

early 1997. As a result of this conversion, Pacific's local wholesale customers now have direct access to Pacific's ordering systems.

Collocation

Also, in California, high demand for physical collocation in Pacific Bell's central offices has caused available space to fill-up quickly. In fact, Pacific Bell has provisioned 395 physical collocation arrangements to CLECs in California as of the end of June 1998 with another 274 under construction to be complete by the end of August 1998 - more than in any other state in the country. Pacific Bell therefore has taken extraordinary steps to expand the space available for collocation use, steps beyond what we believe the Act requires. In offices where space was unavailable, Pacific Bell created new space for CLECs' use through such steps as removing non-functioning equipment, relocating administrative offices, and offering common collocation. These changes enabled Pacific Bell to offer additional space in 53 central offices that were previously out-of-space. In addition, SBC has made virtual collocation generally available to requesting CLECs, even though the 1996 Act only requires that it be offered when adequate

physical collocation space is not available. Moreover, Pacific Bell has offered other innovative solutions which eliminates the need for physical or virtual collocation offering, instead to run lines from the central office to a CLEC's selected location in a neighboring building.

Number Portability

In its five states, SWBT recently revised its procedures for processing CLEC requests for porting telephone numbers. Interim Number Portability ("INP") enables customers of facilities-based carriers to retain their existing telephone number even after they no longer subscribe to SWBT service. INP is an extremely complex process that requires a high degree of coordination between SBC and the CLEC. If the parties are not synchronized during implementation of INP, the conversion can fail and temporary loss of service to the CLEC's new end user customer can result.

In response to coordination problems of this sort, SWBT took aggressive steps to improve the INP process. To begin with, SWBT added additional customer testing technicians to accommodate high INP order volumes, temporarily assigned service representatives exclusively to

performing quality checks on INP orders to ensure accuracy, and devoted customer service representatives to scheduling all INP orders and ensuring that INP cutovers are planned, coordinated, and implemented as requested by the CLEC with no noticeable service interruptions. Additionally, SWBT initiated log procedures to track communications and provided personnel involved in INP cutovers with training that enables them to identify, prior to completing the actual cut, INP orders that will require an unusual degree of coordination with the CLEC. SWBT established in Dallas an INP/UNE quality check group to ensure that INP (as well as unbundled network element) orders are processed without errors. It also imposed an internal checkpoint in the process to ensure that distributed INP orders are sent throughout SWBT's network and provisioned correctly. SWBT also has assigned a single supervisor to be a point of contact and to be responsible for tracking the INP process, and established a jeopardy code that will stop the processing of an order when a supplemental order has been received. Finally, SWBT has initiated an internal weekly conference call to identify root causes of INP failures and to develop generally applicable solutions to these problems.

NEW ENTRANTS' MARKET ENTRY STRATEGY

The following quotes illustrate the local market strategy being employed by most new entrants, i.e., to target higher margin customers:

- "Our strategy is not in the consumer business . . . [i]t's very difficult for us to find a way to make economic sense out of the advertising budgets, the customer service budgets, etc., required to be in the consumer business."¹
- "[N]ot AT&T, not MFS or anyone else, is going to build local telephone facilities to residential customers. Nobody ever will, in my opinion."²
- AT&T will build competitive local facilities only "where and when it makes economic sense."³
- "We don't play in residential."⁴
- "[MCI's] focus is on high-value customers who use multiple services."⁵

¹ M. Mills, WorldCom Would Shift MCI's Focus, Washington Post, Oct. 3, 1997, at A1 (quoting WorldCom Vice Chairman John Sidgmore).

² M. Mills, Hanging Up on Competition?, Washington Post, June 1, 1997, at H1 (quoting WorldCom CEO Bernard Ebbers).

³ AT&T, 1996 Annual Report 3 (1997), former AT&T President Robert Allen.

⁴ T.J. Mullaney, Competition Calling: Anyone There?, Baltimore Sun, Apr. 6, 1997, at 1D (quoting Ron Vidal, WorldCom Vice President for New Ventures).

⁵ MCI, First Quarter 1997 Investor Bulletin, http://investor.mci.com/investor_pubs/quarterlies/qr_1997/r_1997-1.html.

- "[WorldCom's] religious focus is on the business customer . . . [i]t is a jihad . . . [t]his other market is something new."⁶
- MCI has acknowledged that its local strategy has been to target high value business customers because: "Why did Willie Sutton rob banks? You go where the money is."⁷
- "AT&T aims to focus much of its future marketing on the top tier of high-spending consumers of communications services. These are the 20% of people who account for 80% of the company's \$6 billion in annual profit."⁸
- MCI has admitted that its "focus is on high-value customers who use multiple services" and that it intends to "continue to transition away from low-value Mass Markets customers who respond only to price promotions" and "continue to allocate our resources toward the highest margin opportunities."⁹

⁶ M. Mills, WorldCom Clarifies MCI Plans, Washington Post, Oct. 4, 1997, at D1 (quoting John Sidgmore).

⁷ S. Ginsberg, MCI's Buzzing, San Francisco Business Times, August 1-7, 1997, at 20 (quoting Bill Berkowitz, MCI San Francisco executive).

⁸ J. Keller, AT&T Sets Bold New Business Strategy, September 18, 1997, at A3 (quoting John Zeglis, AT&T Vice-Chairman).

⁹ MCI Investor Report, September 19, 1997 (quoting Douglas L. Maine, MCI Chief Financial Officer).

Affidavit of Dennis W. Carlton

AFFIDAVIT OF DENNIS W. CARLTON

I, Dennis W. Carlton, being duly sworn, depose and say:

I am Professor of Economics at the Graduate School of Business of The University of Chicago. I received my B.A. in Applied Mathematics and Economics from Harvard University and my M.S. in Operations Research and Ph.D. in Economics from the Massachusetts Institute of Technology. I have served on the faculties of the Law School and the Department of Economics at The University of Chicago and the Department of Economics at the Massachusetts Institute of Technology. I specialize in the economics of industrial organization, which is the study of individual markets and includes the study of antitrust and regulatory issues. I am co-author of the book Modern Industrial Organization, a leading text in the field of industrial organization, and I also have published numerous articles in academic journals and books. In addition, I am Co-Editor of the Journal of Law and Economics, a leading journal that publishes research applying economic analysis to industrial organization and legal matters. I have served as an Associate Editor of the International Journal of Industrial Organization and Regional Science and Urban Studies, and have served on the Editorial Board of Intellectual Property Fraud Reporter.

In addition to my academic experience, I am President of Lexecon Inc., an economics consulting firm that specializes in the application of economic analysis to legal and regulatory issues. I have served as an expert witness before various state and federal courts, and I have provided expert witness testimony before the U. S. Congress and a variety of state and federal regulatory agencies, including the Federal Communications Commission. I also have served as a consultant to the

Department of Justice on the Merger Guidelines of the Department of Justice and Federal Trade Commission, as a general consultant to the Department of Justice on antitrust matters, and as an advisor to the Bureau of the Census on the collection and interpretation of economic data. I also have provided testimony on telecommunications matters before Congress, Federal Courts, federal and state regulatory agencies and have published academic articles on telecommunications issues.

I have been asked by SBC Communications Inc. ("SBC") to evaluate the competitive consequences of SBC's plan to become a nationwide supplier of local exchange services by merging with Ameritech and entering into the provision of local service in 30 metropolitan areas outside of the home territories of SBC and Ameritech. I conclude that the successful implementation of SBC's "national/local" plan will benefit consumers directly by creating a significant new competitor in the provision of local telecommunications services. I also conclude that the proposed transaction enables SBC to pursue the national/local plan.

The attached report contains the results of my analysis and the bases for my conclusions.

Dennis W. Carlton

Dennis W. Carlton

Subscribed and sworn to before me
this day of July 20, 1998

Margaret J. Kush

Notary Public



REPORT OF DENNIS W. CARLTON

July 20, 1998

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I. QUALIFICATIONS AND OVERVIEW

1. I, Dennis W. Carlton, am Professor of Economics at the Graduate School of Business of The University of Chicago. I received my B.A. in Applied Mathematics and Economics from Harvard University and my M.S. in Operations Research and Ph.D. in Economics from the Massachusetts Institute of Technology. I have served on the faculties of the Law School and the Department of Economics at The University of Chicago and the Department of Economics at the Massachusetts Institute of Technology. I specialize in the economics of industrial organization, which is the study of individual markets and includes the study of antitrust and regulatory issues. I am co-author of the book Modern Industrial Organization, a leading text in the field of industrial organization, and I also have published numerous articles in academic journals and books. In addition, I am Co-Editor of the Journal of Law and Economics, a leading journal that publishes research applying economic analysis to industrial organization and legal matters. I have served as an Associate Editor of the International Journal of Industrial Organization and Regional Science and Urban Studies, and have served on the Editorial Board of Intellectual Property Fraud Reporter. A copy of my curriculum vitae is attached as Exhibit 1 to this report.

2. In addition to my academic experience, I am President of Lexecon Inc., an economics consulting firm that specializes in the application of economic analysis to legal and regulatory issues. I have served as an expert witness before various

state and federal courts, and I have provided expert witness testimony before the U.S. Congress and a variety of state and federal regulatory agencies, including the Federal Communications Commission. I also have served as a consultant to the Department of Justice on the Merger Guidelines of the Department of Justice and Federal Trade Commission, as a general consultant to the Department of Justice on antitrust matters, and as an advisor to the Bureau of the Census on the collection and interpretation of economic data. I also have provided testimony on telecommunications matters before Congress, Federal Courts, federal and state regulatory agencies and have published academic articles on telecommunications issues.

3. I have been asked by SBC to review and evaluate the competitive consequences of SBC's plan to become a nationwide supplier of local exchange services by merging with Ameritech and entering into the provision of local service in 30 metropolitan areas outside of the home territories of SBC and Ameritech.

4. My principal conclusions are as follows:

- The successful implementation of SBC's "national/local" plan will benefit consumers directly by creating a significant new competitor that provides local, long distance and data telecommunications services for business and residential customers in a large number of metropolitan areas. Such entry would significantly increase competition in the provision of local exchange services, both within and outside SBC's and Ameritech's territories, and for both business and residential customers.
 - SBC's national/local plan responds to rapid and dramatic changes in this industry. These include the growing demand for long distance data and voice services, the development of competition for traditional circuit-
-

switched networks from Internet Protocol and other data communications technologies, and the growing demand among large multilocation customers for a single supplier to provide a bundle of local, long distance and data services. Absent this plan to deploy service outside their home regions, SBC and Ameritech have been hampered in competing for multilocation customers.

- The transaction enables SBC to pursue the national/local plan. SBC and Ameritech each had concluded that it could not deploy a strategy of providing facilities and services in a broad number of areas outside of its home region by itself, and that a transaction like the merger of SBC and Ameritech was necessary. The combination of the proposed transaction and out-of-region deployment of facilities and services together yields broad geographic coverage for many large business customers. Successful deployment of this strategy for large business customers gives SBC/Ameritech the economic base on which services to smaller businesses and residences can be built.
- Even if one were to conclude, contrary to the evidence, that either SBC or Ameritech would have pursued some type of out-of-region strategy in the absence of this (or a similar) transaction, this transaction still would benefit consumers by enabling new facilities and services to be deployed more rapidly than otherwise would be possible.
- There are a number of other firms deploying local services using a variety of different strategies. The SBC/Ameritech strategy is only one of many. The transaction will not interfere with the ability of others to

pursue these strategies. It is precisely these circumstances in which regulators must be most cautious about interfering with new entry and deterring investments that are aimed at benefitting consumers.

5. The remainder of this report provides the basis for these conclusions: Section II presents a brief overview of SBC's national/local plan and describes how it creates a new competitor which will benefit consumers. Section III reviews major industry trends and discusses how SBC's national/local strategy responds to these trends. Section IV shows that the proposed transaction enables SBC to pursue the national/local plan. Section V briefly reviews other strategies now being deployed by other firms and shows that the proposed transaction leaves many firms competing to establish market positions as competitive local exchange carriers.

II. THE NATIONAL LOCAL PLAN CREATES A NEW LOCAL EXCHANGE COMPETITOR IN MANY AREAS AND BENEFITS CONSUMERS

6. SBC has stated publicly, and confirmed in its testimony here, that its national/local plan will establish a new facilities-based provider of local telecommunications services in 30 large metropolitan areas:¹

- The plan anticipates the deployment of switches in the 30 largest MSAs outside of SBC's and Ameritech's home region over the next three years and the addition of roughly 2,900 miles of new fiber optic cable. SBC plans to begin deploying facilities and services in the largest out-of-

1. See Affidavit of James Kahan, SBC's Senior Vice-President for Corporate Development, ¶¶ 27-45, for an overview of the national/local plan.

region metropolitan areas (including New York, Washington, Philadelphia, and Atlanta) in 1999.

- SBC plans to provide local exchange, long distance and data services to large business, small business and residential customers. Network design and data integration services for large business customers will also be provided.
- Within three years, SBC will have facilities and other services in each of the 50 largest metropolitan areas in the U.S. Outside of its 13 state home region,² SBC will offer services in nearly as many areas as either WorldCom or AT&T/Teleport, the most widespread of the competitive local exchange carriers (CLECs).

7. SBC has made a significant and serious commitment to the national/local strategy, repeatedly stressing that both the merger with Ameritech and 30-city entry plans are essential elements of its future success. This commitment has been made in representations to investors, analysts, the Congress, the Securities and Exchange Commission, the Department of Justice, the Federal Communications Commission and state regulators. SBC also has emphasized that this strategy needs to be implemented quickly in order to respond to rapid changes in demand and competitive conditions in the industry now occurring. Indeed, I understand that

2. This includes SBC's seven current states (Texas, Missouri, Oklahoma, Arkansas, Kansas, California and Nevada) plus Connecticut, as well as the five states in Ameritech's home region (Illinois, Indiana, Wisconsin, Michigan and Ohio).

SBC's Board of Directors approved this transaction based on the deployment of the out-of-region strategy.³

8. Although SBC plans to start by marketing a broad range of telecommunications services to large businesses, this strategy will have much broader competitive benefits. Large businesses are intended to be the "anchor tenants" of the 30-city out-of-region business. Significant investments in switching technology and transport facilities are planned to serve these customers. Because, by definition, these investments are being made in 30 of the most populated areas of the country, the facilities will be proximate to many other potential customers. SBC believes that it will be able to serve these additional customers effectively, given the presence of its "anchor tenants."

9. SBC intends to market services to residential customers, as well as business customers. SBC believes that state regulators have required incumbent LECs to serve some customers at capped regulated rates without regard to the profitability of doing so.⁴ Yet, SBC has concluded that there are many residential customers who are interested in purchasing a bundle of local exchange, long distance, Internet access, and other services (such as wireless services in some areas) that SBC should be able to serve profitably.

10. Successful implementation of this strategy will benefit consumers within SBC's and Ameritech's region as well. If SBC is successful, others will likely mimic the strategy within SBC's and Ameritech's region. Similarly, increased competition

3. Kahan Affidavit, ¶ 84-85.

4. Kahan Affidavit, ¶ 21.

will spur innovation and higher levels of customer services, as well as reductions in price for customers in all areas.

11. While many CLECs have established facilities and services throughout the United States, the provision of many local exchange services remains concentrated. SBC's entry into the provision of local exchange services outside its home territory creates a significant new competitor that promises to bring significant benefits to a wide range of consumers. To understand the magnitude of the potential benefits, note that even a one percent decline in local service rates in the 30 cities where SBC intends to deploy facilities and services would result in annual savings to consumers of roughly \$175 million.⁵

III. THE NATIONAL/LOCAL PLAN RESPONDS TO CHANGES IN INDUSTRY CONDITIONS

A. Changes in Demand and Supply Conditions

12. The telecommunications industry is in the midst of fundamental changes in demand, supply and regulatory conditions.⁶ These trends include:

- Demand for long distance voice services, and to a greater extent, data services has been growing rapidly. In comparison, demand for the local

5. This figure is based on the year 2000 values for the estimated number of lines and revenue per line used in SBC's financial modelling of the national/local plan. This figure does not reflect either long distance savings that consumers may realize as the result of the transaction or savings to in-region customers.

6. The FCC recognized in its Bell Atlantic/NYNEX decision that "the Commission may consider the trends within and needs of the industry ... and the complexity and rapidity of change in the industry" in evaluating the competitive impact of a merger. (FCC, Memorandum Opinion and Order in Bell Atlantic/NYNEX, August 14, 1997, ¶32.)

exchange services that the Regional Bell Operating Companies (RBOCs) provide has grown much more slowly. For example, revenue earned by the RBOCs has grown by less than 5 percent annually in recent years.⁷ At the same time, data revenue is forecast to grow nearly 25 percent annually in coming years.⁸

- Technologies for providing voice and data services are rapidly converging. This is reflected in part in the current deployment of Internet Protocol (IP) and other data technologies for voice service. Circuit-switched networks, such as those operated by the major incumbent local and long-distance providers, are now subject to competitive pressure from data networks. In recent months, Qwest, Level 3, Frontier, Sprint and others have announced deployment of IP or data networks for voice communications.⁹ These announcements promise significant increases in capacity and reductions in costs relative to traditional telecommunications networks.
- The growth in the variety and complexity of telecommunications services has led to increasing demands among large multi-location business customers for a single or primary supplier to provide a bundle of local, long distance and data services on a national and even international

7. Decision Resources, December 5, 1995, p. 1.

8. Yankee Group estimate, cited in JP Morgan, Industry Update, Nov. 14, 1997, p. 4.

9. <http://www.qwest.com/press/041398.html>; <http://www.l3.com/technology.html>
<http://www.frontiercorp.com/about/news/1998429-839862952.html>;
<http://www.sprintbiz.com/ion/press.html>

basis.¹⁰ This preference is revealed in requests for proposals (RFPs) that many large multi-location customers have issued requesting a "single point of contact" in managing nationwide voice and data services. Similarly, many residential customers have expressed preferences for "one-stop" shopping for local, long distance and data services.

- The regulatory environment continues to change, with a reduction in barriers to entry into the provision of local exchange services established as a principal goal of the Telecommunications Act of 1996.
- RBOCs (and other incumbent LECs) are increasingly subject to competitive pressures, particularly for services to business customers. For the first time, CLECs are adding more business lines than the RBOCs. Nationally, in the first quarter of 1998, the estimated number of net business line additions for RBOCs was 460,000, down from 700,000 the previous year. CLECs added an estimated 500,000 business lines.¹¹
- The telecommunications industry is now undergoing rapid restructuring. Significant examples include WorldCom's acquisitions of MCI, MFS and Brooks Fiber, and AT&T's acquisition and Teleport Communications Group (TCG) and Tele-Communications Inc. (TCI). Such restructuring reflects, in part, various firms' evaluations and strategic responses to the rapid changes now occurring in the industry.

10. SBC, for example, has established a national accounts group to serve multilocation customers. (Kahan Affidavit, ¶ 13).

11. Salomon Smith Barney, May 6, 1998, p. 1.

B. SBC's Evaluation of Industry Changes

13. SBC's national/local plan reflects its attempt to respond to these fundamental changes in industry conditions.¹² In particular, SBC's plan is based on its conclusions that:

- Taking advantage of opportunities for entry into the provision of local exchange services outside of SBC's home territory is important to its continued growth and success. The value of these opportunities is reflected in the success of CLECs in raising capital for new investment projects. If SBC fails to take advantage of these opportunities, it risks losing profitable customers.
- Due to their established relationships with large business customers with headquarters in their home regions, SBC and Ameritech could be in a strong position to compete to provide nationwide services to out-of-region locations operated by these companies. Because each of these large business customers has operations in different groups of cities, entry on a national scale may be required to be competitive. A strategy of "following" these customers by providing service to their out-of-region sites requires deployment of facilities and services in a large number of major metropolitan areas.
- CLECs that succeed in competing against incumbent suppliers of local exchange services will be those that are able to enter rapidly and

12. See generally, Kahan Affidavit, ¶¶ 27-45.

achieve "first mover" advantages in winning customers.¹³ These circumstances create a "race" in which firms that are among the first to deploy facilities and services have the greatest likelihood of long-run success. The provision of services in a particular geographic area to small business and residential consumers can build on the facilities and services deployed to serve large business customers.

C. SBC and Ameritech have concluded that they currently cannot adequately respond to large customers' demand for broad geographical coverage

14. SBC and Ameritech have concluded that they now cannot adequately respond to these changing conditions as regionally limited suppliers of local services. In particular, the regional structure of SBC and Ameritech leaves them poorly situated to provide national (or near national) coverage to large business customers. It is important to remember that the regional structure of the RBOCs is a result of the AT&T settlement and consent decree 15 years ago, not the result of current or even historical patterns of economic efficiency.

15. I have analyzed the ability of SBC and Ameritech to use their own facilities to serve multilocation customers using estimates of telecommunications expenditures by MSA for each of the Fortune 500 companies.¹⁴ These data were

13. Kahan Affidavit ¶ 54.

14. Implicit in SBC's "smart build" strategy is the fact that portions of its "own facilities" are in fact leased from others, while other portions belong to SBC. SBC has concluded that the "smart build" approach enables SBC to efficiently construct a network and at the same time monitor network performance and service quality. However, ownership of a significant part of the network remains a key element in SBC's smart build strategy. (Kahan Affidavit, ¶ 39.)

(continued...)

prepared at the direction of SBC, and reflect estimates of expenditures for local and long distance services.¹⁵ These data indicate that SBC's eight home-state region¹⁶ is headquarters to 129 Fortune 500 companies.¹⁷

16. SBC recognizes that it is important that it be able to provide a significant majority of the telecommunications services these customers need -- as a sort of prime contractor -- but that it is not essential that it be able to provide all of such facilities and services. The ability to provide most services is necessary, from SBC's perspective, to provide overall management and quality control of the services desired by customers. SBC believes that it can successfully market "national" services to customers for which it directly provides roughly 70 percent or more of their national expenditures.¹⁸

17. However, the available data indicate that SBC can now provide broad geographic coverage for only a small share of these firms. Specifically, I calculate the number of firms for which SBC can provide local exchange services in MSAs that account for at least 70 percent of these companies' total telecommunications expenditures. I define such firms as having "near national" coverage from SBC. Today,

14.(...continued)

The remainder of this affidavit uses the term "owned facilities" to include those operated under the "smart build" approach.

15. These data are based on information from WEFA, ABI, and Claritas.

16. Although SBC's acquisition of SNET has not been completed, for current purposes we treat Connecticut as part of SBC's home region.

17. We exclude from the analysis three Fortune 500 telecommunications companies with headquarters in SBC's home region: SBC, GTE, and Sprint.

18. Kahan Affidavit, ¶ 48.

SBC can provide "near national" coverage for only 33, or 26 percent, of the Fortune 500 companies with headquarters in its home territory.

18. Similarly, Ameritech's five home states (Illinois, Michigan, Ohio, Wisconsin and Indiana) are headquarters to 91 Fortune 500 companies.¹⁹ However, Ameritech today can provide "near national" coverage to only 19, or 21 percent, of these companies.

19. These data confirm SBC's and Ameritech's view that each is poorly situated to use its own facilities to respond successfully to RFPs issued by multi-location customers for a nationwide telecommunications provider. The following examples identify a few instances in which SBC was unable to successfully respond to RFPs due to its limited geographic coverage:²⁰

- JCPenney issued an RFP in April 1998 for a single source supplier of end-to-end telecommunications of T1 services nationwide for routing data to and from their data centers in Milwaukee, Lenaxa, Columbus, Dallas, Atlanta and Manchester. SBC was unable to bid on this project.
- JCPenney issued an RFP in July 1997 to evaluate different network transport architectures for their Eckerd Stores. SBC did not have a solution that could address the nationwide single point of contact for end-to-end connectivity requirements of the bid.
- Kerr-McGee requested bids in May 1998 to provide local, national and international access for voice and private line and ATM and Frame Relay data services. The bid required a single point of contact and a single responsible party responsible for service level. SBC did not re-

19. Ameritech is excluded from these tabulations.

20. The examples are based on information received from SBC.

spond to the RFP because it could not meet the customer's requirements.

- ARCO issued an RFP in December 1997 for nationwide point-of-sale telecommunication service in more than 1500 locations. SBC's bid relied on use of other carriers outside of SBC's territory. SBC's was rejected due to ARCO's preference for dealing with a single carrier.

IV. THE AMERITECH TRANSACTION ENABLES SBC TO PURSUE A NATIONAL/LOCAL STRATEGY

20. This section shows that the SBC/Ameritech transaction combined with the out-of-region plan creates merger-specific efficiencies.^{21, 22} SBC decided it could not pursue the out-of-region plan on its own and that a transaction along these lines was necessary. However, even if one thought that SBC might have undertaken such a plan by itself, the Ameritech transaction enables SBC to more rapidly deploy out-of-region facilities and services and thus benefits consumers.

A. SBC had no plans to pursue an out-of-region strategy absent the Ameritech transaction

21. As described in the accompanying Affidavit of SBC's James Kahan, SBC had decided it could not deploy this strategy by itself.²³ As he relates, SBC decided in late 1997 and early 1998 that it needed to expand geographically in order

21. This affidavit does not examine the many specific assumptions used in SBC's financial model.

22. I focus only on efficiencies associated with the out-of-region plan and do not address other efficiencies, such as operating efficiencies and efficiencies in R&D, that result from the transaction.

23. Kahan Affidavit, Section ¶¶ 75-85; Similarly, Ameritech also decided not to pursue out of region entry on a significant scale. (Weller Affidavit, ¶¶ 31-38).

to respond to the changes in industry demand and supply conditions discussed above. SBC pursued the Ameritech merger precisely because it allows SBC to implement this national/local strategy and the 30-city out-of-region plan. This provides simple and powerful evidence that the Ameritech transaction is an essential element to the implementation of the out-of-region strategy and that the 30-city plan is a "merger-specific" efficiency.

B. Even if SBC could have pursued an out-of-region entry strategy on its own, the Ameritech transaction speeds its deployment

22. Rapid deployment of new services benefits consumers, but also is essential to firms attempting to respond to changes in industry conditions and attempting to establish "first-mover" advantages. For example, in pursuing the logic of SBC's national/local plan in attracting anchor tenants, it is important that SBC be in as many different cities as quickly as possible. It is unlikely that SBC would have as much success in marketing to its "anchor tenants" if it could only promise that a near national footprint would be available in ten years.

23. There are several ways in which the Ameritech transaction helps SBC speed the deployment of services and facilities.

1. The transaction reduces the number of out-of-region cities that SBC must enter in order to gain broad geographic coverage

24. At the most basic level, the proposed transaction speeds deployment of the out-of-region plan by reducing the number of out-of-region cities in which SBC must build facilities in order to gain a nationwide footprint. For example, the

Ameritech merger obviates the need for SBC to deploy new facilities in top-50 metropolitan areas already served by Ameritech, including Chicago, Detroit, Cleveland, Milwaukee, Columbus, Indianapolis and Dayton. If SBC alone were to attempt to achieve coverage in the 50 largest metropolitan areas, it would need to deploy facilities and services in 37 metropolitan areas; Ameritech would need to deploy facilities and services in 43 out-of-region areas.

2. The transaction increases the number of large business customers to "follow"

25. The transaction speeds the establishment of a national/local footprint by increasing the number of large in-region businesses with headquarters in SBC/Ameritech's home territories. As mentioned above, "following" these customers is at the core of SBC/Ameritech's expansion strategy. Many of these firms are already significant customers of SBC and Ameritech. With a national/local footprint, SBC's and Ameritech's existing relationships increase the likelihood that the merged firm could successfully compete to become a nationwide supplier of services for such customers. As noted above, SBC estimates that there are 129 Fortune 500 companies with headquarters in SBC's 8-state home territory (again assuming that SBC's acquisition of SNET is approved). Another 91 Fortune 500 companies have headquarters in 5-state Ameritech's home region.

3. The merger and out-of-region plan together enable SBC to offer broad geographic coverage to many firms

26. The proposed merger and out-of-region plan are both essential elements in enabling SBC to rapidly and effectively generate a national/local footprint that provides broad geographic coverage for large business customers. The extent to which these two elements combine to generate broad geographic coverage for many large business customers is observed in the data that identifies telecommunications expenditures by MSA for the Fortune 500 customers. These data are described in Section III.C above.

27. First, the proposed transaction alone, without the 30 city plan, fails to generate a substantial increase (relative to current circumstances) in the number of Fortune 500 customers that can be offered "near national" coverage. Again, near-national coverage is defined to mean that 70 percent of a firm's estimated telecommunications expenditures are generated in MSAs served by SBC/Ameritech. Today, SBC and Ameritech together offer "near national" coverage for only 52 (or 24 percent) of the 220 Fortune 500 companies with headquarters in either company's home territory. A merger between SBC and Ameritech that did not also encompass an out-of-region strategy would enable the firm to offer "near national" coverage to only 73 (or 33 percent) of these customers. (See Table 1.)

28. However, the combination of the SBC/Ameritech merger plus deployment of out-of-region facilities to 30 areas enables the combined firm to offer "near national" coverage to fully 178 (or 81 percent) of the Fortune 500 companies with headquarters in either SBC's or Ameritech's home territories.

Table 1

**The National Local Strategy Expands SBC/Ameritech's
Coverage of Fortune 500 Firms' Telecommunications Expenditures**

Strategy	Number of Fortune 500 Firms With Headquarters In-Region	Firms with 70 Percent of Expenditures in Supplier Footprint		
		Number	Percent	
<u>Non-Merger</u>	Ameritech (current)	91	19	20.9%
	SBC (current)	129	33	25.6%
	<i>Total</i>	220	52	23.6%
	Ameritech + 15 out-of-region	91	28	30.8%
	SBC + 15 out-of-region	129	72	55.8%
	<i>Total</i>	220	100	45.5%
<u>Merger</u>	Ameritech + SBC only	220	73	33.2%
	Ameritech + SBC + 30 out-of-region	220	178	80.9%

Source: Claritas/ABI/WEFA

Notes: Based on estimated local and long distance expenditures by firm and MSA.

SBC 15 out-of-region markets are: Chicago IL, Washington DC, Boston MA, Minneapolis-St. Paul MN, Atlanta GA, Phoenix AZ, Detroit MI, Philadelphia PA, New York-Newark NY-NJ, Seattle WA, Portland OR, Denver-Boulder CO, Milwaukee WI, Baltimore MD and Las Vegas NV.

Ameritech 15 out-of-region markets are: Dallas TX, Phoenix AZ, Los Angeles CA, Atlanta GA, Washington DC, Louisville KY, Houston TX, Philadelphia PA, St. Louis MO, Minneapolis-St. Paul MN, Boston MA, Orange County CA, Pittsburgh PA, Kansas City MO, and New York-Newark NY-NJ.

National-local 30 out-of-region markets are: Albany NY, Atlanta GA, Baltimore MD, Birmingham AL, Boston MA, Buffalo NY, Cincinnati OH, Denver-Boulder CO, Greensboro NC, Honolulu HI, Las Vegas NV, Louisville KY, Memphis TN, Miami-Ft. Lauderdale FL, Minneapolis-St. Paul MN, Nashville TN, New Orleans LA, New York-Newark NY-NJ, Norfolk VA, Orlando FL, Philadelphia PA, Phoenix AZ, Pittsburgh PA, Portland OR, Providence RI, Rochester NY, Salt Lake City UT, Seattle WA, Tampa FL and Washington DC.

29. Second, deployment of separate out-of-region plans by both SBC and Ameritech separately would not yield "near national" coverage for nearly as many large business customers as can be achieved by SBC's national/local plan, including both the proposed transaction and the deployment of facilities in 30-city out-of-region cities. For example, if Ameritech and SBC did not merge but each deployed facilities in 15 out-of-region MSAs, then the two firms would be able to provide "near national" coverage for a total of only 100 (or 46 percent) of the 220 Fortune 500 companies with headquarters in either SBC's or Ameritech's region.²⁴ In contrast, as noted above, SBC's national/local plan (including both the Ameritech transaction and the 30-city plan) extends "near national" coverage to fully 178 of these companies. (See Table 1.)

30. If SBC and Ameritech were each to deploy facilities in 15 out-of-region cities in order to "follow" their large home region customers, it is likely that each would be building facilities in many of the same locations (such as New York Washington, Boston and Atlanta). The merger, in effect, permits coordination of the two out-of-region plans and avoids duplicating facilities. This enables the combined firm to reach more markets and makes the firm more attractive to large business customers. In the absence of significant harm to competition -- which, as discussed in Section V below, I do not anticipate to result from this merger -- there is no reason to interfere with one firm's decision on how to compete efficiently.

24. These calculations are based on the assumption that both SBC and Ameritech would deploy facilities in the 15 out-of-region MSAs that generated the greatest telecommunications revenue for their in-region Fortune 500 customers.

4. The transaction permits more effective utilization of scarce managerial resources

31. The transaction also increases the combined firm's ability to deploy facilities in a large number of out-of-region areas by allowing more effective utilization of scarce managerial resources. Deployment of facilities and services in 30 regions in three years reflects an enormous managerial and logistical undertaking. By combining the managerial and engineering resources of SBC and Ameritech, the merger substantially increases the pool of human resources that can be drawn upon. At the same time, as described above, the transaction limits the number of areas that must be entered in order to obtain a broad national footprint.

32. While not all managers for the out-of-region venture would be drawn from SBC or Ameritech, firms often prefer to staff new ventures using existing employees whose skills are known and who understand the corporate parent's goals.²⁵ This does not imply that a firm would pursue such a strategy without regard to its current businesses. I understand that much of the senior staff of SBC's past new ventures have been drawn from SBC and that SBC intends to rely to a significant extent on managers from SBC and Ameritech to staff the 30-city venture.²⁶

33. A sense of the magnitude of the managerial resources required to undertake the out-of-region entry project is summarized in Table 2. A comparison of the number of managers required to deploy out-of-region services with the current

25. See, for example, A. Campbell, Michael Goold, and Marcus Alexander, "Corporate Strategy, The Quest for Parenting Advantage," *Harvard Business Review* (March-April, 1995); and A. Chandler, Jr., "The Functions of the HQ Unit in the Multibusiness Firm," *12 Strategic Management Journal* 31 (1991).

26. Kahan Affidavit, ¶ 78.

Table 2

**Management Employees Required for Out-of-Region Entry
Relative to Current SBC/Ameritech Management Force**

	SBC/Ameritech	SBC Only	Ameritech Only
Recent Management Employees - Telco	33,968	22,662	11,306
Out-of-Region Markets Needed for Top 50 Coverage	30	37	43
Average Managers Required Per Out-of-Region Area	95	95	95
Required Out-of-Region Managers	2,850	3,515	4,085
Required Out-of-Region Managers as a Percentage of Recent Management Employees	8%	16%	36%

Source: SBC

stock of SBC and Ameritech managerial employees provides a rough measure of the managerial requirements created by the national/local plan. SBC estimates that deployment of facilities and services in an average out-of-region area will require 270 employees, including 95 managerial employees. Managerial employees are defined to include those involved in engineering, sales and marketing, administration, and customer service. Deployment of facilities in 30 areas would require roughly 2,850 managers. SBC and Ameritech together employ roughly 34,000 managers. Thus, the out-of-region venture would require the equivalent of only about 8 percent of the combined managerial work force of SBC and Ameritech.

34. In contrast, if SBC were to attempt to undertake the out-of-region project in the absence of the Ameritech transaction, it would need to deploy facilities in 37 areas and would require roughly 3,500 managers. This total reflects 16 percent of SBC's current managerial workforce. If Ameritech were to attempt such a strategy alone, it would require roughly 4,100 managers, the equivalent of 36 percent of its current managerial workforce.

35. While these figures are only illustrative because not all managers would be drawn from current SBC and Ameritech employees, they reveal that the merger significantly limits the scope of the management effort required for the 30-region plan relative to the combined firms' current activities. This, in turn, facilitates the rapid deployment of facilities and services.

V. THERE ARE MANY POTENTIAL ENTRANTS INTO THE PROVISION OF LOCAL EXCHANGE SERVICE ADOPTING A VARIETY OF STRATEGIES

36. SBC's "national/local" strategy, encompassing the Ameritech merger and 30-city plan, is only one of several recent responses to the changing industry conditions described above. Each of these approaches, including SBC's, involve significant risks and it is unclear which firms and strategies ultimately will succeed. SBC's strategy appears to be distinguished as the only one premised on "following" current customers to new locations and is one of few attempting to provide a "near-national" footprint. Examples of various recent entrants and strategies (in alphabetical order) include:

- Allegiance Telecom: Allegiance plans to offer local exchange services in 24 areas throughout the U.S.²⁷ It plans to offer local and long distance services, including 800/888 and calling card service.²⁸ It intends to offer services to "business, government and other institutional users in major metropolitan areas across the United States."²⁹ Allegiance is pursuing a "smart build" strategy in which it will "deploy digital switching platforms with local and long distance capability and initially lease fiber trunking capacity from the ILECs and other CLECs."³⁰ The CEO of Allegiance is the former President of MFS.
- AT&T/TCG/TCI: At year end 1997, Teleport Communications Group (TCG) operated local networks in 65 MSAs, including 19 of the 20 largest metropolitan areas.³¹ AT&T announced its intention to acquire Teleport in January 1998. TCG provides "basic local exchange telephone services, enhanced switched services, dedicated services, high speed switched data services, Internet service, disaster avoidance

27. http://www.allegiancetele.com/html/body_aboutallegiancemap.html

28. http://www.allegiancetele.com/html/body_products_and_services.html

29. Allegiance Telecom Inc. Prospectus, 7/2/98, p. 5.

30. Allegiance Telecom Inc. Prospectus, 7/2/98, p. 5.

31. Teleport Communications Group Inc. 10-K, 12/31/97, p. 4.

services and video channel transmission services."³² TCG describes its customers as "principally telecommunications-intensive businesses, healthcare and educational institutions, governmental agencies, long distance carriers and resellers, Internet service providers, disaster recovery service providers, wireless communications companies and financial service companies".³³ AT&T also announced its intention to acquire TCI in June 1998. This transaction has been viewed as providing AT&T with a means to enter into the provision of local service through TCI's cable facilities.³⁴ TCI now offers cable television service to 13.9 million households³⁵ and passes more than 33 million households.³⁶

- Covad Communications: Covad "is a packet-based Competitive Local Exchange Carrier which provides high-speed data communications services using Digital Subscriber Line technology."³⁷ Covad "depends on leased copper lines and its own DSL central-office and customer premise equipment to reach its customers."³⁸ The firm's target customers are large businesses, government entities, educational institutions, and ISPs. Covad currently offers DSL service in the San Francisco Bay Area, and has "plans to launch its services in other regions, initially including Boston, Los Angeles, New York, Seattle and Washington DC."³⁹ Covad's senior executives were formerly with Intel.
- Cox Communications: Cox Communications is one of the nation's largest cable television systems. Cox states that its "strategy ... is to capitalize on the capabilities of its advanced broadband platform and the strength of its current cable television business to provide its residential and commercial customers with an integrated package of existing multichannel video and new services, including digital video, high-speed

32. Teleport Communications Group Inc. 10-K, 12/31/97, p. 5.

33. Teleport Communications Group Inc. 10-K, 12/31/97, p. 4.

34. <http://www.att.com/press/0698/980624.cha.html>

35. TCI Communications Inc. 10-K, 12/31/97, p. 7.

36. <http://www.att.com/press/0698/980624.cha.html>

37. Covad Communications Group Inc. Prospectus, 4/27/98, p. 1.

38. <http://www.clec.com/latest/data/clec/datastory1.cfm>

39. Covad Communications Group Inc. Prospectus, 4/27/98, p. 1.

Internet access and local and long distance telephone services."⁴⁰ In 1997, "Cox Digital Telephone" was "introduced to residential customers in Orange County, California and Omaha, Nebraska. During 1998 Cox will launch Cox Digital Telephone in additional markets."⁴¹ Cox additionally offers conventional fiber optic networks to businesses in four cities.

- e.spire: e.spire (formerly American Communication Services) has local networks in service in 32 areas, predominantly in southern states.⁴² e.spire offers dedicated access services, switched voice services (both local and long distance), as well as Internet and data services.⁴³ It "intends to continue to target businesses in the southern half of the United States, ... and strives to be the first to market integrated communications services in each of its markets."⁴⁴ The firm targets large businesses and national accounts, and its carrier sales group targets dedicated services to long distance carriers and ISPs.⁴⁵
- Electric Lightwave: Electric Lightwave provides services in five western MSAs.⁴⁶ The firm also constructed long-haul fiber optic networks connecting their service areas. Electric Lightwave offers dedicated services (special access and private lines), local dial tone, long distance and enhanced services, such as frame relay and video conferencing.⁴⁷ Electric Lightwave" offers services to retail customers, primarily large- and medium-sized communications-intensive businesses, and wholesale customers."⁴⁸ Citizens Utility Company owns 83 percent of Electric Lightwave.
- Focal Communications: Focal "is a rapidly growing competitive local exchange carrier which is focused on providing local switched telecommunications services to large corporations, Internet service providers

40. Cox Communications Inc. 10-K, 12/31/97, p. 3.

41. Cox Communications Inc. 10-K, 12/31/97, p. 8.

42. <http://www2.empire.net/networks/netmap.cfm>

43. American Communications Services Inc. 10-K, 12/31/97, p. 8-10.

44. American Communications Services Inc. 10-K, 12/31/97, p. 7.

45. American Communications Services Inc. 10-K, 12/31/97, p. 7

46. Electric Lightwave Inc. 10-K, 12/31/97, p. 1.

47. Electric Lightwave Inc. 10-K, 12/31/97, p. 1.

48. Electric Lightwave Inc. 10-K, 12/31/97, p. 1.

and value-added resellers in Tier I Markets."⁴⁹ Focal currently offers services in Chicago and New York and intends to expand into eight additional large metropolitan markets by the end of 1999.⁵⁰ Focal is a "switch-based" CLEC, having "chosen to pursue a network design approach which involves purchasing and maintaining its own switches while leasing fiber optic transmission facilities on an incremental basis as demand dictates."⁵¹ Focal does not offer a bundle of telecommunications services, instead offering a "focused set of value-added local switched services to its customers, which management believes differentiates the Company from a majority of competitors who are seeking to provide 'one-stop' telecommunications services."⁵² Former executives of MFS head Focal's management team.

- GST Telecommunications: GST Telecommunications operates in 11 western metropolitan areas.⁵³ GST also operates long haul fiber optic facilities in three western states.⁵⁴ GST offers switched and dedicated local service, long distance, Internet services, and frame relay services.⁵⁵ GST's 10-K states that the company "focuses on small to medium sized businesses that have significant telecommunications requirements."⁵⁶ Additionally GST "offers shared tenant services to large apartment and residential communities in several western states that bundle local, long distance, Internet access, cable television and home alarm services."⁵⁷ The 10-K further notes that the company's "network strategy is to ... assemble, through a combination of owned and leased facilities and joint ventures, an integrated regional network for the on-net provision of CLEC services ..."⁵⁸

49. Focal Communications Corp. S-4, 4/3/98, p. 1.

50. Focal Communications Corp. S-4, 4/3/98, p. 1.

51. Focal Communications Corp. S-4, 4/3/98, p. 1.

52. Focal Communications Corp. S-4, 4/3/98, p. 2.

53. <http://www.gstcorp.com/location.html>

54. GST Telecommunications Inc. 10-K, 12/31/97, p. 3.

55. GST Telecommunications Inc. 10-K, 12/31/97, p. 3-5.

56. GST Telecommunications Inc. 10-K, 12/31/97, p. 3.

57. GST Telecommunications Inc. 10-K, 12/31/97, p. 5.

58. GST Telecommunications Inc. 10-K, 12/31/97, p. 5.

- Hyperion: Hyperion offers, or has plans to offer, local dial tone in 21 areas, principally in northeastern and south-central states. Hyperion operates in smaller metropolitan areas, including, for example, Albany NY, Louisville KY, and Little Rock AR. In many of these markets Hyperion has established partnerships with other firms to construct and operate the network.⁵⁹ Hyperion offers dedicated access, switched local service, long-distance and enhanced data services including frame relay, Internet access and video conferencing.⁶⁰ Hyperion states that it "is a leading provider of integrated local telecommunications services to small, medium and large businesses, government and educational end users and resellers, including IXCs, in its markets."⁶¹ Adelphia Communications Corporation, the nation's seventh largest cable company owns 88% of Hyperion.
- ICG Communications: ICG operates in four regional "clusters": California (Sacramento, San Diego, and portions of the Los Angeles and San Francisco areas); Colorado (Denver, Colorado Springs and Boulder); Ohio (Akron, Cleveland, Columbus and Dayton) and the Southeast (Birmingham, Charlotte, Louisville and Nashville). The company has plans to build networks in Atlanta and Texas.⁶² ICG offers local, long distance, special access service, voice mail, calling card, and debit card services to its retail customers.⁶³ Additionally, ICG provides local switched services on a wholesale basis.⁶⁴ ICG focuses on offering "bundled services to business end users" as well as resellers.⁶⁵
- Intermedia Communications: Intermedia operates fiber optic networks in 10 southeastern cities. It also owns a 5,000 mile long-haul microwave transmission network in the Northeast. Additionally, Intermedia intends to deploy ATM switching nodes in 35 cities across the US by the end of 1998.⁶⁶ Intermedia offers local service, long distance, frame relay services, dedicated Internet access, network management, voicemail,

59. Hyperion Telecommunications 10-K, 3/31/97, p. 13.

60. Hyperion Telecommunications 10-K, 3/31/97, p. 3.

61. Hyperion Telecommunications 10-K, 3/31/97, p. 8.

62. ICG Telecommunications Inc. 10-K, 12/31/97, p. 8.

63. ICG Telecommunications Inc. 10-K, 12/31/97, p. 11.

64. <http://www.icgcomm.com/telecom/prodserv/wholesale.htm>

65. ICG Telecommunications Inc. 10-K, 12/31/97, p. 9.

66. Intermedia Communications Inc. 10-K, 12/31/97, p. 9.

ISDN, Centrex Service, PBX Trunks, CPE and private lines.⁶⁷

Intermedia targets business customers including "small to medium sized companies whose initial service offering is generally local and long distance voice, ... medium sized companies with both voice and enhanced data needs...[and] the largest multi-location companies whose interests usually begin with Intermedia's enhanced data services."⁶⁸

Intermedia also "plans to introduce a new class of voice products which utilize data protocols to deliver voice traffic over Intermedia's Packet/Cell Switched Network."⁶⁹

- Level 3 Communications: Level 3 is constructing an Internet Protocol network that will "encompass local facilities in approximately 40 North American markets, leased backbone facilities in approximately 10 additional North American markets." In addition, Level 3 plans to establish local facilities in approximately 10 European and 4 Asian markets.⁷⁰ Level 3 plans to offer "local, long distance and data transmission as well as other enhanced services..."⁷¹ Level 3's 10-K states that it "intends to optimize its international network to provide Internet based communications services to businesses at low cost and high quality, and to design its network to the extent possible, to more readily include future technological upgrades than older, less flexible networks owned by competitors."⁷² The CEO of Level 3 is the former Chairman of MFS.
- McLeodUSA: McLeodUSA refers to itself as a "Super-Regional CLEC".⁷³ Its 1997 10-K states the company "is a provider of integrated telecommunications services to small and medium-sized businesses"⁷⁴ in 10 states in the midwest and upper tier. It also provides service to residential customers in six states. McLeod has plans to deploy services in five additional western and midwestern states.⁷⁵ McLeodUSA offers

67. http://www.intermedia.com/company/overview/overview_f.html

68. Intermedia Communications Inc. 10-K, 12/31/97, p. 8.

69. Intermedia Communications Inc. 10-K, 12/31/97, p. 3.

70. Level 3 Communications Inc. 10-K, 12/27/97, p. 10.

71. <http://www.l3.com/background.html>

72. Level 3 Communications Inc. 10-K, 12/27/97, p. 10.

73. <http://www.mcleod-usa.com/headline925.html>

74. McLeodUSA Inc. 10-K, 12/31/97, p. 1.

75. McLeodUSA Inc. 10-K, 12/31/97, p. 2.

local phone service, long distance phone service, paging, Internet access and e-mail and voice mail.⁷⁶ McLeod "principally targets small and mid-sized markets (cities and towns with a population between 8,000 and 350,000) in its service areas."⁷⁷

- NEXTLINK Communications: NEXTLINK provides switched local services in eight states, including a number of communities in California, and plans to offer services in three additional states in 1998. NEXTLINK offers local, long distance, voice messaging, dedicated lines, and high capacity private lines (DS-0/1/3).⁷⁸ NEXTLINK'S 10-K identifies its targeted customer base as "small and medium sized businesses, generally those businesses with fewer than 50 access lines."⁷⁹ The Company enters into larger markets on a stand alone basis and pursues smaller markets where it can extend or cluster an existing network with relatively little incremental capital.⁸⁰ Craig McCaw, founder of cellular-provider McCaw Communications is the founder of NEXTLINK.
- Sprint: Sprint recently announced its Integrated On-Demand Network (ION), which it claims "can provide homes and businesses with virtually unlimited bandwidth over a single existing telephone line for simultaneous voice, video calls and data services."⁸¹ ION will allow Sprint to offer "local and long-distance voice, IP, frame relay, and ATM ... [using] high speed local data circuits leased from local providers and connected to Sprint's nationwide data network ... "⁸² This network will rely on a "hub" that "takes voice and data traffic and turns it into an ATM stream."⁸³ Sprint will use "many different broadband services, such as digital subscriber lines (xDSL), cable modems, and wireless technolo-

76. <http://www.mcleod-usa.com/>

77. McLeodUSA Inc. 10-K, 12/31/97, p. 4.

78. <http://www.nextlink.net/xpage/xprod1.htm>

79. NEXTLINK Communications Inc. 10-K, 12/31/97, p. 3.

80. NEXTLINK Communications Inc. 10-K, 12/31/97, p. 4.

81. <http://www.sprintbiz.com/ion/press.html>

82. PC Week, June 29, 1998

83. ISDN News, June 16, 1998

gies ... for the last mile to the customer."⁸⁴ Sprint states that "ION will be available in 36 metropolitan markets this year and 60 in 1999."⁸⁵

- Time Warner Telecom: Time Warner Telecom describes itself as "a leading facilities-based competitive local exchange carrier in selected metropolitan markets across the United States."⁸⁶ Time Warner "plans to provide switched services in all of its [19] current markets by the end of 1998."⁸⁷ Time Warner Telecom "provides its customers with a wide range of integrated telecommunications services, including dedicated transmission, local switched, data, and video transmission services and certain Internet services."⁸⁸ The company markets its services "primarily to medium- and large-sized business customers and other carriers. The Company's customers are principally telecommunications-intensive business end users, IXCs, ISPs, wireless communications companies and governmental entities."⁸⁹ Although Time Warner Telecom's majority owner is Time Warner Inc., one of the nation's largest cable operators, Time Warner Telecom has constructed conventional fiber optic networks, although it does benefit from "TW Cable's access to rights-of-way, easements, poles, ducts and conduits."⁹⁰
- Teligent: Teligent plans to offer services in 10 areas by the end of 1998 and 30 areas by the end of 1999 and ultimately 74 areas.⁹¹ Teligent "plans to focus its primary marketing efforts of small and medium-sized businesses with 5 to 350 telephone lines"⁹² and offer "an integrated package of services, including local and long distance telephone service, high speed data connectivity, Internet access and videoconferencing."⁹³ Teligent is deploying point to multipoint fixed

84. Communications Today, June 4, 1998

85. <http://www.techweb.com/se/directlink.cgi?INW19980608S0019>

86. Time Warner Telecom Inc. S-1, 4/6/98, p. 7.

87. Time Warner Telecom Inc. S-1, 4/6/98, p. 44.

88. Time Warner Telecom Inc. S-1, 4/6/98, p. 43.

89. Time Warner Telecom Inc. S-1, 4/6/98, p. 43

90. Time Warner Telecom Inc. S-1, 4/6/98, p. 44.

91. Teligent 10K, 12/31/97, p. 3.

92. Teligent 10K, 12/31/97, p. 5.

93. Teligent 10K, 12/31/97, p. 5.

wireless facilities to provide "last mile connectivity" in its licensed market areas. Teligent is led by Alex Mandl, former President and Chief Operating Officer for AT&T. NTT recently made an equity investment in Teligent.⁹⁴

- WinStar: WinStar currently offers CLEC services in 21 MSAs⁹⁵ and has plans to offer service in an additional seven MSAs by end of 1998.⁹⁶ WinStar offers "local dial tone, private branch exchange trunks, individual business lines, Centrex...long distance, data services such as Internet access, Wide Area Network services utilizing frame relay, IP, and ATM data transport ... private network services...[and] Carrier Services".⁹⁷ WinStar provides CLEC service by means of fixed wireless technology. WinStar plans to target business customers. "Initially, WinStar targeted small and medium sized business customers in buildings that have no more than 100,000 square feet of commercial space and which, in most instances, are not served by fiber facilities provided by CLECs."⁹⁸ WinStar also plans to offer "its broadband Carrier Services to other telecommunications providers."⁹⁹ WinStar holds radio spectrum licenses, which cover 125 MSAs, including the 50 largest MSAs.¹⁰⁰
- WorldCom/MCI/MFS/Brooks: WorldCom operates facilities in 105 MSAs.¹⁰¹ Through its purchase of MFS, it provides local exchange services in major metropolitan areas such as Chicago, New York, Los Angeles and Washington DC.¹⁰² Through its purchase of Brooks, it operates in smaller cities such as Tulsa OK, Little Rock AR, Lansing MI, and Albuquerque NM.¹⁰³ WorldCom "provides businesses with high quality local, long distance, Internet, data and international communica-

94. Los Angeles Times, October 1, 1997.

95. WinStar Communications Inc. 10-K, 12/31/97, p. 2.

96. http://www.winstar.com/buisserv_display.html

97. WinStar Communications Inc. 10-K, 12/31/97, p. 2.

98. WinStar Communications Inc. 10-K, 12/31/97, p. 4.

99. WinStar Communications Inc. 10-K, 12/31/97, p. 4.

100. WinStar Communications Inc. 10-K, 12/31/97, p. 2.

101. http://www.wcom.com/products+services/voice_products/locals.html

102. <http://www.mfsdatanet.com/mfs/corporate/index.html>

103. http://www.brooks.net/site_3/locations.html

tions services over its global networks.¹⁰⁴ WorldCom also provides local service on a wholesale basis. It recently announced that wholesale service "will be available in all domestic locations where WorldCom owns local facilities during 1999."¹⁰⁵

37. As these examples suggest, there are a significant number of potential entrants into the provision of local service. Several entrants have adopted regional strategies; others are deploying facilities in "clusters"; some focus on large business customers, others on smaller business and even certain categories of residential customers such as multiple dwelling units. Some entrants exclusively provide retail services; others are attempting to establish roles as wholesale suppliers of local services. Many entrants are deploying "conventional" digital fiber optic technology; others are using alternative technologies such as IP, fixed wireless or cable television. With only two exceptions (Focal and Covad), all of the companies are offering bundles of local, long distance and data services. In general, these entrants are credible, well financed, and often led by experienced and highly successful managers.

38. It is clear that these strategies represent many and varied responses to changes in technology and customer demands. Notice that, other than SBC, none are based on the concept of "following" existing customers and few attempt to establish a "near-national" footprint. All encompass significant risks due in part to the rapid changes in demand and supply conditions in the industry. Although it is difficult to predict the outcome now, some of these strategies undoubtedly will succeed while

104. WorldCom Inc. 10-K 12/31/97 p. 6.

105. http://www.wcom.com/about_worldcom/press_releases/archive/1998/980515.2.shtml

others will not. Successful strategies may differ significantly from each other. These are precisely the circumstances in which regulators must be most cautious about interfering with firms' attempts to develop and implement new entry strategies. The more firms that make actual investments in providing new services and facilities, the greater the likelihood that consumers will benefit from increased competition in the provision of local service.

39. These examples also suggest that large established telecommunications companies have no special advantage in entering into the provision of competitive local exchange services. In particular, incumbency may have certain drawbacks during times of rapidly changing technology and smaller firms may be able to respond to these changes more quickly than established ones. As a consequence, new firms have often been the first to implement new technologies and have succeeded in attracting capital to support these ventures. SBC's out-of-region plan appears to reflect its recognition that established firms must rapidly respond to these changes in order to remain competitive.

40. Many firms and competing strategies will remain after the transaction. The proposed transaction does not interfere with the ability of other firms to pursue alternative strategies and deploy services. While it is likely that there will be no substantial reduction in potential competition resulting from the proposed transaction, implementation of the national/local plan will establish a significant competitor in the provision of local exchange services.¹⁰⁶

106. The accompanying affidavit by R. Schmalensee and W. Taylor shows that the merger of SBC and Ameritech will not substantially reduce potential competition.

41. The FCC recognizes in the Bell Atlantic/NYNEX decision that evaluation of the competitive effects of mergers requires balancing the benefits and potential harms to consumers.¹⁰⁷ In this case, the evaluation is easy. The transaction creates an actual competitor in the provision of local exchange services in 30 new metropolitan areas without significantly reducing the number of firms that are potential competitors. The benefits to consumers of an increase in actual competition must weigh heavily in this balance.

VI. CONCLUSIONS

42. The successful implementation of SBC/Ameritech's "national/local" strategy will result in significant consumer benefits by creating a large and significant new competitor in the provision of local exchange services in 30 metropolitan areas. The transaction will create an actual competitor providing nationwide services to business customers as well as services to small business and residential customers in 30 metropolitan areas, and in SBC's and Ameritech's home territories.

43. My review indicates that neither SBC nor Ameritech would have pursued the national/local plan in the absence of this or a similar transaction. Even in the unlikely event that either firm were to pursue the national/local strategy in the absence of this or a similar transaction, deployment of new facilities and services would be significantly slower than would be expected with the transaction. The transaction reduces the number of areas that must be entered to gain a national/local

107. FCC, Memorandum Opinion and Order in Bell Atlantic/NYNEX, ¶157.

footprint and increases the number of large businesses with headquarters in SBC/Ameritech's home region that can be "followed."

44. Moreover, the Ameritech merger and out-of-region plan together increase the combined firms' ability to provide broad geographic coverage relative to that which would be expected if two firms were to follow individual entry strategies. This enables facilities and services to be deployed more effectively and quickly than otherwise would be possible.

45. While the transaction creates an actual competitor in 30 metropolitan areas, there will not be a significant reduction in the number of potential competitors in the provision of CLEC services. There are now a variety of firms using of variety of strategies attempting to enter into the provision of local exchange services. No opportunities for these alternative suppliers are foreclosed by the proposed transaction.

46. In sum, implementation of the national/local strategy creates a significant competitor in the provision of local services and leaves unchanged many other new entrants and strategies. Public policy should encourage entry under these circumstances and the transaction should be approved.

AFFIDAVIT OF DENNIS W. CARLTON

EXHIBIT 1

DENNIS WILLIAM CARLTON

Economist

June 1998

Business Address: Lexecon Inc.
332 South Michigan
Chicago, Illinois 60604 (312) 322-0215

Home Address: 184 Sheridan Road
Glencoe, Illinois 60022 (847) 835-8855

EDUCATION

Ph.D., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts:
Economics, 1975.

M.S., MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts:
Operations Research, 1974.

A.B., HARVARD UNIVERSITY (Summa cum laude): Applied Math and Economics, 1972.

EMPLOYMENT

LEXECON INC., Chicago, Illinois: President.

UNIVERSITY OF CHICAGO, Graduate School of Business (1984 - present): Professor of
Business Economics.

UNIVERSITY OF CHICAGO, Law School (1980 - 1984): Professor of Economics.

UNIVERSITY OF CHICAGO, Department of Economics: Assistant Professor (1976 - 1979):
Associate Professor (1979 - 1980).

MASSACHUSETTS INSTITUTE OF TECHNOLOGY, Cambridge, Massachusetts, Department of
Economics (1975 - 1976): Instructor in Economics.

OTHER PROFESSIONAL EXPERIENCE

HARVARD UNIVERSITY, Public Policy Summer Course in Economics (1977): Professor.

BELL TELEPHONE LABORATORIES (Summers 1976, 1977).

JOINT CENTER FOR URBAN STUDIES OF M.I.T. AND HARVARD UNIVERSITY, Cambridge,
Massachusetts (1974 - 1975).

CHARLES RIVER ASSOCIATES, Cambridge, Massachusetts (Summers 1971, 1972): Research
Assistant.

FIELDS OF SPECIALIZATION

Theoretical and Applied Microeconomics
Industrial Organization
Econometrics
Urban Economics

ACADEMIC HONORS AND FELLOWSHIPS

M.I.T., National Scholar Award, 1968
Edwards Whitacker Award, 1969
Detur Book Prize, 1969
John Harvard Award, 1970
Phi Beta Kappa, 1971
National Science Foundation Fellowship, 1972 - 1975
Recipient of Post-doctoral Grant from the Lincoln Foundation, 1975
National Science Foundation Grant, 1977 - 1985
Recipient of the 1977 P.W.S. Andrews Memorial Prize Essay, best essay in the field of Industrial Organization by a scholar under the age of thirty
Ph.D. Thesis chosen to appear in the Garland Series of Outstanding Dissertations in Economics

PROFESSIONAL AFFILIATIONS AND ACTIVITIES

Co-editor, Journal of Law and Economics, 1980 - present
Associate Editor, Regional Science and Urban Economics, 1987 - 1997
Associate Editor, The International Journal of Industrial Organization, 1991 - 1995
Member, American Economics Association, Econometrics Society
National Bureau of Economic Research, Research Associate
Member, Advisory Committee to the Bureau of the Census, 1987 - 1990
Editorial Board, Intellectual Property Fraud Reporter, 1990 - 1995
Consultant on Merger Guidelines to the U.S. Department of Justice, 1991 - 1992
Accreditation Committee, Graduate School of Business, Stanford University, 1995
Visiting Committee, Massachusetts Institute of Technology, Department of Economics, 1995 - present
Resident Scholar, Board of Governors of the Federal Reserve System, Summer, 1995
Member, Advisory Board, Economics Research Network, 1996 - present
Member, Steering Committee, Social Science Research Council, Program in Applied Economics, 1997 - Present
Participant in meetings with Committee of the Federal Reserve on Payment Systems, June 5, 1997
Participant in round table discussions on "The Role of Classical Market Power in Joint Venture Analysis," before the Federal Trade Commission, November 19, 1997 and March 17, 1998.

BOOKS

"Market Behavior Under Uncertainty," Ph.D. Thesis, Massachusetts Institute of Technology (September 1975); Garland Publishing (1984).

Modern Industrial Organization, Scott, Foresman & Co., co-authored with Jeffrey Perloff, second edition (1994), first edition (1990).

RESEARCH PAPERS

- "The Equilibrium Analysis of Alternative Housing Allowance Payments," (with Joseph Ferreira) Chapter 6 of Analysis of a Direct Housing Allowance Program, The Joint Center for Urban Studies of M.I.T. and Harvard University, (July 1975).
- "Theories of Vertical Integration," presented at Fourth Annual Telecommunications Conference. Appears in a volume of Proceedings of the Fourth Annual Telecommunications Conference, Office of Telecommunications Policy, (April 1976).
- "Uncertainty, Production Lags, and Pricing," American Economic Review, (February 1977).
- "Selecting Subsidy Strategies for Housing Allowance Programs," (with Joseph Ferreira) Journal of Urban Economics, (July 1977).
- "Peak Load Pricing With Stochastic Demand," American Economic Review, (December 1977).
- "The Distribution of Permanent Income," (with Robert Hall) presented at the Symposium on Income Distribution and Economic Inequality, (May 1976). Published in Income Distribution and Economic Inequality, edited by Zvi Griliches, et al. (Halsted Press, 1978).
- "Market Behavior with Demand Uncertainty and Price Inflexibility," American Economic Review, (September 1978).
- "Why New Firms Locate Where They Do: An Econometric Model," in Studies in Regional Economics, edited by W. Wheaton, (Urban Institute, 1980). Presented at the Conference on Regional Economics, sponsored by the Committee on Urban and Public Affairs, Baltimore, Maryland (May 1978).
- "Vertical Integration--An Overview," in Congressional Record Hearings on the Communications Act of 1978. Bill H.R. 13105, (August 3, 1978).
- "Vertical Integration in Competitive Markets Under Uncertainty," Journal of Industrial Economics, (March 1979). Awarded the P.W.S. Memorial Prize for the best essay in the field of Industrial Organization by a scholar under the age of thirty.
- "Valuing Benefits and Costs in Related Output and Input Markets," American Economic Review, (September 1979).
- "Contracts, Price Rigidity and Market Equilibrium," Journal of Political Economy, (October 1979).
- "Benefits and Costs of Airline Mergers: A Case Study," (with W. Landes and R. Posner) Bell Journal of Economics, (Spring 1980).
- "The Limitations of Pigouvian Taxes as a Long Run Remedy for Externalities," (with G. Loury) Quarterly Journal of Economics, (September 1980).
- "The Law and Economics of Rights in Valuable Information: A Comment," Journal of Legal Studies, (December 1980).