1998.

18/ See "Statement of Matthew I. Kahal Concerning Cost of Capital," In the Matter of Rate of Return Prescription for Local Exchange Carriers, File No. AAD95-172, March 11, 1996.

competition in the long distance market.[19] Costs are falling due to advances in switching and transmission technology that are affecting all high-technology companies.[20]

25. In a competitive market, there would be pressure to reduce access charges when profits are as high as those being experienced by ILECs. If competitive firms experienced such decreases in costs and increases in demand, they too might see dramatic increases in profitability, but such levels of profit would be transitory. They would quickly be competed away.

B. From a National Perspective, the Local Exchange Business Is Becoming Heavily Concentrated.

26. Two major ILEC mergers have already been approved by the Commission: SBC-Pacific Telesis and Bell Atlantic-NYNEX, with the result that the industry is much more concentrated than it was at the time the Act was passed. If the remaining announced mergers between SBC and SNET, SBC and Ameritech, and Bell Atlantic and GTE, are consummated, concentration will take another dramatic turn upward. Tables I and II compare the concentration among ILECs at the time the Act was passed and under the hypothetical assumption that all announced mergers

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19/ Recent per minute access charge reductions ordered by the Commission have been largely offset by increases in per line charges and explicit universal fund assessments.

20/ In the BA-NYNEX Order, the Commission noted that "price cap regulation, for example, may not constrain market power . . . ." Among the reasons cited by the Commission is the fact that "if carriers offer bundles that contain both price-capped services and some services not subject to price caps but potentially subject to the exercise of market power, the price of the overall bundle is not price capped and market power may be exercised by increasing the overall price of the bundle." (fn 201) are consummated. The change is dramatic. The largest firm will control almost 40 percent of the total revenues and the two largest will control almost 70 percent of the revenues.

Table I					
1/1/96			1/1/98		
Companies	**Revenues (000)**	**% of Total Revenues**	**Companies**	**Revenues (000)**	**% of Total Revenues**
Bell South	13,900	14.53%	BA Group	38,303	37.14%
Bell Atlantic	12163	12.72%	SW Bell Group	32,207	31.23%
GTE	12,115	12.67%	Bell South	14,666	14.22%
NYNEX	12,099	12.65%	US West	10,021	9.72%
Ameritech	10,795	11.29%	All Others	7,935	7.69%
US West	9,214	9.63%	**Total**	103,134	100.00%
Southwestern Bell	8,860	9.26%			
Pacific Bell	7,825	8.18%			
SNET	1,472	1.54%			
All Others	7,198	7.53%			
Total	95,646	100.00%			

Source: FCC, Statistics of Common Carriers, Table 2-9

Table II					
1/1/96			1/1/98		
Companies	Lines (000)	% of Total Lines	Companies	Lines (000)	% of Total Lines
Bell South	22,595	13.61%	BA Group	63,519	32.81%
Ameritech	21,889	13.19%	SW Bell Group	66,878	34.54%
Bell Atlantic	20,705	12.47%	Bell South	25,732	13.29%
Pacific Bell	18,782	11.31%	US West	25,294	13.06%
NYNEX	18,032	10.86%	All Others	12,191	6.30%
US West	17,671	10.64%	**Total**	193,614	100.00%
GTE	17,354	10.45%			
Southwestern Bell	16,343	9.84%			
SNET	2,057	1.24%			
All Others	10,580	6.37%			
Total	166,013	100.00%			

Source: FCC, Statistics of Common Carriers, Table 2.10

27. According to SBC and Ameritech, only very large ILECs are capable of a national expansion program; standing alone, they say they are too small. Tables III and IV provide concentration figures using the RBOCs and GTE as the universe. At the time the Act passed, the largest RBOC, BellSouth, controlled only 14.54 percent of the lines and 15.72 percent of the revenue for this collection of firms. If the mergers are consummated, the "Bell Atlantic group" of telephone companies will control about 40 percent of the lines and revenues while the "SBC group" will control 36.86 percent of the lines and 33.8 percent of the revenue. Only four major ILEC players will be left.

Table III					
1/1/96			1/1/98		
Companies	Revenues (000)	% of Total	Companies	Revenues (000)	% of Total

Bell South	13,900	15.72%	BA Group	38,303	40.24%
Bell Atlantic	12,163	13.75%	SW Bell Group	32,207	33.83%
GTE	12,115	13.70%	Bell South	14,666	15.41%
NYNEX	12,099	13.68%	US West	10,021	10.52%
Ameritech	10,795	12.21%	**Total**	95,197	100.00%
US West	9,214	10.42%			
Southwestern Bell	8,860	10.02%			
Pacific Bell	7,825	8.85%			
SNET	1,472	1.65%			
Total	88,443	100.00%			

Source: FCC, Statistics of Common Carriers

Table IV

Companies	Lines (000)	% of Total Lines	Companies	Lines	% of Total Lines
Bell South	22,595	14.54%	BA Group	63,519	35.01%
Ameritech	21,889	14.08%	SW Bell Group	66,878	36.86%
Bell Atlantic	20,705	13.32%	Bell South	25,732	14.18%
Pacific Bell	18,783	12.08%	US West	25,294	13.94%
NYNEX	18,032	11.60%	**Total**	159,311	100.00%
US West	17,671	11.37%			
GTE	17,354	11.17%			
Southwestern Bell	16,343	10.51%			
SNET	2,057	1.33%			
Total	155,429	100.00%			

Source: FCC, Statistics of Common Carriers

28. This concentration in nation-wide control is significant for several reasons. First, there would be competitive effects in both the local and long distance markets resulting from increases in nation-wide concentration. Second competitive benchmarks are an important regulatory tool, the value of which is reduced as large ILECs merge. Third, the universe of potential entrants is being reduced significantly by the mergers. Finally, the merger has potential negative implications for the "local-national" customers discussed in the SBC-Ameritech Application. Thus, the

SBC/Ameritech merger raises a fundamental question for the FCC: How much consolidation will the Commission allow among the RBOCS and/or major ILECs -- including GTE? These problems are discussed in Sections III and IV below.

III. THE SBC/Ameritech MERGER IS INCONSISTENT WITH THE PUBLIC INTEREST.

30. This section discusses three major reasons why this merger will harm the public interest. First, a potentially valuable potential entrant -- one of a dwindling set of firms -- will be lost. Second, a valuable regulatory benchmark will be lost. Finally, competition for long distance and bundled local and long distance service will be put at risk.

A. The Merger Will Remove a Valuable Potential Entrant

31. Neither SBC nor Ameritech has entered local markets out of their territory to date in any significant way. SBC's claim that they will do so only if the merger is approved is discussed in Section IV below. Even if neither SBC or Ameritech have *current* plans to enter independently, these firms are among a small group of firms with the requisite skills and capital to enter the mass market segments of the local exchange business. And current market conditions and plans can change. SBC and Ameritech argue that their out-of-region entry will provoke other RBOCs to enter the SBC/Ameritech region in response. Similarly, SBC's and Ameritech's plans for out-of-region local entry could change if they felt the need to respond to successful local entry on a

significant scale in their regions by MCI Worldcom, AT&T, or any of the CLECs.[21/] Therefore, they are valuable potential entrants.

32. One of the reasons that large ILECs such as SBC and Ameritech are important potential entrants to the mass market is that penetration of the mass market will likely require substantial reliance on resale and unbundled network elements. The prices, terms and conditions for these entry modes are established in contentious arbitration hearings in the states. As noted in the introduction, State Commissions ruling in arbitration proceedings face a significant information asymmetry problem. They are faced with competing claims by ILECs and by competitors of the cost and difficulty of provisioning unbundled network elements. An out-of-region ILEC would be an extremely credible participant in these arbitration proceedings.

33. SBC did contemplate mass market entry earlier this decade through the purchase by SBC of the Hauser Communications assets in the Maryland suburbs of Washington D.C. However local competition did not result, likely at least in part for the reasons discussed in detail in ELB II. Nevertheless, this move showed a willingness on the part of SBC to break ranks with its fellow RBOCs. In regulatory proceedings in Maryland, SBC filed testimony contrary to the positions being taken by Bell Atlantic.[22/] We would also note that Ameritech is entering cable markets in its

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21/ The issues surrounding defensive entry of this sort are discussed below at paragraphs 70-73 and 115.

22/ See Reply Testimony of Jerry A. Hausman on behalf of SBC Media Ventures in Public Service Commission of Maryland, in the Matter of the Investigation by the Commission on its Own Motion into Legal and Policy Matters Relevant to the Regulation of Firms, Including Current Telecommunications Providers and Cable Television Firms, Which May Provide Local own region. With this learning, it may be a credible cable entrant out of region It would then be in a position to use the newly developing broadband access technology to reach the mass market for local telephony.

34. The national-local market for the business of Fortune 500 firms addressed by SBC-Ameritech is discussed in detail in the next section. We would note here that, if SBC and Ameritech are incorrect about the size and scale required to be viable in that market, the number of significant potential entrants will have been reduced by one.

35. We would also note that potential entry merger analysis must be calibrated differently for telecommunications than for other markets. Standard potential entry theory focuses on "most likely" potential entrants. However, standard potential entry analysis typically focuses on unregulated markets where there have been no legal entry barriers, and where the market is not almost completely monopolized. Entry has only been allowed in local telephone markets for a relatively few years. As a result, the dynamic entry process is not well developed. Therefore, the second, third and fourth most likely potential entrants are more important in this market than in other industrial markets.[23/] This is especially true if, as SBC and Ameritech argue[24/], unlikely potential entrants *today* might be transformed into actual entrants in the future as market

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Exchange and Exchange Access Services in Maryland in the Future, Case No. 8587, filed July 22, 1994.

23/ The Commission reached this conclusion in the BA/NYNEX Order.

24/ See the "defensive entry" discussion below at paragraphs 70-73 and 115.

conditions change. It would be a mistake not to value the potential pro-competitive prospects of significant potential entrants very highly, even if the potential entrants are not planning current entry. The loss of major potential entrants into SBC's and Ameritech's territories (i.e., Ameritech and SBC, respectively) with an admitted strong interest in out of region local entry would be substantial.

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B. An Important Regulatory Benchmark Will Be Lost

36. Regulators and economists have long understood the importance of benchmarks. This fact has also been recognized by the ILECs, as the Commission noted in the BA/NYNEX Order.[25] While benchmarking has not eliminate discrimination, it has been a useful regulatory tool. As the number of potential benchmarks is reduced, the value of the tool is correspondingly devalued.

37. Neither SBC nor Ameritech have opened their markets sufficiently to justify approval of Section 271 applications. However, there are significant differences between the two firms. These differences are potential sources of information for regulators that will be lost if the merger is approved. For example, Ameritech generally supported lower UNE rates than SBC, while SBC has had less restrictive policies concerning certain aspects of shared access to UNEs. When SBC controls Ameritech, it will be able to stop Ameritech from making improvements in the terms and conditions of its resale and UNE offerings. Advances in local competition that may otherwise have occurred in the Ameritech region are thus placed at risk if Ameritech is acquired

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25/ BA-NYNEX Order, para. 149.

by SBC. SBC's acquisition of Ameritech will cut off the progress, and any likely future benchmark that would apply to SBC. Similarly, the acquisition will eliminate policy differences between the companies that would place benchmarking pressure on Ameritech from those areas where SBC's policies are more conducive to local entry than Ameritech's. SBC's acquisition of Ameritech will thus reduce the possibility of meaningful benchmark competition.

38. Benchmarks are also useful to customers. Large ILEC customers such as AT&T are able to benchmark the performance of ILECs. The Rivers Affidavit filed by SBC provides an example of such benchmarking. Rivers reports (at page 9)

> . . . that AT&T, our largest wholesale customer, which is familiar with the methods used by all major carriers in providing HiCap lines, preferred Southwestern Bell's HiCap procedures to those used by other companies. . . . Consequently, because of AT&T's request, many of those procedures that were superior to those we were previously using have become standard with us. Business customers, interexchange customers, CLECs, wireless carriers, and others who use HiCap service have benefitted from our experience.

SBC-Ameritech use this as an example of how they can rely on one another for ways to improve their service to IXCs. This improvement took place without the merger because AT&T had a competitive benchmark to use. A more likely post-merger outcome is that, with loss of the benchmark, service quality will be lower on average. SBC-Ameritech have no large economic incentive to voluntarily improve its service to IXCs, with whom it hopes to compete in the near term.

39. The nationwide structure of the industry also plays an important role in the development of industry standards. A dominant ILEC may impose standards on the industry, bypassing

standards processes. The development of industry standards has always been problematic, with the local telephone companies able to control the process and adopt standards that disadvantage other players, such as IXCs. With fewer voices in the standards process, the ability of a single large firm to drive the results will increase. This is particularly important given the current evolution of broadband technologies. A more consolidated local telephone industry will have a greater ability to force anticompetitive standards on the industry.

C. Competition for Long Distance and Bundled Local and Long Distance Service Will Be Harmed by the Merger

40. It is appropriate to analyze the competitive effects of the merger under the assumption that RBOCs obtain near term 271 authority to provide interLATA long distance service within their regions. Based on the analysis in Section II, significant local competition is not likely in the near term. An inevitable result of the merger will be that more calls will originate and terminate in the combined territory of SBC. This is significant because the artificial access charge advantage enjoyed by ILECs will increase as a result of the merger.

41. The artificial access advantage stems from the fact that access charges are currently priced well above costs. Excessive access charges result in subsidies from the long distance carriers to ILECs. These subsidies give the ILECs an artificial and anticompetitive advantage in the long distance market. These advantages are not the result of efficiency or innovation by ILECs. They are the result of its position as the incumbent local exchange carrier, with the consequent ability to charge its competitors high prices for access. One significant problem is that ILECs can place their long distance competitors in a price squeeze.

42. Under a price squeeze, a firm supplying a monopoly input incurs less cost for the monopoly input than it charges its competitors. As a result, the competitors are unable to earn a profit even though they may be as efficient or more efficient than the monopolist. Modern economic theory recognizes the anticompetitive nature of such price squeezes. Raising the price of an essential monopoly input is a "raising rivals' cost" strategy.[26/]

43. Imputation rules do not solve this problem. Under imputation, the monopolist charges itself or its affiliate toll provider the same rate for the monopoly input, i.e., access, as it charges it competitors. Experience in administering the imputation rules shows that these rules are hard to enforce in the face of incentives for the local monopoly telephone companies to abuse them -- and the incumbent telephone companies do indeed have these incentives.

44. At the request of AT&T and MCI Worldcom, HAI reviewed imputation of access charges by New York Telephone ("NYT") for its toll and Regional Calling Plan ("RCP") services. The conclusion reached was that despite the Commission's imputation rules and policies, many NYT intraLATA toll services were priced too low to allow competing, equally efficient interexchange carriers to make a profit. The NYT imputation analysis contained unrealistically low costs of administration and marketing. As a result of this and other problems identified, NYT placed its

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26/ See, for example, Salop, S. and D. Scheffman, "Raising Rivals' Costs," American Economic Review, 73, May, 1983.

competitors in a price squeeze. Thus, imputation as a competitive safeguard is flawed in both theory and practice.

45. These competitive problems would not be resolved if the imputation rules were changed. Excessive access charges provide incentives for abuse. It is very difficult for regulation to overcome these incentives. With the introduction of local competition, the resources of regulators are stretched even further. The evidence in the interLATA market is that there will be a variety of pricing plans and frequent service innovations. At best, regulators will be able to perform cursory imputation reviews of ILEC offerings. By the time reviews are completed, plans that fail an imputation test may have already damaged competition. As the experience in New York demonstrates, this problem is exacerbated by the fact that the issues surrounding a proper imputation can be quite complex. The New York Commission recently found that " . . . the incumbent local exchange carrier is advantaged by the difficulties and delays inherent in policing imputation . . ."[27/] A New York administrative law judge described the problems in more detail.

> "...as a practical matter the [imputation] rule appears difficult to apply, and with the proliferation of competitive services, New York Telephone's rates may be increasingly difficult to police for imputation failure...staff reported in July 1996 that New York Telephone's personalized rate plan failed the imputation standard. Despite filing of tariff revisions, New York Telephone conceded and the Commission found that the service still failed imputation in July 1997."[28/]

27/ See Opinion and Order Establishing Access Charges for the New York Telephone Company and Instituting a Targeted Accessibility Fund, Opinion 98-10, June 2, 1998, p. 12, fn. 2.

28/ Recommended Decision of Judge Stein in Case no. 94-C-0095, 1/23/98.

The bottom line is that pricing access at economic cost is an essential competitive safeguard. If ILECs are not earning excessive profits on access, they are less able to earn low or negative margins on the non-access portion of toll rates.

46. Incumbent local exchange carriers have argued that they have no incentive to discriminate against long distance competitors because they would lose the profits they are making on access as a result. This "opportunity cost" argument is not correct; under some, empirically relevant, circumstances neither imputation nor the firm's own calculus provides the correct opportunity cost to the ILEC. First, the monopolist will have incentives to offer volume discounts or other types of discount plans that long distance competitors cannot match. On minutes of use stimulated by such plans, the long distance carrier will still pay the ILEC full access charges, but the ILEC will recognize that its marginal cost of access is less than a long distance carrier's marginal cost of access. It will therefore be able to profitably offer consumers deeper discounts. These discounts are not due to efficiency or innovation, but are due simply to the fact that access charges are priced above cost for competitors.

47. Second, if the monopoly telephone company is subject to an explicit or implicit profit cap from regulators, it will not perceive the same cost of discriminating against competitors as when this is not the case. In other words, pricing its own long distance services without regard to access charges may be profitable. Its access profits will fall, but it may avoid a general rate reduction. In addition, it will gain a competitive advantage against its long distance rivals.

48. Third, above cost access charges distort competition because the ILEC can profitably engage in non-linear pricing strategies (e.g., volume discounts or multi-part declining tariffs) that IXCs cannot profitably match. Under these pricing strategies, usage charges can be reduced all the way to marginal cost. The marginal cost floor for an IXC is the per minute access charge paid to the ILEC while the marginal cost floor of the ILEC is the true marginal cost of access. Because the ILEC's private marginal cost of access is far less than an IXC's private marginal cost of access, it can profitably offer non-linear pricing packages for its long distance service (or bundles that include long-distance and local services) that include deeper discounts for marginal long-distance users than can the IXCs, which cannot internalize (and thus eliminate) the distortion created by above-cost prices for access.[29/]

49. Mergers among ILECs exacerbate the problems discussed above because mergers will result in a larger number of ILEC calls both originating and terminating within territory. This increases the total access charge advantage accruing to the ILEC. Access charges have fallen in recent years, reducing the magnitude of the advantage. Nevertheless, access charges remain well above costs.[30/]

29/ See Declaration of Kenneth C. Baseman and Frederick R. Warren-Boulton on Behalf of MCI, CC Docket Nol. 97-208 (r.e. BellSouth's application for interLATA authority in South Carolina), paragraphs 27 and 28 for a more detailed explanation.

30/ Usage-based access charges have fallen even faster than total access charges because access charge revenue requirement has been transferred to fixed rate elements such as the PICC or explicit universal service requirements.

50. The Commission reviewed this argument in the context of the Bell Atlantic-NYNEX merger, concluding that the problem was not sufficient to justify disapproving the merger in light of other regulatory rules concerning price squeezes and its expectation that Bell Atlantic would comply with market-opening conditions imposed by the Commission in connection with the merger.[31] However, since the Commission review of that merger, it has become even more apparent that competition is unlikely to rapidly move access charges towards cost. As discussed above, local exchange competition is not developing rapidly.

51. The merger may also reduce the prospects for local competition within the territories of the merged firm. Local and long distance services will likely be offered as a bundle. Customers choosing SBC-Ameritech local and long distance service bundles will not be available to CLECs. The access charge advantages the ILECs enjoy (because they are uniquely able to integrate around the problem that overpriced access charges create for IXCs) will result in a smaller potential market for their local competitors. This, in turn, will make it more difficult for independent entrants to reach a viable size. The effects on local markets are discussed further in the next section.

52. Non-price discrimination will also become more likely with a merger. A merged firm degrading quality will have a greater impact on its long distance rivals than non-merged firms because a higher proportion of the independent rivals' calls will both originate and terminate within region. That is, discrimination will carry a higher pay-off after a merger. This incentive is

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31/ BA/NYNEX Order para. 115.

exacerbated by the fact that the probability of detection of discrimination will be reduced by the loss of benchmarks.

53. The risk of technical discrimination is actually higher now than it has been in the past. The deployment of new signaling systems, intelligent network architectures, and the growth of broadband applications are all leading to different and more complex forms of network interconnection. This in turn increases the opportunity to discriminate. To take the Advanced Intelligent Network ("AIN") as an example, an ILEC can refuse to interconnect at critical points or to convey essential information messages across the network. Instead of refusing to cooperate, the ILEC can choose to cooperate in a painfully slow way – with the same ultimate result. It can also put competitors at a substantial disadvantage by slow-rolling their requests for interconnection based on unjustified claims of technical infeasibility or lack of capacity. Regulators have a difficult time refereeing technical disputes of the sort that would be created. The implication is that competitors will not be able to design customized applications for customers that the ILEC would be able to provide – not because the ILEC is more efficient but only because the ILEC controls the last mile.

54. Of course, another problem is that simply by having to ask for new or special forms of interconnection to meet special customer needs or develop new products, IXCs are put at a disadvantage. The ILEC can delay provision of the necessary interconnection until it is ready to market the same service.

IV. Allowing SBC and Ameritech to implement their "National/Local" business plan through the merger will harm customers.

55. SBC and Ameritech argue that their merger is in the public interest because the new SBC intends to invest heavily to enter local service out of region, whereas each company standing alone would not. SBC refers to this business plan as the "National/Local" plan. In this section we first describe the National/Local plan. Second, we show that SBC and Ameritech's advocacy for the plan is both internally inconsistent and inconsistent with their prior statements about local competition. With this background, in Section C, we show that the merger will actually reduce the prospects for local competition. Of course, it is not out-of-region entry by itself that harms consumers. If SBC or Ameritech want to implement the plan individually, out-of-region consumers would benefit and in-region consumers would not be harmed. In contrast, as we explain, the merger makes it likely that in-region customers will be harmed even if SBC/Ameritech follows through on its promises for out-of-region entry.

A. Description of the National/Local Plan.

56. Each merger partner says that it has seriously examined the economics of out of region entry, and concluded that local entry, whether by resale, UNEs or own facilities, would be unprofitable in an economic sense, i. e. it would not generate future returns sufficient to warrant the investment. SBC and Ameritech argue that profitable local entry requires very large scale investments in many localities at once. Thus, they claim that each company, on a stand-alone basis, is too small.

57. They assert that a merged SBC/Ameritech will find out-of-region local, facilities-based entry profitable because the merged firm will be able to more economically "follow" major, Fortune 500-type customers out of region.[32] SWB and Ameritech state that many of these large customers desire a single source from which to procure a bundle of local/long distance and other services. SBC/Ameritech state that these customers will require that the "sole source" vendor provide 70-80 percent of the local service nationwide with facilities under its control.[33]

58. After the merger, SBC and Ameritech can provide customers with a much larger base of local facilities under its ownership and control. The merged company will be able to profitably enter local markets out of region because a smaller proportion of the country will be out of region. Therefore the amount of incremental investment needed to achieve any given level of "controlled" facilities is smaller for the merged firm than for each firm alone.

59. For example, after the merger SBC can use Ameritech's local facilities (which it will then own) in Ameritech's region, rather than building its own facilities or dealing at arm's length with Ameritech for UNEs. This difference, the parties claim, is of enormous importance. In essence, SBC (and Ameritech) are saying they could not profitably launch stand-alone national local plans without the leg up of being able to avoid investing in their own local facilities in the other's region and/or procuring UNEs from the other merger partner.

32/ "Description of Transaction...", op. cit., p. 5

33/ Ibid., pp. 14-15

60. Finally, the parties indicate that they will employ a mix of owned and rented facilities when entering out of region. Long distance transport will be rented, as will some local transport. However, at least for larger customers, SBC will own the local loops (on SBC's fiber rings) and switching facilities. They say they will rent loops for residential and small business customers to fill out their network.

B. The critical assumptions of the National/Local Plan are incorrect or mutually inconsistent, and are inconsistent with the BOCs' (and GTE's) positions in previous public policy debates.

61. First, entry into local telephony is time-consuming and costly. After previously arguing that local competition is developing slowly because of strategically-motivated slow-growth plans by the IXCs and CLECs, SBC now comes clean and admits what has long been obvious to everyone else: very large barriers to entry remain in local markets. And the UNE procedures in place have done little to change that fact. The UNE provisioning process is not working. Moreover, the prices are too high.[34/] The practical reality is that, to the extent local entry is occurring, it is predominantly with facilities constructed by the entrant.

62. MCI Worldcom has argued that local entry cannot be viable if it depends substantially on UNEs purchased under the terms and conditions that now prevail from an entity, the ILEC, with no incentive to make the transaction work. SBC and Ameritech have reached the same judgment. They have decided that out-of-region local entry must be predominantly facilities-based and they

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34/ Note that SBC and Ameritech say out-of-region local entry is now unprofitable for them anywhere, including the Bell Atlantic/NYNEX region. Thus the concessions BellAtlantic/NyNEX made to get their merger cleared are inconsequential to SBC and Ameritech.

cannot pursue National/Local strategies by relying substantially on UNEs purchased from the out-of-regions ILECs on the terms and conditions at which they are currently available (at least during the early stages of entry).

64. *Second, the initial benefit SBC claims from the merger is greater competition for the integrated telephone needs of Fortune 500 companies. It must be recognized, however, that this is the class of customers for whom facilities-based competition is most likely to develop with or without the SBC/Ameritech merger.* Major business customers have been targeted by the CLECs. Thus the claimed initial benefit is quite modest. In fact, using the BOCs' normal metric, there are no benefits from the SBC/Ameritech national/local plan.

65. BOCs generally claim that local service as a whole is now competitive, even though there is very little facilities-based competition, because their markets are (they allege) *open* to competition. Thus their normal assertion is that some prospect of entry in local service (even where actual entry is minuscule) ensures that a close to competitive result will occur. Consider the testimony of economists Richard Gilbert and John Panzar sponsored by Ameritech in its 271 application in Michigan.[35/]

> Mobility conditions <u>(the ease of entry and exit) are critical determinants of market outcomes; concentration is secondary.</u> If costs of entry and exit faced by potential entrants into the local exchange market are low, Ameritech's ability to exert market power is limited. If Ameritech attempted to discriminate in price, quality, or any other dimension of access, it would be foiled by the profit opportunity thereby created for potential entrants or actual competitors. For example, suppose

35/ See Joint Affidavit of Richard J. Gilbert and John C. Panzar of Behalf of Ameritech Michigan, Dec. 1996 at paragraph 81.

> Ameritech attempted to degrade the quality of access provided to competitive long distance providers. The threat of opportunistic entry saves as a deterrent against discriminatory behavior. <u>The provisions of the Act</u>, requiring Ameritech to provide unbundled network elements to existing and potential local competitors <u>makes such opportunistic entry very easy - the entrants need only incur minimal sunk costs.</u> With easy entry, any discrimination by Ameritech would create a profit opportunity for a potential competitor, who could enter as a competitive access provider, or enter as a competitive local exchange carrier by leasing the unbundled loop, and providing access to long distance carriers. <u>Of course, actual competitors would also discipline an incumbent, but the threat of entry can be an effective discipline even if the incumbent faces little or no actual competition. This is the sense in which market concentration is secondary to entry conditions.</u> (Emphasis added.)

By that standard, the national/local market for Fortune 500 companies is already adequately competitive, since the ILECs' (alleged) compliance with the 1996 Act makes entry conditions easy enough that there is no room for the exercise of any appreciable market power, and no further significant competitive gain that can be expected from additional, facilities-based entry.

66. The SBC-Ameritech proposal produces few, if any, benefits even using a more reasonable competitive metric. Local markets are not competitive, although the major facilities of large Fortune 500 firms are sometimes served by multiple suppliers. MCI Worldcom, TCG, and a number of smaller CLECs have facilities in major cities throughout the country. The competitive benefits of an additional entrant into this segment of the market are correspondingly reduced.

67. SBC and Ameritech clearly possess technical and financial resources for entry better than, or at the very least as good as, any other entrant. Nevertheless, they have decided that independent out of region local entry will not generate returns sufficient to justify the investment. Thus, in the Application they recognize that enormous entry barriers remain in local service. This

position completely undermines claims by both of these BOCs that the IXCs and stand-alone local entrants have been timing and scaling their entry so as to prevent BOC entry into long distance service or "game" the regulator into requiring lower rates or better terms for BOC services or UNEs. If these BOCs (who say they have no strategic motive to avoid out-of-region local entry) find such entry unprofitable, one need not look for subtle, strategic reasons why MCI Worldcom, AT&T and others have scaled back their local entry plans. There are substantial barriers to local entry for them as well. It is ironic that SBC and Ameritech castigated other local entrants for not entering sooner or on a broader scale (for example, see SBC, "Description of the Transaction, Public Interest Showing and Related Demonstrations", at pages 20-21), when they evidently decided not enter out of region local service at all.[36/]

68. *Third, SBC and Ameritech are likely to enter local service out of region as and if local competition begins to become significant within their regions. Indeed, SBC claims that significant local entry (specifically, its out-of-region entry) will motivate ILECs to enter local service out of region in order to compete for the national/local business of large business*

36/ SBC is more than a little schizophrenic on this issue. When attempting to assure the Commission that the loss of Ameritech's possible competition in St. Louis will not reduce overall competition there, SBC argues ("Description of Transaction..." at pp. 75-6)

> "In a market with a large incumbent, all of the other market participants have a powerful incentive to compete and expand output. In other words, whether Ameritech competes in St. Louis or not, AT&T (especially in light of its pending mergers with TCI and TCG), WorldCom/MCI/MFS/Brooks/UUNet, Sprint, the many CLECs and all of the other competitors will continue to try to expand their business and compete vigorously with SBC in order to build their customer bases. Nor is there any reason to believe that such emerging competitors would be likely to collude among themselves or that such coordination would have any impact on the market".

customers.[37] *But one must ask how SBC and Ameritech can predict smaller BOCs, such as Bell South or US West, would undertake such entry, when they say that each of them lacks the critical mass to make such entry viable?*[38] *If such entry is not profitable for Ameritech and SBC today because they do not possess sufficient scope and scale, how will similarly-sized or smaller BOCs be able to enter profitably in the future?* We see only two logical possibilities, each of which undermines the merger benefit claims made by SBC.

69. First, out-of-region local entry would be profitable now, but the BOCs have not attempted such entry in order to avoid destabilizing an implicit market-sharing agreement among the BOCs. With such an implicit agreement, refraining from entering each others' territories is more profitable than entering. The Commission must ask whether increased concentration among the already dwindling supply of ILEC potential entrants is a reasonable price to pay for an unenforceable entry commitment from SBC and Ameritech. It is reasonable to question whether the cartel is more likely to be broken with the merger, or with a larger number of firms with incentives to act independently as the future unfolds.

37/ See "Description of Transaction...", op. cit., p. 25; Carleton Aff. at para. 10, Schmalensee/Taylor Aff. at para. 16, and Gilbert/Harris Aff. at para. 28, and Kahan Aff. at para 88.

38/ We accept for discussion purposes SBC's implicit assumption that it will be successful in getting in-region, interLATA authority soon (i.e. before local competition has taken root and forced access charges to economic cost). SBC assumes near - term 271 authority both in its National/Local product description (bundled local and long distance service, p. 14) and its facilities description" (intercity trunks to be purchased from Qwest, Williams and others, p. 15). It then contemplates offering long distance service as part of the product bundle it offers customers who prefer to deal with a single telecommunications. We believe such interLATA authority should not be granted until local competition is far better established than it is today.

70. The second logical possibility is that out-of-region entry by (say, Bell South) is not profitable today because its Fortune 500 customer base has not yet been much eroded. However, when faced with a substantial possible loss of business to facilities-based local competition in its region in the future, SBC argues that ILECs such as BellSouth will invest defensively out of region to protect their customer bases.

71. The economics of defensive entry are far different than the economics of offensive entry. The returns from offensive entry (entering out-of-region local service before there is meaningful in-region local competition) are simply the (low) profits from competing as a small player against the host ILEC.

72. The returns from defensive out-of-region entry include both the low out-of-region profits from local service plus the larger monopoly profits from local service within region that the ILEC retains if it retains local business, rather than losing it CLECs who have established a nationwide footprint.

73. Thus the notion that ILECs may enter out of region for defensive, but not offensive, purposes has logical appeal, and does not depend upon a tacit market-sharing agreement among the BOCs. However, if this argument is correct, then this merger is not needed to induce Ameritech and SBC to enter local service out of region. As they begin to lose "national/local" business to facilities-based local entrants in their regions (such as MCI Worldcom) they will begin investing out of region to protect their customer base, exactly as they claim other major ILECs will do in response to their out-of-region entry.

74. *Fourth, SBC's claims that the market opening measures taken thus far under the 1996 Telecommunications Act have reduced entry barriers is contradicted by its statement that recent changes in the market have required greater scale and scope for successful market participation.* SBC claims that entry barriers have been lowered under the Telecommunications Act, yet on net other changes have increased the scale and scope necessary for it to succeed.[39] Modern economics recognizes that a market characterized by the need to incur sunk costs in entry (as in the largely facilities-based local entry plans of SBC/Ameritech), coupled with the need to achieve large scale and scope to produce cost-effectively, is a market with substantial entry barriers. SBC's assertions that the 1996 Telecommunications Act reforms have reduced entry barriers is thus completely trumped by its analysis that entry barriers to local service are still extremely high.

75. *Fifth, SBC and Ameritech argue that, especially as compared to MCIWorldcom and AT&T, they do not have the financial resources to undertake large-scale out-of-region entry.* They argue that other players, such as AT&T and MCI Worldcom, possess nationwide brand-name recognition, nationwide staffs and a massive base of revenues and profits that it must somehow match to compete for national/local accounts. SBC claims the merger-related synergies will allow it to compete with the IXCs for these accounts. These claims are unpersuasive.

76. SBC's and Ameritech's argument that they don't have the financial resources to compete out-or-region without the merger (Kahan Aff. P. 79-81) is completely bizarre. According to their own numbers, the merged company will have revenues about equal to the sum of MCI Worldcom

39/ Description of Transaction....at page 19.

and Sprint, and net income over *two and one-half times* larger than the sum of the net incomes of these two IXCs. Yet SBC criticizes these IXCs for strategically avoiding broad-based local entry. At least they have attempted to compete against ILECs in local service, while SBC and Ameritech have not!

77. SBC tries to show that AT&T has greater resources available for out-of- region entry than the combined SBC and Ameritech. This comparison is completely wrong. It compares its own *net income* with AT&T's *operating cash flow*. In fact, SBC's pre-merger cash flow from operations was almost $ 7 billion dollars, or about 50 percent greater than the $4.3 billion in operating cash flow it attributes to AT&T.[40/]

78. Cash flow has some significance to the investment a company can undertake in that cash flow over and above that necessary in the near term to sustain the existing business can be available for investment in other endeavors. But it is surely also relevant to ask what kinds of returns on investment various companies are making. A company with high returns on investment has greater internal cash flow available for investing in new markets because the returns from old markets far exceed the amounts that will have to reinvested to sustain the existing businesses. Dow Jones Interactive reports both returns on assets and returns on capital employed. By either measure, SBC's and Ameritech's average returns have been about double the average returns of MCI Worldcom and AT&T in recent years.

40/ See "Description..." at p. 53.

79. The brand name argument is a red herring. Brand names matter little to Fortune 500 accounts who are contemplating some sort of sole-source arrangement with a single vendor. For smaller business customers and residential customers, brand names are useful to the extent they provide accurate summary information about the firms' reputations and qualities. However, Fortune 500 accounts will directly investigate and extensively test the services of any vendor before a committing to them on a sole source basis. In addition, we doubt that any Fortune 500 telecommunications manager is not familiar with the names Ameritech, Southwestern Bell or Pacific Bell.

80. SBC places great weight on the argument that out-of-region local entry will be far cheaper for it after the merger than for the two companies standing alone. See Kahan Aff., P. 77-78 and Carlton Aff. paragraphs 31-35.[41] These "savings" reflect only the fact SBC and Ameritech save money if each does not have to enter local service in the other's territory. But these "savings" for facilities-based local entry claimed by SBC are a symptom of a problem, not a merger benefit, if SBC or Ameritech would, but for this merger, have entered each other's territory. In that case, the alleged savings are merely a symptom of an anticompetitive output restriction. Any expansion of output, such as out-of-region local entry by an BOC, takes resources. Monopolists cannot defend their output restrictions on the grounds that resources are saved due to less entry, because the social benefit of increased output outweigh the resource costs. Here, where local markets remain almost completely monopolized, the Commission should not allow a merger today, with

41/ Carlton assumes that out-of-region entry will require 95 managers per city. However, when an Ameritech city is converted from out-of-region to in-region by the merger, *no hiring of additional managers is assumed necessary to market and service national/local accounts.*

some resource "savings", when the effect may well be to reduce competition in the future. And the Commission should be especially wary of doing so when the merging parties have indicated they

have a strong interest in out-or-region local entry[42], and where the merging parties' own analysis of entry indicates that, even though they see no reason for out-of-region entry today, they would likely be moved to enter out-of-region to defend their existing local business as local competition develops and their major in-region business accounts begin patronizing other vendors of national/local service (who <u>have</u> made the investments necessary to provide their customers with a national footprint).

81. In sum, SBC and Ameritech's financial and synergy arguments are completely unpersuasive, at least as applied to its ability to enter local service out of region. We think, contrary to SBC's position, that a major effect of the merger will be to reduce the prospects for local competition in the territories of SBC and Ameritech, a subject to which we now turn.

C. This merger will reduce local service competition in the SBC and Ameritech territories, and thereby harm consumers.

82. <u>Disapproving the merger provides the best chance for local competition to develop in SBC's and Ameritech's territories</u>. SBC's and Ameritech's defense of their merger proposal

42/ See Kahan at paragraph 10 ("...during the fall of 1997 ...events in the industry compelled SBC to more aggressively seek to become a national, and ultimately an international, enterprise in order to remain a viable contender for the many growth opportunities which we anticipated.") and Carlton affidavit at paragraph 21 ("SBC decided in late 1997 and early 1998 that it needed to expand geographically in order to respond to the changes in industry supply and demand conditions...")

explicitly recognizes that entry into local service is extraordinarily difficult. The proposal also recognizes that the market opening measures for local service that thus far have been implemented under the '96 Act have not opened local markets very much, even in the Bell Atlantic/NYNEX region, where the Commission required additional market-opening measures (upon which Bell Atlantic has thus far defaulted). In contrast to out-of-region long distance inputs, which SBC and Ameritech plan to rent in a competitive market free of opportunistic behavior by a major rival, SBC and Ameritech recognize that they must build their own facilities, at least to serve their core large and mid-sized business accounts.

83. Ameritech and SBC are in effect conceding that out-of-region local markets are not yet "open to competition," which the '96 Act makes a prerequisite for BOC interLATA authority. Ameritech and SBC are as well positioned as anyone in terms of the technical and financial capabilities for local entry. If entry is unprofitable for them, the market is not "open to competition" in any meaningful economic sense.

84. If the local inputs needed to compete with ILECs for the business of major business customers could be procured in a competitive environment, then out of region local entry by SBC/Ameritech would not be needed to satisfy these customers, just as SBC/Ameritech recognize that they need not provide out-of-region long distance service with their own facilities to satisfy these customers. However, ILECs can be expected to discriminate against anyone (including national/local operations of out-of-region BOCs) trying to take away local service revenues.

85. ILECs have an incentive to provide non-discriminatory UNE service to entities that are both capable of entering with their own local facilities and in a position to offer sole-source or one-stop shopping to large corporate accounts. In this case the ILEC has an incentive to provide good UNE service in order to avoid losing all local revenues flowing from the business of those customers. This incentive is eliminated by the merger if 271 authority has also been granted prematurely (e. g. before local competition has taken root and forced access charges far closer to economic cost). The merged company will move to provide its own one-stop shop immediately, and therefore will be able to compete for the patronage of its own Fortune 500 customers on an end-to-end basis. It will not have to consider whether to make UNEs available on a more reasonable, competitive basis in order to keep a portion of the business of these large customers. Thus, a SBC/Ameritech merger coupled with 271 authority raises serious risks to the possibility of effective local competition by reducing the chances SBC or Ameritech otherwise might have moved, as local competition developed, to provide UNEs on more reasonable terms.

86. If SBC and Ameritech do not provide in-region interLATA service, the merger still creates a serious risk that SBC/PacTel/Ameritech/SNET and Bell Atlantic/NYNEX/GTE will be able to seriously disadvantage smaller competitors for national/local accounts. The smaller competitors would include CLECs and other ILECs who might consider out-of-region entry. By definition, these carriers have less extensive local facilities in place. SBC/Ameritech would compete for national/local business by providing the telephone equivalent of the "first screen" on desktop computers. SBC/Ameritech could install out-of-region switches and fiber rings so as to provide national customers with the same telecommunications interface in all areas where it had its own

facilities. Without interLATA authority, SBC would have to set up its service so that customers could use it with any long distance service. But because there is no serious disagreement that long distance service for large corporate amounts is quite competitive, SBC need not fear that long distance carriers will purposely design their service so as not to work well with Ameritech's national/local service. Customers who like Ameritech's national/local service features will search out long distance services that interconnect well with SBC.

87. Consider a customer for whom 80 percent of its traffic originates and terminates in SBC's territory, and 20 percent of which flows between points in SBC's territory and the territory of another ILEC. In competing for the national/local business of that customer, SBC has a substantial advantage. If the smaller ILEC wants to compete for that customer, it will need to build its own facilities or procure UNE's from SBC for 80 percent of the customer's business. CLECs would have to build facilities or buy UNEs for 100% of the locations. SBC will need to build facilities or buy UNEs to serve only 20 percent of the customers requirements. For UNE-based entry, SBC can discriminate against rivals for a far greater volume of business. And SBC's investment to build around such discrimination is far smaller than the other ILEC, because it already provides facilities-based service for four times as many calls. This gives SBC (and Bell Atlantic) both the incentive and ability, without fear of effective retaliation, to discriminate against other firms attempting to meet the demand for national/local service.

88. It then may make (private) sense for Ameritech/SBC to build their own out-of-region local facilities. It will then control both local ends for far more major clients than any other ILEC or

non-ILEC competitor. Because it will be far larger than other competitors, it can inflict far more discrimination on others than it will have to incur itself. In these circumstances, the post-merger SBC (and Bell Atlantic-GTE) will find themselves uniquely well-positioned to win the business of Fortune 500 clients, since they can offer service far less prone to discrimination than IXCs and other ILECs.

89. To see how works, consider the following simple example. Suppose that if an ILEC provides "good" UNE services, other local carriers can profitably serve corporate customers using a UNE-based strategy. However, currently the ILECs' incentives are to offer "bad" UNE services, which prevents UNE-based local competition. Offering UNEs on this basis allows the ILEC to keep all local revenues from those corporate accounts. The ILEC would obtain lower revenues and profits from selling UNEs.[43] So, while the ILEC could provide good UNE service to its competitors, it chooses not to do so. Rather, it provides them with bad UNEs so as to forestall local competition. It provides good service to itself (but these are not called UNEs).

90. This situation can be understood using the theory of network externalities. In a competitively structured market, firms have an incentive to interconnect on mutually beneficial terms. In this context, this means that firms have an incentive to open their networks to other

43/ As we noted above, if (as) local competition develops (without interLATA authority) at some point the ILECs incentives change. It will have incentives to provide good service to other carriers because they have competitive alternatives of getting good quality service from other local facilities-based competitors. At that point, the ILEC finds it profitable to stop discriminating (or to begin providing more compatibility), for it is better for the ILEC to get the UNE revenues than nothing at all.

competitors through provisioning UNEs and terminating network interconnection on reasonable physical and financial terms and conditions. To not do so means the loss of business to other firms. However, if SBC gets too large, it loses any private incentives to maintain compatibility. It will have more to lose than to gain by opening its networks. When it gets large enough, it has incentives to "tip" the system to incompatibility.[44/]

91. Premature interLATA relief exacerbates the problem. SBC can still provide good service to itself, yet continue to provide bad UNE service to others. It is not backsliding on the performance of UNEs it sells to others, it just never offered UNEs of any serious commercial value. In these circumstances, under SBC's National/Local theory, their merger creates additional incentives for discrimination (for less compatibility offered to customer/competitors). The merged firm now finds it profitable to be the only provider of high quality one-stop (local plus interLATA) service, and it now has stronger incentives to resist local competition (because it now captures all one-stop revenues that previously were captured by no one).

D. Mergers between major ILECs (such as SBC/Ameritech and Bell Atlantic/GTE) threaten competition for advanced services and Internet service.

92. The Commission is currently concerned about competition for the advanced services that will bring broadband Internet access to residential and small business customers.[45/] A key fact in

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44/ Jean-Jacques Laffonte, Patrick Rey, and Jean Tirole, "Network Competition: 1. Overview and Nondiscriminatory Pricing," The Rand Journal of Economics, Spring '98, pp. 1-37.

45/ In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability, CC Docket No. 98-147, Memorandum Opinion and Order and Notice of Proposed Rulemaking, released August 7, 1998. ("Broadband NPRM") the development of the Internet is that there have been no dominant firms involved in its evolution. Due to the Line of Business Restrictions in the MFJ, BOCs were originally restricted from providing information services. After this restriction was eliminated, the BOCs claimed that the interLATA restriction limited their ability to provide information services. Despite constant claims by the BOCs that these services would not reach the mass market without their involvement[46/], the Internet flourished. Both large and small entrepreneurs were able to innovate and invest in Internet technology. As explained below, the mergers between SBC and Ameritech and Bell Atlantic and GTE will have negative consequences for development of both broadband and Internet competition.

93. There are many ways in which an ILEC can discriminate against competitors that are dependent on access to the ILEC networks to reach customers. Discrimination is a particular problem when technologies are changing.[47/] Discrimination can be built into new network architectures and new technologies can be deployed to favor the advanced services provided by the ILEC.[48/] For example, the ILECs generally have been trying to limit competition for new DSL technologies by refusing to allow customer/competitors to purchase essential facilities needed to provide broadband services. Rather, the ILECs insist that would-be competitors to its broadband

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46/ See Memorandum of the Bell Companies in Support of Their Motion for a Waiver of the Inteexchange Restriction to Permit Them to Provide Information Services Across LATA Boundaries (D.D.C. filed April 24, 1995).

47/ See Baseman and Warren-Boulton, op. cit., at paragraphs 20-24.

48/ See HAI Consulting Inc., Economics and Technology of Broadband Deployment, September 25, 1998.

offerings must purchase an unbundled loop and collocate their own equipment to provide DSL service to their customers. The problem is exacerbated by the fact that ILECs in general are refusing to allow efficient collocation, and imposing a variety of other restrictions that have the effect of limiting the ability of competitors to offer competitive versions of xDSL.

94. The problem will only become worse as broadband technology evolves. xDSL technology provided over copper loops has been available for almost a decade and is fairly well understood. The ILECs are deploying digital loop carrier ("DLC") systems to more and more of their customers. With DLC systems, competitors may require access to electronics located at the fiber-feeder interfaces in the loop. So far, no ILEC has allowed the subloop unbundling required to provide this access. With evolving technology, it may be possible for ILECs to select for strategic reasons a broadband/DLC architecture that does not allow efficient unbundling at ether the subloop or the wire center.

95. There is also a substantial risk to Internet service providers. The Commission was quite concerned about the potential for MCI Worldcom to monopolize the Internet backbone. It required a divestiture of MCI Worldcom's Internet operations before approving the merger. These concerns struck us as theoretically valid, but empirically suspect, since it was not at all clear that (given the extensive building of backbone and other routing facilities by many other players) there was any danger that there was in fact a backbone bottleneck or that MCI Worldcom could gain control of it.

96. But there is clearly a local bottleneck. As discussed above, the ILECs thus far have been able to restrict competition for that bottleneck by refusing to provide competitor/customers all the choices they are supposed to have under the 1996 Telecommunications Act. The bottleneck and the many ways the ILECs have to discriminate do not go away simply because the network is evolving to incorporate local broadband technologies such as xDSL. Indeed, local broadband technologies provided over ILEC monopoly networks may become the preferred method of access to the Internet. That is, there is great risk that the bottleneck will simply evolve to encompass the new technologies. ILEC mega-mergers exacerbate that problem. There are two major reasons why. First, benchmarks will be affected. Second, the very structure of the Internet business could be affected adversely. These potential problems are discussed below.

97. First, there is a great risk that ILECs will be able to favor their own ISPs.[49/] This, of course, is a risk any time a vertically integrated monopolist competes in regulated monopoly and competitive markets. The problem will be exacerbated to the extent that xDSL access becomes a significant means of accessing the Internet. It is in fact likely that xDSL, or other forms of broadband access, will become increasingly significant as the consumer demand for high bandwidth Internet applications grows.[50/]

49/ See Complaint of the Department of Public Service and the Office of Attorney General, Before the Minnesota Public Utilities Commission, In the Matter of an Investigation Into U S West Communications Provision of MegaBit Services, Docket No. P421/EM-98-471, September 10, 1998.

50/ See Economics and Technology of Broadband Deployment, Section II.

98. Current Internet access for most end users is through dial-up local connections. Discrimination against ISPs to date has been limited due to the fact that ILECs have been late in entering the market and the fact that the pricing, technology and provisioning of these connections is standardized. By contrast, xDSL connections will be subject to pricing, technological, and provisioning uncertainty. This will open up the opportunity for discrimination against CLECs and ISPs.[51/]

99. Second, it is during a period of rapid technological change that competitive benchmarks can be particularly revealing. Broadband technology is relatively new and has not evolved to the extent that traditional circuit switched technology has evolved. In these circumstances, different firms will be experimenting with different technologies and approaches to providing the service. To the extent that major ILECs make independent broadband technology choices, adopt independent collocation polices, or make independent unbundling decisions, the Commission is provided with invaluable information.

100. Even if the ILECs all refuse to cooperate with potential broadband competitors (a likely short-run outcome), the arguments they make in opposition to cooperation can be revealing. To

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51/ We are not suggesting that discrimination over dial-up connections can not or has not occurred. But the ILECs were not among the first movers in the ISP business. The absence of discrimination to date could merely reflect the fact that the ILECs were not in a position to benefit from discrimination, not that existing regulation is sufficient to prevent discrimination in dial-up access. Our main point, however, is that incentives for discrimination are far harder for regulators to control when technology is changing.

the extent these arguments are different, they may be inconsistent, thus providing the Commission with a basis for further analysis.

101. The problems discussed above, of course, are likely to occur with or without the merger. However, the negative consequences for the development of the Internet are exacerbated by the merger. As described in Tables III and IV, after the merger, SBC/Ameritech and Bell Atlantic/GTE will control almost 70 percent of the lines between them. These lines are the true bottlenecks to the Internet. If SWB-PacTel-SNET-Ameritech and BA-NYNEX-GTE leverage their advantages in the provision of broadband access into a significant position in the ISP business, the problems will only be worse. Perhaps separately, and certainly in "gentlemen's agreement" duopoly, these parties would have the ability to refuse to peer with other ISPs, or to discriminate in other terms in favor of their own ISPs, in precisely the ways that concerned the Commission in the MCI Worldcom merger.[52/]

102. In short, with two major suppliers of Internet connections to end-users, there is a risk that they will act in concert to disadvantage all other suppliers. For example, by imposing discriminatory terms of interconnection on other providers, they can raise their rivals' cost of

52/ The problem is ameliorated if other technologies emerge to provide broadband access for ISPs. For the cable industry, at least, the prospects for effective competition from the cable industry for the last mile of Internet access are uncertain. See Barbara Esbin, "Internet Over Cable: Defining the Future in Terms of the Past," FCC, OPP Working Paper no. 30, August 1998 for a discussion of Internet over cable.

doing business.[53/] With several smaller firms, this is less likely. Even though, prior to the mergers, individual ILECs may disadvantage ISPS in their own regions and therefore gain control over a disproportionate share of the ISP business, there would still likely be a sufficient number of large players to ensure that interconnection in the Internet business generally is on reasonable terms. There would be incentives to exchange traffic on reasonable terms since no one supplier controls a disproportionate share of the business. Recent economic analysis shows that in network industries, there is an incentive to cooperate as long as no single player or small set of players dominates. However, once the industry moves to an asymmetric structure (e.g. where the merged SBC/Ameritech and Bell Atlantic/GTE substantially control more choke points on the Internet than other players) the dominant firm or firms have incentives to not cooperate with smaller firms.[54/]

103. The negative consequences of two large firms essentially controlling the financial and physical terms of entry into the Internet business are substantial. For example, ISPs are not merely gateways to information services. They are becoming important content providers and

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53/ Critics of a merger of MCI's and Worldcom's Internet businesses argued that it would be easy to customize discrimination so as to pick off one competitor at a time, as part of a divide and conquer strategy. (See "Internet Reply Affidavit of Robert G. Harris on behalf of GTE Corporation", June 8, 1998, paragraph 46. and "The Strategy of Targeted Degradation", pp. 10-13 of "The degradation of quality and the domination of the Internet" by Jacques Cremer, Patrick Rey and Jean Tirole submitted by GTE to the European Competition authorities and to the FCC in June 1998.

The Commission took those complaints seriously. If discrimination can be customized, it would clearly be feasible for the Bell Atlantic and the SBC groups of ILECs to treat one another quite differently than they treated other Internet companies.

54/ See Laffont, Rey and Tirole, op. cit.

Internet service innovators. ISPs increasingly are in the content business and the business of assisting other firms with Internet commerce through designing, hosting and managing web sites. By imposing costs on independent firms and thereby making it more difficult to enter and expand in the Internet business, social welfare could be dramatically affected.

104. The Commission has already determined (in MCI Worldcom) that this market is capable of being monopolized by players with asymmetrically large positions. The SBC and Bell Atlantic groups will control the majority of bottleneck local facilities necessary for Internet service. Their potential for effective discrimination far exceeds anything MCI Worldcom would have possessed, because the "last mile" bottleneck is far more secure than any temporary choke points MCI Worldcom might have possessed if no divestiture of Internet assets had been required for regulatory approval of that merger.

105. We recognize that (unlike MCI/Worldcom) the SBC/Ameritech merger does not consolidate existing strong positions among two former competitors. SBC's and Ameritech are not now competitors for control of the "last mile" of the Internet access in any area, and they are each minor ISP players. But they each now have a monopoly in their home region. And the merged company will have a greater incentive and/or ability than the individual companies to distort inefficiently competition in adjacent markets, such as ISP or backbone service out of region.

106. Exactly how the incentives play out depends on other decisions the Commission and state regulators must make. If the ILECs are required by the Commission to sell xDSL UNEs at regulated rates based on forward-looking cost, then they will have strong incentives to evade the profit constraint by entering adjacent markets and discriminating against competitors. If the Commission does not require the ILECs to sell xDSL UNEs on a regulated, carrier-to-carrier basis, the xDSL consumer prices will likely still be constrained directly or indirectly by regulation. The next best alternative may well be inferior service provided by competitors who buy conventional unbundled loops at regulated rates and assemble their own xDSL service as best they can in face of noncooperation from the ILEC concerning issues such as collocation.[55/] Alternatively, competitors to the ILECs may attempt to compete reselling xDSL service purchased at state-regulated retail rates. In any of these cases, because its xDSL profits are constrained by some form of regulation; the ILEC will want to integrate into adjacent markets, discriminate against rivals, and take profits in those markets that regulation denies it by limiting xDSL prices to less than the monopoly level.[56/]

55/ We recognize that the Commission is addressing these issues in its Broadband Rulemaking. Separate affiliates and enhanced unbundling and collocation requirements are under consideration. To the extent that the Commission adopts suggestions made in HAI's "Economics and Technology of Broadband Deployment" and in the Comments of parties in the Broadband proceeding, the problems discussed here might be ameliorated. However, as long as the bottleneck is in place and vertical integration is allowed, there will be competitive concerns. Regulation is simply not adequate to eliminate all problems when there are strong incentives for evasion.

56/ Of course, this is not to say that regulators ought to deregulate the ILECs xDSL service, or that there is little to choose from among the various possible regulatory alternatives for xDSL. The ecomomic spirit of the 1996 Act is that ILECs should unbundle their services, offer inputs to rivals at forward-looking, cost-based rates, and offer rivals the option of purchasing ILEC services at wholesale discounts for resale to their own customers. Competitors to the ILECs should have all these options for the xDSL business for the same reasons they should have them

107. These incentives for discrimination will exist with or without the merger. However, a merged SBC/Ameritech (and a merged Bell Atalantic/GTE) will have greater ability than the companies standing alone to discriminate effectively because of their greater combined control of Internet bottleneck facilities.

108. The merged super BOCs will also have incentives for monopolization of out-of-region Internet activity. That is, even if they earned the entire profit available from monopolizing in-region advanced and Internet services and if no further profit could be extracted from monopolizing adjacent or related in-region services, they still have incentives to leverage their control of the lion's share of local Internet access into additional profits in out-of-region ISP services. For example, after entry into out-of-region Internet services (and in-region Internet services if the Commission's interpretation of Section 271 allows it), the merged BOCs could discriminate against competing ISPs at either backbone to backbone connections, or at backbone to local interconnections. Since the BOCs will control more local Internet access after merger than before, merger will increase their ability to discriminate effectively.

109. In summary, there is a danger that Internet service will "tip" to SBC and Bell Atlantic if they are allowed to consummate their pending mergers. Competition among ISPs or backbone service providers could be seriously distorted due to these mergers. The result would be higher

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for conventional local telephony.

prices for consumers of Internet services and reduced opportunity for innovation by independent firms. This magnitude of the social risk depends on a number of factors, about which we now offer no empirical assessment. First, the risk is greater the more completely and quickly the Internet moves away from dial-up access to xDSL connections, where the potential for successful discrimination is far greater. Second, the risk is greater the lower the ultimate competitive significance of alternatives provided by CLECs or the cable industry.[57/] Third, the risk is greater the lower the entry barriers for BOCs into the adjacent markets, since merger-related Internet problems occur only when the merged company enters (or expands from a fringe position) in a market in which it was either not present previously, or in which it was small.

110. Even if the probability that all three factors will be present in the near future is small, the Commission should still view the risks to Internet competition as serious. As discussed above, the SBC/Ameritech merger carries very little potential for public benefits, so additional risks, such as the risk to Internet competition, add to the public interest case against the merger.

V. SUMMARY AND CONCLUSIONS

111. We have shown here that this merger will not improve consumer welfare and is in fact likely to reduce it. As we noted at the outset, this merger should be evaluated using the learning produced in the aftermath of the BA/NYNEX merger. Even though the Commission believed it

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57/ This is not to say that the market will exhibit competitive performance if, say, the cable industry becomes a significant local player in high speed Internet access. Duopoly is not competition as we know, for example, from the cellular business. There the addition of more sources of competition, such as PCS, has benefitted consumers.

was anticompetitive, it approved that merger because of its belief that merger conditions would provide substantial benefits. That merger has not had the intended effects. As we demonstrated in Sections III and IV this merger is also anticompetitive and the national/local business plan will not resuscitate it. The prognosis for other mergers among large ILECs is no better.

112. The SBC/Ameritech merger is not in the public interest whether SBC/Ameritech enters local service out of region or not.

113. If SBC/Ameritech decides after the merger not to enter local service out of region, then the public interest approval would have been based on a false premise.

114. If SBC or Ameritech would have entered each others' territory absent the merger, then the substantial consumer benefits from entry by one ILEC into another ILEC's territory will likely be lost, because local competition is now so poorly developed and one could not presume that other, non-ILEC entrants would replace the competitive effect of the lost out of region entry by SBC or Ameritech in the other merger partner's region.

115. We think it likely, based on our own analysis and SBC and Ameritech's presentations, that either or both would engage in out of region local entry in the near term as and if facilities-based competition for local business access develops within region. This developing competition creates strong incentives for "defensive" out-of-region entry, to protect their in-region business with major corporate customers. Indeed, unlike Bell Atlantic and NYNEX, who denied any corporate

interest in out-of-region entry, SBC and Ameritech acknowledge that they have a strong interest in out-of-region entry. They merely state that they have no current plans for such entry (because, they say, neither company alone has the necessary nationwide scale). They also recognize that, as local competition begins to develop, the ILEC's incentives for out-of-region entry can increase dramatically. They hypothesize that other, far smaller ILECs would abandon their stay-at-home strategies and enter the SBC/Ameritech region after SBC entered their regions. Thus SBC says other, smaller ILECs possess sufficient economies of scale and scope to profitably enter local service out of region on a defensive basis once a critical mass of their key local corporate customers begin to seriously contemplate buying local service from a facilities-based local competitor. Exactly the same analysis applies to SBC and Ameritech. The economics of their current stay-at-home business plans will be undermined as they begin to face serious competition for major corporate accounts from facilities-based local entrants such as MCI Worldcom. They too would find defensive out-of-region entry a profitable strategy in the future even though today, with their local monopolies intact, they do not find offensive out-of-region entry a worthwhile endeavor.

116. If a merged SBC/Ameritech enters local service out of region after the merger, it is probably only because they can discriminate more effectively than smaller ILECs to get the national/local business of major business customers.

117. The merger exacerbates the problem of discrimination by SBC and Ameritech to attempt to monopolize the emerging Internet and advanced services (such as xDSL). On a stand alone

basis, the discrimination merely threatens the evolution of local competition in their service territories. On a merged basis, and especially if the local operations of Bell Atlantic and GTE are also consolidated, the discrimination will threaten competition on the Internet.

118. The merger would remove benchmarks that are helpful to regulators as they try to control market power and introduce competition in local telephony.

119. Finally, the merger would exacerbate potential competitive problems in the long distance business (assuming ILECs are allowed into interLATA service before local competition has developed sufficiently to drive access charges to cost).

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Education

1975 Ph.D. Candidate, Economics, Stanford University (M.A. plus two years additional course and seminar work required for admission to Ph.D. candidacy.)
1975 M.A., Economics, Stanford University
1971 B.A., Economics, *magna cum laude*, Carleton College

Experience

Mr. Baseman is a Principal of Microeconomic Research and Consulting Associates, Inc., (MiCRA). He was a founder of the firm in 1991.

Prior to joining MiCRA, Mr. Baseman was a vice president of ICF Consulting Associates and previously employed by the Antitrust Division of the U.S. Justice Department (1975-1981, 1983-1985) and by Economists, Inc. (1981-1983). In these positions, he developed expertise in a wide variety of industries, including: telecommunications; computer software; cable television; crude oil markets; tires; numerous chemicals; newspapers; electric utilities; air conditioning; elevators; jet engines; and various aspects of the television industry, including program production, contractual licensing arrangements, music licensing, TV set manufacturing and R&D joint ventures. As a private consultant, his work has been primarily focused on providing economic analysis for antitrust or regulatory issues.

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Mr. Baseman has headed or (where indicated) shared lead responsibility for the following projects:

Antitrust

- Preparation of an expert report on behalf of LePage's regarding 3M's exclusionary practices in the home and office tape business. (LePage's vs. 3M).

- Deposition and trial testimony on behalf of the Antitrust Division in its lawsuit challenging the acquisition of the Northwest Arkansas Times by the owners of the Morning News of Northwest Arkansas.

- Preparation of economic analysis regarding Outdoor Systems' acquisition of Gannett's Houston area billboard business.

- Preparation and presentation of economic analysis regarding Outdoor Systems' acquisition of 3M's billboard business.

- Economic analysis of the acquisition of weekly newspapers by daily newspapers:

    - Baltimore Sun and Patuxent Publishing.

    - Bergen Record and North Jersey Newspapers

    - Milwaukee Journal-Sentinel and Community Newspapers Inc.

- Preparation and presentation of economic analysis to the Antitrust Division about Michelin's acquisition of Uniroyal Goodrich.

- Preparation of a report, co-authored with Frederick Warren-Boulton, on the competitive effects of Microsoft's licensing practices for operating systems and complementary software.

- Preparation and presentation of "disruptive buyer" analysis to the FTC on behalf of Brunswick regarding Brunswick's partial equity interest in and supply contract with Tracker.

- Preparation and presentation to the FTC of analysis on behalf of Brunswick on the economic effects of Brunswick's market share discounts in the recreational marine engine business.

- Preparation of an affidavit filed on behalf of McClatchy Newspapers on the absence of any competitive effect of the purchase by McClatchy of the Raleigh News & Observer.

- Economic testimony on behalf of Trane on market power, market definition, and vertical restraint issues in Tarrant v. Trane.

- Preparation and presentation of economic analysis to the FTC on St. Gobain's acquisition of Carborundum.

- Affidavit and deposition testimony on behalf of PMBR in its antitrust litigation with BAR/BRI.

- Economic testimony on behalf of the Antitrust Division in hearings on the proposed newspaper joint operating agreement in Detroit.

- Preparation and presentation of economic analysis to the FTC on First Data Corporation's proposed acquisition of Western Union.

- Preparation and presentation of economic analysis to the FTC on Illinois Tools Works' acquisition of Cyklop.

- Preparation of economic analysis submitted to the FTC on Brunswick's licensing and acquisition agreement with Perry-Austen.

- Preparation and presentation of economic analysis to the FTC concerning Witco's acquisition of DeSoto.

- Presentation of economic analysis and deposition testimony to the FTC involving a merger in the chemicals industry (Henkel Corp. acquisition of Parker Chemical).

Telecommunications and FCC Issues

- Affidavit testimony for MCI on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in Michigan, New York, New Jersey, Maryland, Ohio, Wisconsin, Georgia and South Carolina. The Michigan and South Carolina affidavits were co-authored with Frederick Warren-Boulton for submission to the FCC.

- Direct and cross examination testimony for MCI on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in Ohio, Wisconsin, and Georgia.

- Affidavit testimony (co-authored with Frederick Warren-Boulton) for MCI to the FCC on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in Michigan and South Carolina.

- Preparation of a report submitted to the FCC, co-authored with Frederick Warren-Boulton and Susan Woodward, on appropriate principles of depreciation and capital recovery under the 1996 Telecommunications Act.

- Analysis for MCI and AT&T of various interconnection pricing and costing issues under the 1996 Telecommunications Act.

- Preparation of a report submitted to the FCC, co-authored with Harold Van Gieson, on appropriate depreciation for local exchange carriers.

- Preparation of a report submitted to the FCC on appropriate bidding restrictions to prevent anticompetitive pre-emption in spectrum auctions.

- Preparation of an affidavit for MCI on the effects of expanded interconnection between local telephone companies and competing providers of access.

- Preparation of several reports for MCI, some of which were co-authored with Stephen Silberman, on the effects of price cap regulation; especially as applied to the local exchange carriers. Presentation of the analysis to the FCC staff.

- Preparation of a report for the National Cable Television Association on integration by local telephone companies into video programming markets.

- Preparation of a report for MCI, co-authored with Stephen Silberman, on the economics of line-of-business restrictions.

Other Regulation

- Testimony filed at the FERC on behalf of wholesale customers in litigation against Maine Public Service's proposed tariff for transmission and ancillary service.

- Preparation of an affidavit, co-authored with Robert J. Reynolds, on the market power issues in an FERC abandonment proceeding in the natural gas pipeline industry.

- Preparation of a report, co-authored with John Woodbury, Frederick Warren-Boulton and Daniel Sherman, for the National Cable Television Association on the effects on consumers of cable deregulation.

- The preparation of testimony to be presented by Mr. Baseman, on behalf of the U.S. Justice Department, in an electric utility monopolization case (U.S. v. Kentucky Utilities).

In addition, Mr. Baseman was substantially involved in the following projects:

Telecommunications and FCC Issues

- Preparation of a report on principles for evaluating "significant economic harm," submitted by INTELSAT to its members in treaty consultation over the entry of the Orion satellite network.

Antitrust

- Preparation and presentation of economic analysis to the Antitrust Division concerning Akzo's acquisition of Filtrol.

- Iron ore damages litigation.

- Preparation and presentation of economic analysis to the FTC concerning General Electric's acquisition of Roper Corporation.

- Preparation and presentation of economic analysis to the FTC concerning Stanadyne's proposed acquisition of United Technologies Diesel Systems Division.

- Preparation and presentation of economic analysis to the Antitrust Division concerning General Electric's acquisition of Thomson - CGR's medical imaging business.

- Antitrust assessments of possible mergers or joint ventures in several industries, including the HVAC, elevator, and jet engine industries.

Other Regulation

- Preparation of expert testimony submitted to FERC by an ICF colleague on the effect of Northeast Utilities' acquisition of Public Service of New Hampshire.

Publications

"Exclusionary Behavior in the Market for Operating System Software: the Case of Microsoft," in *Opening Networks to Competition: the Regulation and Pricing of Access,* David Gabel and David Weiman, eds.; Kluwer Press, 1996, with Frederick R. Warren-Boulton and Glenn Woroch.

"Microsoft Plays Hardball: Use of Exclusionary Pricing and Technical Incompatibility to Maintain Monopoly Power in Markets for Operating Software," co-authored with Frederick R. Warren-Boulton and Glenn A. Woroch, Antitrust Bulletin, Summer 1995.

The Economics of Intellectual Property Protection for Software: The Proper Role for Copyright," co-authored with Frederick R. Warren-Boulton and Glenn A. Woroch, Standard View, June 1995.

"Copyright Protection of Software Can Make Economic Sense," co-authored with Frederick R. Warren-Boulton and Glenn A. Woroch, The Computer Lawyer, February 1995.

"The Detroit Newspaper Joint Operating Agreement," in Kwoka and White, eds., *The Antitrust Revolution,* Harper Collins (1993).

"Sustainability and the Entry Process," *American Economic Review* (May 1981) pp. 272-277.

"Open Entry and Cross-Subsidization in Regulated Markets," in Gary Fromm, ed., *Economics of Public Regulation,* National Bureau of Economic Research and M.I.T. Press, Cambridge, Massachusetts, 1981.

Other Papers

"Depreciation Policy in the Telecommunications Industry: Implications for Cost Recovery by the Local Exchange Carriers", co-authored with Harold Van Gieson, December 1995.

"Microsoft Plays Hardball: Use of Exclusionary Pricing and Technical Incompatibility to Maintain Monopoly Power in Markets for Operating Software," co-authored with Frederick R. Warren-Boulton and Glenn A. Woroch, presented at Columbia University Institute for Tele-Information on Sustaining Competition in Network Industries through Regulating and Pricing Areas, November 1993.

"The Economics of Intellectual Property Protection for Software: The Proper Role for Copyright," co-authored with Frederick R. Warren-Boulton and Glenn A. Woroch, presented at American

Committee for Interoperable Systems, June 1994.

"The Effect of Deregulation on Cable Subscribers," co-authored with John Woodbury, Oct. 1990, presented at American Enterprise Institute conference, Policy Approaches to Deregulation of Network Industries.

"The Economics of Bell Operating Company Diversification in the Post-Divesture Telecommunications Industry," co-authored with Stephen Silberman, with the assistance of Roger Noll, ICF, Inc., September 1986.

"A Framework for Economic Analysis of Electronic Media Concentration Issues," co-authored with Bruce Owen, Economists, Inc., December 1982.

Other Professional Experience

Journal referee: *International Economic Review*, *Journal of Industrial Economics*, and *International Journal of Industrial Organization.*

Trial Testimony

Direct and cross examination testimony for MCI on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in Ohio, Wisconsin, and Georgia, (1996-97).

Testified on market definition and competitive effects of joint ownership of two competing daily newspapers in U.S. vs. Nat. L.C. and D. R. Partners, (May 1995).

Testified on market power, market definition and vertical restraint issues in Tarrant v. Trane (November 1993).

Expert witness for the Antitrust Division on the Detroit Newspaper Joint Operating Agreement (August 1987). Testified that the Detroit *Free Press* was not a failing newspaper when it agreed to joint operations.

Deposition Testimony

- U.S. vs Nat. L.C. and D. R. Partners, (April 1995).
- PMBR v. Harcourt Brace Jovanovich, et al. (February 1994).

- Deposed in Detroit JOA proceeding (July 1987).
- Deposed by the FTC concerning Henkel's acquisition of Parker Chemical (January 1986).
- U.S. v. Kentucky Utilities, (July 1985).

Expert Affidavits

- Rocket Holding, Inc. v. McNeilus Truck and Manufacturing (February 1993).
- PMBR v. Harcourt Brace Jovanovich, et al. (February 1994).
- AD/SAT v. McClatchy Newspapers (July 1995).

Expert Statements Submitted to Regulatory Agencies

- Affidavit testimony for MCI on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in state regulatory hearings in New York, New Jersey, Maryland, Ohio, Wisconsin, Georgia and South Carolina, (1996-97).
- Affidavit testimony (co-authored with Frederick Warren-Boulton) for MCI to the FCC on the "public interest" issues regarding entry by the Bell Operating Companies into long distance service in Michigan and South Carolina, (1997).
- "The Economics of Bidding for Scarce Resources: The Lessons of Monopoly Preemption as Applied to FCC Auctions of LMDS Licenses", August 1996, submitted on behalf of WebCel in FCC Docket No. 96-98.
- "Depreciation and Capital Recovery Issues, A Response to Professor Hausman", co-authored with Frederick Warren-Boulton and Susan Woodward, July 1996, submitted on behalf of MCI in FCC Docket No. 96-98.
- Testimony in FERC Docket ER95-836-000 on behalf of wholesale customers, who were objecting to certain aspects of Maine Public Service's transmission and ancillary service tariff (August 1995).
- A comment on the relationship between advertising and sales, January 1995, submitted on behalf of MCI in FCC Docket No. 92-77, concerning proposals for implementing billed party preference in the selection of long distance carriers.

- Affidavit, co-authored with Robert J. Reynolds, concerning an FERC abandonment proceeding, October 1991, submitted on behalf of Sun Refining and Marketing Company in FERC Docket No. CP91-2819-000.

- Affidavit concerning Expanded Interconnection with Local Telephone Company Facilities, September 1991, submitted on behalf of MCI in Federal Communications Commission Docket No. CC 91-41, ENF-87-14.

- "The Economic Effects of Cable Deregulation," co-authored with John Woodbury, Frederick Warren-Boulton and Daniel Sherman, May 1990, submitted on behalf of the National Cable Television Association in Federal Communications Commission MM Docket No. 90-4.

- "The Economics of Local Telephone Company Integration into the Retailing of Video Programming," December 1988, submitted on behalf of the National Cable Television Association in the Federal Communications Commission Docket No. CC 87-266.

- "The Choice of Productivity Offsets for Rate Cap Regulation," July 1988, submitted on behalf of MCI in Federal Communications Commission Docket No. CC 87-313.

- "An Analysis of the Utility of Price Cap Regulation as Applied to the Local Exchange Carriers," co-authored with Stephen Silberman, December 1987, submitted on behalf of MCI in Federal Communications Commission Docket No. CC 87-313.

- "The Economics of Line of Business Restrictions and Structural Separations," co-authored with Stephen Silberman, January 1986, submitted on behalf of MCI in Federal Communications Commission Docket No. CC 85-229.

DANIEL KELLEY

PROFESSIONAL EXPERIENCE:

Senior Vice President, HAI Consulting, Inc., Boulder Colorado (current position).

Conducting economic and applied policy analysis of domestic and international telecommunications public policy and business issues. Recent projects have included advising Central and Eastern European Governments on privatization and competition matters, assisting a private client with entry into the long distance market in Mexico, analyzing competitive conditions in cellular radio markets, analyzing the economics of cable television regulation, analyzing the prospects for local competition and measuring the economic cost of local service.

Director of Regulatory Policy, MCI Communications Corporation, 1984-1990.

Responsible for developing and implementing MCI's public policy positions on issues such as dominant carrier regulation, Open Network Architecture, accounting separations and Bell Operating Company line of business restrictions. Also managed an interdisciplinary group of economists, engineers and lawyers engaged in analyzing AT&T and local telephone company tariffs.

Senior Economist and Project Manager, ICF Incorporated, 1982-1984.

Telecommunications and antitrust projects included: forecasting long distance telephone rates; analysis of the competitive effects of AT&T's long distance rate structures; a study of optimal firm size for cellular radio markets; analysis of the FCC's Financial Interest and Syndication Rules, and competitive analysis of mergers and acquisitions in a variety of industries.

Senior Economist, Federal Communications Commission, 1979-1982.

Served as Special Assistant to the Chairman during 1980-1981. Advised the Chairman on proposed regulatory changes in the broadcasting, cable television and telephone industries; analyzed legislation and drafted Congressional testimony. Coordinated Bureau and Office efforts on major common carrier matters such as the Second Computer Inquiry and the Competitive Carrier Rulemaking. Also held Senior Economist positions in the Office of Plans and Policy and the Common Carrier Bureau.

Staff Economist, U.S. Department of Justice, 1972-1979.

Analyzed proposals for restructuring the Bell System as a member of the economic staff of U.S. v. AT&T; investigated the competitive effects of mergers and business practices in a wide variety of industries.

EDUCATION:

1976	Ph.D. in Economics	University of Oregon
1971	M.A. in Economics	University of Oregon
1969	B.A. in Economics	University of Colorado

PUBLICATIONS AND COMPLETED RESEARCH:

"Cable and Wireless Alternatives to Residential Local Exchange Service," Berkeley Conference on Convergence and Digital Technology (1997), with Alan J. Boyer and David M. Nugent.

"A General Approach to Local Exchange Carrier Pricing and Interconnection Issues," Telecommunications Policy Research Conference, (1992), with Robert A. Mercer.

"Gigabit Networks: Is Access a Problem?" IEEE Gigabit Networking Workshop (1992).

"Advances in Network Technology" in Barry Cole, ed., After the Break-Up: Assessing the New Post-AT&T Divestiture Era (1991).

"Alternatives to Rate of Return Regulation: Deregulation or Reform?" in Alternatives to Rate Base Regulation in the Telecommunications Industry, NARUC (1988).

"AT&T Optional Calling Plans: Promotional or Predatory" in Harry M. Trebing, ed., Impact of Deregulation and Market Forces on Public Utilities: The Future Role of Regulation (1985).

"The Economics of Copyright Controversies in Communications" in Vincent Mosco, ed., Policy Research in Telecommunications (1984).

"Deregulation After Divestiture: The Effect of the AT&T Settlement on Competition," FCC, OPP Working Paper No. 8 (1982).

"The Transition to Structural Telecommunications Regulation," in Harry M. Trebing, ed., New Challenges for the 1980's (1982), with Charles D. Ferris.

"Social Objectives and Competition in Common Carrier Communications: Incompatible or Inseparable?" in Harry M. Trebing ed., Communications and Energy in Transition (1981), with Nina W. Cornell and Peter R. Greenhalgh.

"An Empirical Survey of Price Fixing Conspiracies," Journal of Law and Economics (1974), with George A. Hay. Reprinted in Siegfried and Calvari, ed., Economic Analysis and Antitrust Law (1978) and the Journal of Reprints for Antitrust Law and Economics (1980).

TESTIMONY:

Federal Communications Commission, Application of Cellular Communications of Cincinnati, July 25, 1983 (with Robert J. Reynolds): Optimum firm size in the cellular radio market

Maryland Public Service Commission, Case No. 0450-Phase II, May 31, 1983: Access charge implementation issues

New York Public Service Commission, Case No. 28425, June 1983: Access charge implementation issues

Florida Public Service Commission, Docket No. 820537-TP, June 30, 1983, November 4, 1983, April 9, 1984, June 4, 1984, September 7, 1984, October 25, 1984 and August 15, 1985: Access charge implementation issues

Pennsylvania Public Utility Commission, Docket No. R-832, August 5, 1983: Pennsylvania Bell Rate Case

New Jersey Board of Public Utilities, Docket No. 83-11, February 20, 1984: Access charge implementation issues

New York Public Service Commission, Case 88-C-102, March 2, 1990: Alternative Operator Service Issues

California Public Service Commission, A.90-07-015, July 10, 1990: AT&T Deregulation

New York Public Service Commission, Case 28425, October 8, 1990: IntraLATA Dial 1 Competition

Massachusetts Department of Public Utilities, DPU 90-133, October 17, 1990: AT&T Deregulation

Georgia Public Service Commission, 3905-U, November 16, 1990: Incentive Regulation

California Public Service Commission, I-87-11-033, September 23, 1991: IntraLATA Competition

Georgia Public Service Commission, Docket No. 3987-U, January 31, 1992: Cross-Subsidy

Colorado Public Utilities Commission, Docket No. 92R-050T, August 24, 1992: Collocation

Connecticut Department of Public Utility Control, Docket No. 9106-10-06, September 25, 1992: Infrastructure

Maryland Public Service Commission, Case No. 8584, Phase II, July 21, 1995: Local Competition.

Connecticut Department of Public Utility Control, Docket No. 95-06-17, September 8, 1995: Local Competition .

Federal-State Joint Board on Universal Service, CC Docket No. 96-45, June 5, 1996: Cost Modeling.

Colorado Public Utilities Commission, Docket No. 96A-287T, September 6, 1996: Arbitration.

Oregon Public Service Commission, Dockets ARB 3 & 6, October 14, 1996: Arbitration.

Hawaii Public Utilities Commission, October 17, 1996: Arbitration.

Michigan Public Service Commission, October 24, 1996: Arbitration.

New York Public Service Commission, Case No. 28425, May 9, 1997: Access charges.

Colorado Public Utilities Commission, Docket No. 97F-175T, July 18, 1997: Access Charges.

Utah Public Service Commission, Docket No. 97-049-08, October 2, 1997: Access charges.

Connecticut Department of Public Utility Control, Docket No. 96-04-07, February 10, 1998: Access Charges.

We declare under penalty of perjury that the foregoing is true and correct.

Executed on October 14, 1998.

Ken Baseman

Ken Baseman

Executed on October __, 1998.

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Daniel Kelley

We declare under penalty of perjury that the foregoing is true and correct.

Executed on October __, 1998.

Ken Baseman

Executed on October 14, 1998.

Daniel Kelley

Daniel Kelley