

wireless network to reach numerous cities and towns across the United States.⁸⁴ NTT has also invested in Nextel and owns a substantial fiber network in the U.S., which, in turn, is connected with NTT's other network assets around the world.⁸⁵

d. Neither SBC Nor Ameritech Alone Would Incur The Risk And Earnings Dilution Caused By The National-Local And Global Strategy

The National-Local Strategy represents a truly massive undertaking: 30 major markets that cover portions of over 20 states, 8,000 employees, and billions of dollars of new spending. Unsurprisingly, SBC and Ameritech project negative cumulative cash flows and earnings from the project for nearly a decade.⁸⁶

The accompanying Reply Affidavit of Jack Grubman, a senior analyst at Salomon Smith Barney, confirms that neither company alone could suffer the earnings dilution that implementation of the plan will entail.⁸⁷ Our shareholders are mainly conservative individuals and institutions. The investment community measures the performance of companies like SBC and Ameritech on the basis of current earnings and dividends. A unilateral undertaking to "go national" by SBC — an undertaking that would be even larger because it would require entry into even more new markets⁸⁸ — would have an entirely unacceptable impact on the price of its stock.⁸⁹ Only the merger will spread the earnings dilution over a sufficiently large shareholder

⁸⁴ See NTT Monitor, NTT to Invest in Teligent, <http://pr.info.ntt.co.jp/mon/97_nov/97nov1.html> (visited Nov. 13, 1998).

⁸⁵ See NTT Monitor, Overseas Business Activities of NTT, <http://pr.info.ntt.co.jp/mon/96_apr/overseas.html> (visited Nov. 13, 1998).

⁸⁶ Kahan Aff. ¶ 58.

⁸⁷ Grubman Reply Aff. ¶ 7; see also Kahan Reply Aff. ¶ 44.

⁸⁸ Carlton Aff. ¶ 24; Carlton Reply Aff. ¶¶ 20-21, 41-42.

⁸⁹ Grubman Reply Aff. ¶¶ 8-9.

and revenue base to make the undertaking acceptable to our shareholders and the investment community.⁹⁰

Other major telecommunications companies have learned this lesson the hard way. When MCI announced “MCI Metro” in 1994, its stock price plummeted, even while its core long distance business continued to perform well.⁹¹ After GTE announced plans to buy BBN and acquire dark fiber from Qwest, its stock languished by comparison with the RBOCs’ stock. Bell Atlantic’s stock declined significantly after its 1993 attempt to purchase TCI and Liberty Media, and that venture, too, eventually collapsed. The market has made clear that scale, scope, facilities, personnel and — above all — a concrete, prudent, realistic strategic plan — are essential predicates to any undertaking to compete in local markets nationwide.⁹² Even AT&T, which has twice SBC’s revenues, higher profits, more employees, more customers and the most famous brand name in the telecommunications industry, has had to make a series of acquisitions and enter into a major global alliance in order to follow a strategy like the National-Local Strategy.

Commenters argue, nonetheless, that SBC and Ameritech could each finance a national strategy on its own by simply asking the capital markets for cash.⁹³ But the issue has nothing to

⁹⁰ Grubman Reply Aff. ¶¶ 7-8; see also Kahan Aff. ¶ 79; Weller Aff. ¶¶ 34, 36.

⁹¹ See Grubman Reply Aff. ¶ 10.

⁹² In an attempt to appease the concerns of its conservative shareholders regarding the dilution that it would experience as a result of its plans to acquire TCI and make major investments to provide telephone service through TCI’s facilities, AT&T has proposed the creation of two tracking stocks. Grubman Reply Aff. ¶ 10. Nevertheless, as Mr. Grubman explains, AT&T’s stock has suffered, and he does not believe that tracking stocks would be an acceptable mechanism for either SBC or Ameritech alone to execute the National-Local Strategy. Id. ¶ 11.

⁹³ See AT&T at 36-37, Levinson Aff. ¶¶ 2-9; Citizens for a Sound Economy Foundation at 11-12 (but conceding that the “composition of [SBC’s and Ameritech’s] investors may well
(Footnote continued on next page)

do with our ability to raise capital;⁹⁴ it has everything to do with the unacceptable dilution of earnings.⁹⁵ That other small, start-up CLECs can operate on a different financial footing is equally irrelevant.⁹⁶ Those who invest in such companies do so on a quite different basis; with no expectation of current earnings and dividends, they invest in concepts and for long-term growth, and thus accept much higher volatility and risk.⁹⁷ Investors do not value companies of that kind on the basis of current earnings and, in general, they have little or no earnings to

(Footnote continued from previous page)

change” if the Applicants were to pursue the National-Local Strategy individually (emphasis in original)); KMC Telecom at 3; MCI WorldCom at iii, 27-31, Baseman/Kelley Decl. ¶¶ 76-78; McLeodUSA at 5-7; CoreComm Newco at 14-16; Focal Communications at 2, 9; Hyperion Telecomm. at 10; Level 3 Communications at 8-9; Telecomm. Resellers Ass’n at 10. But see Communications Workers of America at 3.

⁹⁴ Kahan Reply Aff. ¶ 39. Sprint also argues that the merger is not necessary because the Applicants have not shown that the costs of switches, unbundled loops or other costs will be significantly higher than they would be if SBC and Ameritech undertook separate expansion programs. Sprint, Besen Decl. at 12-13. Even if the costs were the same, however, the problem is that those costs need to be spread over a larger base of revenues and shareholders than either company now has alone. In any event, as shown elsewhere, see Section II.B below, *infra*, the merger will result in considerable cost savings.

⁹⁵ See Kahan Aff. ¶ 75 (“The problem is not primarily that SBC, on a stand-alone basis, is incapable of raising the capital necessary to fund the National-Local Strategy.”) (emphasis in original). Kahan Reply Aff. ¶ 44; Grubman Reply Aff. ¶¶ 7-8.

⁹⁶ Richard Klugman and Daniel Cummins, Goldman Sachs, Telcos and Long Distance: Telecom’s New World Order at 25 (Apr. 11, 1997) (“Unlike Goliaths [incumbents], Davids [new entrants] aren’t burdened by annual dividend payouts. While AT&T, the RBOCs, and GTE could reduce their combined \$10 billion annual dividends if necessary, they would face harsh criticism from long-standing, income-oriented investors. Davids devote their capital exclusively to capital spending and strategic acquisitions.”) (“Klugman Report”).

⁹⁷ Klugman Report at 35; Grubman Reply Aff. ¶ 9.

dilute.⁹⁸ And, of course, no company of that kind has undertaken anything approaching the scope of the National-Local Strategy that will be undertaken by SBC and Ameritech.⁹⁹

B. The Merger Will Result In Substantial Technology Synergies, Cost Savings And Other Efficiencies

No one seriously doubts that mergers can significantly benefit consumers. The Department of Justice and the Federal Trade Commission recently amended their Merger Guidelines to recognize expressly that “[m]ergers have the potential to generate significant efficiencies by permitting a better utilization of existing assets, enabling the combined firm to achieve lower costs. . . . Indeed, the primary benefit of mergers to the economy is their potential to generate such efficiencies.”¹⁰⁰ This Commission has likewise cited lower prices, improved quality, enhanced service and new products as examples of consumer benefits resulting from merger-specific efficiencies that are relevant to the public interest analysis.¹⁰¹

We have demonstrated that the merger of SBC and Ameritech will realize over \$2.5 billion in benefits from, among other things, the development and marketing of new services, the consolidation of combined functions and the reciprocal application of best practices. SBC realized similar benefits in connection with the Telesis merger. The record clearly establishes — much more clearly than was established by AT&T in its TCG and TCI applications, or by MCI

⁹⁸ Grubman Reply Aff. ¶ 9.

⁹⁹ Nor must CLECs simultaneously open their markets at a cost of billions of dollars, maintain and enhance existing networks and provide high quality service to such large numbers of current customers as do SBC and Ameritech.

¹⁰⁰ Department of Justice and Federal Trade Commission, 1992 Horizontal Merger Guidelines § 4 (as revised April 8, 1997) (“1992 Merger Guidelines”).

¹⁰¹ In re Applications of NYNEX Corp. and Bell Atlantic Corp., Memorandum Opinion and Order, 12 FCC Rcd. 19985, ¶ 158 (1997) (“BA/NYNEX”); see also MCI/WorldCom ¶ 9 n.30.

and WorldCom in their merger application¹⁰² — that the merger will produce concrete and substantial economic benefits.

1. The Prediction Of Efficiencies Is Based On Actual Results Achieved In The Telesis Merger

As the attached Reply Affidavit of Martin Kaplan explains, the prospective efficiencies of the SBC/Ameritech merger have been identified and quantified on the basis of direct experience: SBC's experience in delivering comparable benefits in the Telesis merger.

In the aftermath of that merger, PacBell has rolled out a wide variety of new voice and data services for both residential and business customers — just as SBC promised the Commission it would.¹⁰³ SBC and Telesis combined their respective experience in ADSL services to launch the broadest roll-out of this high-speed Internet access service anywhere in the United States.¹⁰⁴ In California and Nevada, SBC has attractively priced and effectively marketed vertical services, increasing penetration rates by over 42 percent.¹⁰⁵

The cost savings originally anticipated in that merger are being realized ahead of schedule and are on track to surpass pre-merger projections. Mr. Kaplan, who has had overall

¹⁰² See In re Applications of Teleport Communications Group, Inc. for Transfer of Control, AT&T/TCG Reply Comments, CC Docket No. 98-24, at 22 (filed Apr. 27, 1998) (The merger will “result in . . . cost reductions, productivity enhancements, [and] improved incentives for innovation.”); In re Application of WorldCom Inc. and MCI Communications Corp. for Transfer of Control, MCI/WorldCom Joint Reply, CC Docket No. 97-211 at 12 (filed Jan. 26, 1998) (increased scale will result in “opportunities to reduce costs by avoiding expenditures on duplicative activities, greater purchasing power, and the adoption of best practices”) (citing WorldCom SEC Form S-4).

¹⁰³ These services include Caller ID with name delivery, on-demand features such as pay-per-use Three-Way Calling, enhanced internet service, home packs with ISDN/Internet service, managed frame relay service and web hosting. Kahan Aff. ¶ 98.

¹⁰⁴ Kaplan Reply Aff. ¶¶ 22-24.

¹⁰⁵ Kahan Reply Aff. ¶ 34.

responsibility for these integration efforts, explains how SBC identified and implemented cost-saving and revenue-enhancing strategies in over 350 specific areas of the combined company's operations.¹⁰⁶ The SBC/Telesis merger will generate over \$2 billion in total synergies, to the ultimate benefit of consumers and competition.¹⁰⁷

At the same time, and contrary to some of the commenters' assertions, the quality of local telephone service in PacBell's region has unquestionably improved. California customers have seen a 60 percent reduction in repair time and an 80 percent reduction in service installation time. The informal complaint rate on repairs fell more than 50 percent between April 1997 and April 1998.¹⁰⁸

2. The Merger Will Result In Substantial Synergies That Would Not Be Achieved Without the Merger

a. Technology And Product Development Synergies

TRI. Combining their research and development efforts will enable SBC/Ameritech to deliver new and improved telecommunications services to customers faster, more effectively, and at a lower cost. SBC's research and development subsidiary, TRI, has over 300 employees

¹⁰⁶ Kahan Reply Aff. ¶¶ 6-13.

¹⁰⁷ Kahan Reply Aff. ¶ 11. SBC also followed through on its commitment to use its wireless expertise to accelerate the build-out and improve the quality of Pacific Bell Mobile Services' ("PBMS") new wireless service. Management synergy, together with increased investment, has enabled a faster build-out of the PCS network and improvements in network quality and stability through engineering design modifications. Moreover, using SBC's experience in competitive pricing and cost-saving efficiencies (including significant cost savings in procurement), PBMS was able to offer lower rate plans. *Id.* ¶ 15. PBMS was also the first wireless carrier in California to offer a rate plan including all of California and Nevada as a single calling area with no roaming charges. *Id.*

¹⁰⁸ Kaplan Reply Aff. ¶ 41; Gilbert/Harris Reply Aff. ¶¶ 21-22.

and a \$73 million budget.¹⁰⁹ Ameritech has no counterpart to TRI; rather it does some of the research and development internally and outsources a portion of this work. In approving SBC's recent acquisition of SNET, the Connecticut Department of Public Utility Control identified access to TRI as a "major benefit of the merger for Connecticut's residential and business communities," a "material addition" to SNET's ability to commercialize new telecommunications technologies and therefore "critical to the future economic development of this state."¹¹⁰ "Following the Merger, TRI will offer SNET and its customers earlier access to superior products and services and an enhanced telecommunications network,"¹¹¹ the DPUC concluded. There is every reason to expect that the SBC/Ameritech merger will realize similar benefits.¹¹²

New Technologies. The merger will permit SBC and Ameritech to compound the benefits of a number of efficiency-enhancing technologies. SBC, for example, is developing a product to use the Global Positioning System ("GPS") satellite network to monitor the location of repair trucks, improve utilization, enhance driver productivity and improve safety.¹¹³ No other telephone company has deployed similar technology. Similarly, Ameritech has recently

¹⁰⁹ See Kaplan Reply Aff. ¶ 20; SBC Technology Resources, Inc., About TRI, available at <http://www.tri.sbc.com/About_TRI.html> (visited Nov. 12, 1998).

¹¹⁰ In re Joint Application of SBC Communications Inc. and Southern New England Telecommunications Corp. for a Change of Control, Decision, Docket No. 98-02-20, at 41 (Sept. 2, 1998) (emphasis added) ("Connecticut DPUC SBC/SNET Decision"). The FCC also noted this finding in its Order approving the merger. See In re Applications for Consent to the Transfer of Control of Licenses and Authorizations from Southern New England Telecommunications Corp. to SBC Communications, Inc., Memorandum Opinion and Order, CC Docket No. 98-25, FCC 98-276, 1998 WL 740632, ¶ 45 (1998) ("SBC/SNET").

¹¹¹ Connecticut DPUC SBC/SNET Decision, at 65.

¹¹² See Carlton Reply Aff. ¶¶ 108-10; Gilbert/Harris Reply Aff. ¶¶ 45-55.

¹¹³ See Kaplan Reply Aff. ¶ 21; Carlton Reply Aff. ¶ 117.

launched a new service, “Ameritech Privacy Manager,” which allows customers to screen out unwanted telephone calls. This service can be made available to SBC’s customers as well.¹¹⁴

ADSL. SBC has advanced further in its deployment of ADSL services than any other incumbent local telephone company, in large part because the SBC/Telesis merger combined TRI’s expertise in “telecommuting” and other ADSL technical applications with Telesis’ expertise in working with ISPs and DSL management system technology.¹¹⁵ Southwestern Bell began an ADSL market trial in Austin, Texas in September 1997;¹¹⁶ since July 1998 the primary focus of the company’s ADSL effort has been a large-scale deployment in 87 PacBell offices that serve approximately 4.4 million households and 650,000 business customers.¹¹⁷ That initiative has given SBC valuable experience in the effective marketing, provisioning and pricing of ADSL services. Ameritech has developed its own ADSL service too, but has had only a

¹¹⁴ See Carlton Reply Aff. ¶ 117.

¹¹⁵ SBC’s proprietary DSL management system, which was developed by Telesis, is an application that receives and coordinates service requests, provisions ADSL virtual and physical components, and distributes provisioning information. The system provides support to multiple organizations within the company and other external companies that perform different functions to process requests for ADSL service. See Kaplan Reply Aff. ¶ 22.

¹¹⁶ Beginning in September 1997, SBC deployed ADSL to four central offices in Austin, Texas in a market trial that has been extended through April 1999. SBC plans to deploy ADSL in the first through third quarters of 1999 to all 271 central offices in Texas, Arkansas, Missouri, Kansas and Oklahoma. See Kaplan Reply Aff. ¶ 24.

¹¹⁷ See SBC Press Release, SBC Communications Announces Broad ADSL Deployment Across California (May 27, 1998), available at <http://www.sbc.com/News/Article.html?query_type=article&query=19980527-02> (visited Nov. 4, 1998); Kaplan Reply Aff. ¶ 23; Carlton Reply Aff. ¶ 114.

limited roll-out.¹¹⁸ The merger will enable Ameritech to use the experience of SBC's California initiative to accelerate deployment, reduce costs, and improve efficiency and service quality.¹¹⁹

It comes as no surprise that Sprint is the company that would most like to thwart these particular benefits of the merger. Sprint has announced plans to roll out its own high-speed, digital network (ION) nationwide. But Sprint's affiants make clear that ION is still in the rudimentary stages of development, lacking both a billing system and critical network software.¹²⁰ With its engineers far from ready to deliver a service of their own, Sprint instead complains that SBC and Ameritech lack incentives to innovate, and — at the same time — that they are merging so as to thwart competition in the market for innovation.¹²¹ But as a price-capped company facing rapidly escalating levels of competition, SBC/Ameritech will have abundant incentive to innovate. Amid the many sources of innovation in the telecommunications industry, the merger of SBC and Ameritech cannot possibly have any adverse impact on competition in the rapidly expanding market for telecommunications innovation.¹²²

¹¹⁸ See Carlton Reply Aff. ¶ 115.

¹¹⁹ Kaplan Reply Aff. ¶ 25; Carlton Reply Aff. ¶¶ 111-16. As noted by AT&T's chief technology officer, in the competition for high-speed digital communications, the "advantages are not going to be that we have technology that no one else has"; instead, "the market is going to be won by better understanding the customer and getting services in the right places." Scott Thurm, Keeping the Customer Satisfied, Wall St. J., Sept. 21, 1998, at R-24 (quoting David Nagel of AT&T).

¹²⁰ Sprint, Agee Aff. at 7-8.

¹²¹ Sprint at 64-65.

¹²² Gilbert/Harris Reply Aff. ¶ 43-45.

b. Cost Savings And Capital Expenditures

By 2003, as we have demonstrated earlier, the SBC/Ameritech merger will result in expense savings of \$1.17 billion and reductions in capital costs of \$260 million.¹²³ These projections are based on actual results achieved in the SBC/Telesis merger. They reflect SBC's real-world experience in eliminating duplication and aggressively extending "best practices" company-wide.¹²⁴

Comments suggesting that "best practices" would be shared anyway, absent the merger, are absurd. Independent companies do not share their best practices with each other.¹²⁵ Even if they did, effective implementation of such practices requires unified management. "Best practices" are identified only by systematically and aggressively comparing one way of doing business with another. That inevitably happens when two companies in similar lines of business merge their operations; it can rarely happen otherwise. It happened after SBC merged with Telesis. Hundreds of ideas were shared and combined, and the upshot was costs lowered by over \$1 billion per year.¹²⁶

c. Procurement Savings

The merger will also permit SBC/Ameritech to save a great deal on procurement, as experience in the Telesis merger again confirms. SBC/Telesis has successfully renegotiated

¹²³ Public Interest Statement at 38. These cost savings break down as follows: \$381 million in procurement savings, \$201 million in administrative (headquarters) costs, \$390 million in support functions, \$313 million in telco operations, and \$146 million in other lines of business (Internet, Yellow Pages, Wireless, Long Distance and International). Kaplan Aff. ¶¶ 17, 20-25.

¹²⁴ Carlton Reply Aff. ¶¶ 92-97. See also Gilbert/Harris Reply Aff. ¶¶ 19-21, 23-29.

¹²⁵ Carlton Reply Aff. ¶¶ 88-91; Gilbert/Harris Reply Aff. ¶¶ 25-26.

¹²⁶ Kaplan Reply Aff. ¶ 30; Carlton Reply Aff. ¶¶ 95-97.

hundreds of existing agreements, and saved hundreds of millions of dollars as a result.¹²⁷ The cost of providing service has fallen commensurately.¹²⁸

Some commenters argue that SBC and Ameritech could realize similar results by participating in buying consortia.¹²⁹ SBC has in fact participated in a number of buying consortia, but has learned that any cost savings extracted from vendors are dissipated by the new cost of negotiating with the consortium.¹³⁰ Moreover, purchasing requirements for the R&D and innovation efforts that result in differentiated products must be filled privately to maintain confidentiality. The procurement of equipment for the implementation of our National-Local Strategy cannot possibly occur through consortia because other members would have to be actual or potential competitors. In any event, buying by consortium is practical only when the buyers are purchasing identical, commodity-like products. It is not useful or feasible for the purchase of the big-ticket customized products that major telecom carriers typically use.

d. Delivery Of Services Valued By Customers

In approving SBC's merger with SNET, the Connecticut DPUC characterized SBC as "an international leader in the development and marketing of new telecommunications services"¹³¹ SBC currently leads the industry with a penetration rate of 2.45 vertical

¹²⁷ For example, SBC was able to negotiate the discount on an existing contract from one that provided SBC with a 30% discount, to one that gave the merged firm a 42% discount, resulting in a total savings of \$8.6 million. The renegotiation of another contract resulted in a 3 percent savings for SBC and a 20% savings for Telesis, representing savings in excess of \$6 million. Kaplan Reply Aff. ¶ 36.

¹²⁸ Kahan Reply Aff. ¶ 36; see also Carlton Reply Aff. ¶ 97 (detailing savings).

¹²⁹ See, e.g., Sprint, Besen Decl. at 37.

¹³⁰ Kaplan Reply Aff. ¶¶ 37-38.

¹³¹ Connecticut DPUC SBC/SNET Decision at 42.

features per access line.¹³² Bringing this same expertise to Ameritech's region will yield over \$430 million from increased sales of vertical services and second lines.¹³³

Contrary to the allegations of certain commenters, SBC's packaging of these services typically lowers prices for customers. Prior to the SBC/Telesis merger, for example, PacBell offered a few packages of two to four vertical services at a 10 percent discount. At SBC's instigation, PacBell began offering two new packages at higher discounts after the merger.¹³⁴ The merger will extend similar benefits to Ameritech's customers, and the new SBC/Ameritech will realize similar revenue increases.¹³⁵

III. COMPETITIVE EFFECTS OF THE MERGER

We have shown that the SBC/Ameritech merger will produce numerous competitive and other public benefits with no adverse competitive effects in any relevant market. In this section we address the principal competition-related claims by our opponents, and in the last two appendices (A and B) to this Reply we address various allegations regarding the Applicants which, in any event, pertain to matters completely unrelated to this merger.

¹³² Public Interest Statement at 47; Kaplan Aff. ¶ 8.

¹³³ Kaplan Aff. ¶¶ 8-10. In addition, as explained in Mr. Kaplan's initial affidavit, SBC estimates another \$233 million in expected sales growth from Centrex, data services, directory publishing and wireless business. *Id.* ¶¶ 11-14; see also Carlton Reply Aff. ¶¶ 98-100.

¹³⁴ The "Basics" package provides customers a 22% discount on a package of four features, and the "Works" package offers customers a 54% discount on a package of ten features. PacBell customers who elect to purchase one of these packages of services may do so at a substantial discount off the pre-merger prices. Kaplan Reply Aff. ¶ 34.

¹³⁵ Gilbert/Harris Reply Aff. ¶ 19.

A. The Merger Will Not Substantially Lessen Actual Or Potential Competition

Apart from cellular overlaps that must and will be resolved in accordance with the Commission's Rules, there is no significant actual competition between SBC and Ameritech. As to that point, there is no genuine dispute. Our opponents focus on potential competition instead. They argue that Ameritech and SBC should be considered "most significant market participants" in some or all of each other's markets,¹³⁶ particularly the "mass market" for local exchange and exchange access services.¹³⁷

Some of the opponents suggest that every RBOC is a significant likely competitor of every other RBOC, everywhere and always.¹³⁸ The Commission has made it clear, however, that "local exchange service" is indeed geographically local.¹³⁹ The Commission has already rejected the notion that all RBOCs are automatically most significant market participants in the territories of other RBOCs.¹⁴⁰

¹³⁶ See, e.g., Sprint at 11-20; Swidler Group (Hyperion Telecomm. at 26-30; Focal Communications at 12-15; Level 3 Communications at 27-34); AT&T at 22, 24-27.

¹³⁷ BA/NYNEX ¶ 70; In re Applications of Teleport Communications Group and AT&T Corp., Memorandum Opinion and Order, CC Docket No. 98-24, FCC 98-169, 1998 WL 413204, ¶ 33 (1998) ("AT&T/TCG").

¹³⁸ Consumer Federation of America/Consumers Union at 3-7; Texas Office of Public Utility Counsel at 6-7.

¹³⁹ See, e.g., BA/NYNEX ¶¶ 54-57; AT&T/TCG ¶ 21; MCI/WorldCom ¶ 166. Texas Office of Public Utility Counsel's argument that the relevant market is becoming a national one, Texas Office of Public Utility Counsel at 6, if accepted, would support the Applicants' contention that the merger will stimulate competition on a national and global basis. Texas Office of Public Utility Counsel's alternative argument that the relevant market is "the combined serving areas of SBC and Ameritech, with the exception, perhaps, of more rural areas," id., is not supported by any comprehensible analysis and is simply blatant gerrymandering.

¹⁴⁰ BA/NYNEX ¶ 93; see also In re Applications of Pacific Telesis Group and SBC Communications Inc., Memorandum Opinion and Order, 12 FCC Rcd. 2624, ¶¶ 19-28 (1997) ("SBC/Telesis").

As to the more specific allegations of potential competition,¹⁴¹ the controlling facts are not in serious dispute. First, SBC and Ameritech both explored the possibility of competing in each other's region — and both rejected that idea, each concluding that it would start at a significant disadvantage to the major IXCs and other CLECs. Second, neither SBC nor Ameritech has advantages that make it a “most significant” entrant in the other's markets. Third, numerous other firms are at least equally qualified and more likely to enter.

Determining whether a firm is a future competitor in a market, let alone a significant future competitor, is a difficult predictive exercise, highly prone to error. The Federal Trade Commission and most courts that have weighed potential competition arguments have accordingly insisted on clear proof that entry was in fact likely.¹⁴² As the FTC has held, failing to credit a company's decision to reject entry into a market “would place the Commission in the undesirable position of substituting its business acumen for that of the acquiring firm, and of ignoring the apparent conclusion of the acquiring firm at the time of the acquisition that both the acquisition and other alternative investments would be more profitable and otherwise more sensible than independent entry.”¹⁴³

¹⁴¹ See, e.g., AT&T at 22, 27; Consumer Coalition at 14-15; Sprint at 11-20; Swidler Group (Hyperion Telecomm. at 26-34, Focal Communications at 12-16, Level 3 Communications at 27-35).

¹⁴² FTC v. Atlantic Richfield Co., 549 F.2d 289, 294 (4th Cir. 1977); B.A.T Industries, 104 F.T.C. 852, 926 (1984); see also Tenneco Inc. v. FTC, 689 F.2d 346, 353-54 (2d Cir. 1982) (despite evidence of Tenneco's interest and incentive to enter market and consideration of entry, FTC's finding that entry was likely based on unsupported speculation); Areeda & Hovenkamp, Antitrust Law 819 (1996 Supp.) (describing trend to place more weight on evidence of actual plans and intentions).

¹⁴³ B.A.T., 104 F.T.C. at 928.

1. **Ameritech Is Not A “Most Significant Market Participant” In SBC’s Markets**

a. **St. Louis**

The affidavit of Paul G. Osland, submitted with the Public Interest Statement, demonstrated that Ameritech Cellular’s “Project Gateway” in St. Louis was intended to be very limited and entirely defensive. Its purpose was to enable Ameritech Cellular to offer its residential cellular subscribers in St. Louis a bundled offering of local exchange, long-distance, and wireless service to forestall the loss of these customers to the anticipated bundled offerings of Ameritech’s wireless competitors. Several commenters still argue that Ameritech should be considered a most significant market participant in St. Louis.¹⁴⁴ But they fail to refute the showing we have already made that Ameritech’s actual plans for Project Gateway at the time of its agreement to merge with SBC contemplated only a limited, unproven, resale offering to Ameritech’s existing cellular customers.

Sprint’s selective and out-of-context quotations of boilerplate language from several regulatory documents and press statements made in connection with Ameritech’s general consideration of out-of-region expansion or its promotion of Project Gateway itself do not undermine the fundamental facts set forth by Mr. Osland. For example, the fact that Ameritech’s subsidiary, Ameritech Communications International, Inc. (“ACII”), filed a Missouri CLEC application in May 1996, almost a year before Project Gateway was even proposed by Ameritech’s cellular business unit, does not contradict the fact that Ameritech’s ultimate actual

¹⁴⁴ See Sprint at 11-17; Hyperion Telecomm. at 26-30; Focal Communications at 12-15; Level 3 Communications at 27-31; AT&T at 25-27.

consideration of entry was exclusively cellular-based.¹⁴⁵ Furthermore, when the Missouri Public Service Commission (“MPSC”) granted ACII’s amended application for CLEC certification on February 28, 1997, its order clearly indicated that ACII would operate as a reseller.¹⁴⁶ That the MPSC understood that ACII would provide local exchange service via resale and not on a facilities basis is reiterated in the MPSC’s December 1997 decision approving ACII’s tariff.¹⁴⁷ These early efforts to obtain CLEC authority in Missouri are in no way inconsistent with Mr. Osland’s Affidavit regarding the origins of Project Gateway, which devolved to Ameritech Cellular after other Ameritech business units lost interest in potential out-of-region activities. As discussed below, ACII abandoned its plans in St. Louis and never separately provided any service in St. Louis pursuant to this certification. Ameritech Cellular decided to use the

¹⁴⁵ Most Ameritech state CLEC certifications were obtained by ACII. Indeed, ACII filed for long distance resale authority in all out-of-region states and for local resale authority in a number of other states including, for example, Georgia, Florida, Colorado, Kentucky, New York and North Carolina. See Notice of Ex Parte Presentation from Antoinette Cook Bush, Counsel for Ameritech, to Magalie Roman Salas, Secretary, Federal Communications Commission (Oct. 13, 1998) (submitted in CC Docket No. 98-141).

¹⁴⁶ “Ameritech cannot price its resold services until it has reached price agreements with the ILECs from which it will purchase those services.” In re Application of Ameritech Communications International, Inc., for a Certificate of Local Exchange Service Authority to Provide and/or Resell Basic Local Telecommunications Service and Local Exchange Telecommunications Service, Report and Order, Case No. TA-96-415 at 6 (Mo. Pub. Serv. Comm’n Feb. 28, 1997) (emphasis added), available at <<http://www.ecodev.state.mo.us/psc>> (visited Nov. 13, 1998). Contrary to Sprint’s assertions, the tariff application simply noted on the title sheet that “[a]t such time as Carrier provides facilities-based service, Carrier will file an access tariff.” Nowhere in its tariff P.S.C. Mo. No. 2 did Ameritech indicate it was providing or would provide facilities-based service. Neither ACII nor Ameritech Cellular ever filed an access tariff to provide facilities-based service.

¹⁴⁷ “At the present time, ACII intends to offer services by resale, only.” In re Application of Ameritech Communications International, Inc., for a Certificate of Local Exchange Service Authority to Provide and/or Resell Basic Local Telecommunications Service and Local Exchange Telecommunications Service, Order Approving Tariff, Case No. TA-96-415 (Mo. Pub. Serv. Comm’n Dec. 3, 1997), available at <<http://www.ecodev.state.mo.us/psc>> (visited Nov. 13, 1998).

certification to provide resold local service to its residential cellular customers.¹⁴⁸ There is no evidence that Ameritech intended to provide facilities-based local service in St. Louis, because Ameritech never had any such intent.¹⁴⁹

Likewise, contrary to Sprint's allegations,¹⁵⁰ Ameritech's statements that "Project Gateway" was conceived in early 1997 are in no way inconsistent with ACII's efforts to obtain state certifications for competitive local and interexchange services in Missouri. Throughout 1996 — and particularly after the passage of the 1996 Act — officials responsible for Ameritech's overall corporate strategy looked at possible expansion opportunities in a number of areas outside Ameritech's service areas. By early 1997, however, the internal strategic analysis

¹⁴⁸ While ACII's interconnection agreement with SWBT provided for interconnection arrangements as a reseller, as a facilities-based provider, or as a mixed-mode provider combining resale and facilities-based offerings, that is because ACII exercised its right to adopt ("MFN") the terms and conditions of the interconnection agreement previously negotiated between Brooks Fiber and SWBT (and approved by the Missouri Public Service Commission) which incorporated such terms. See In re Joint Application of Ameritech Communications International, Inc., and Southwestern Bell Telephone Company for Approval of Interconnection Agreement under the Telecommunications Act of 1996, Order Approving Interconnection and Resale Agreement, Case No. TO-98-61 (Mo. Publ. Serv. Comm'n Nov. 4, 1997) (Staff noted that the terms of this agreement are similar to terms of other agreements previously approved by the Commission).

¹⁴⁹ The public relations statements made by Ameritech officials and cited by opponents (e.g., Sprint at 16; AT&T at 26) are not inconsistent with this evidence. In fact, the Ameritech press release issued to announce the Project Gateway initiative clearly stated the company's limited, cellular-focused, bundling strategy: "Pending commission approval, the company plans to begin marketing packages of local, long distance and cellular phone service in the St. Louis area in early 1998." See Ameritech Press Release, Ameritech to Expand in St. Louis (Nov. 6, 1997) (emphasis added), available at <<http://www.ameritech.com/media/releases/release-1254.html>> (visited Nov. 13, 1998). Moreover, none of the press comments made by Ameritech officials, intended to create a promotional lift for Project Gateway, contained any reference to facilities-based service. Indeed, the Osland Affidavit shows that as Ameritech Cellular proceeded with the planning and preliminary testing for Project Gateway, far from expanding its limited objective, it scaled back the scope of its effort and also became more aware of the uncertainties and risks of the plan. Osland Aff. ¶¶ 6, 8-9.

¹⁵⁰ See Sprint at 15.

of Ameritech's opportunities for entry as a stand-alone CLEC, with or without long distance, had been abandoned as a corporate initiative.

As the Osland Affidavit shows, in early 1997 Ameritech Cellular perceived that other wireless competitors in St. Louis were planning to implement a bundling strategy that would add local and long distance, and perhaps other services to their wireless offering.¹⁵¹ Ameritech Cellular concluded that it had to provide a similar offering, and that it could achieve that goal more efficiently by using the existing ACII authorization for Missouri. All of this undisputed background is completely consistent with the demonstration made previously to the Commission.¹⁵² Project Gateway was a defensive strategy created to respond to that anticipated competition by offering a bundled cellular/local exchange/long distance offering in St. Louis.

Moreover, the record also is clear that there are numerous other market participants in St. Louis at least as, if not more significant than, Ameritech.¹⁵³ In contrast to Ameritech, several CLECs, including AT&T/TCG and MCI WorldCom, already have wireline facilities in place and are serving customers in St. Louis.¹⁵⁴ Through its TCI acquisition and its prior acquisition of

¹⁵¹ See Public Interest Statement at 70-71; Notice of Ex Parte Presentation from Antoinette Cook Bush, Counsel for Ameritech, to Magalie Roman Salas, Secretary, Federal Communications Commission (Sept. 14, 1998) (submitted in CC Docket No. 98-141) ("Ameritech Sept. 14, 1998, Ex Parte Letter").

¹⁵² See Public Interest Statement at 70; Ameritech September 14, 1998 Ex Parte Letter.

¹⁵³ See Schmalensee/Taylor Reply Aff. ¶¶ 6-13. See generally BA/NYNEX ¶ 65 ("it is particularly relevant to identify which competitors, other than the merging parties, are likely to be as significant a competitor as the lesser of the merging parties").

¹⁵⁴ Eight different CLECs are already reselling SBC local service in St. Louis: Birch Telecom, Fast Connections, Frontier, Intermedia, Max-Tel Communications, MCI WorldCom, Midwestern Tel, and Omniplex. Public Interest Statement at Table 5. Both AT&T/TCG/TCI and MCI/WorldCom/MFS/Brooks/UUNet have large customer bases and actual CLEC facilities in St. Louis. See id. at Table 11. Similar, though smaller, networks are operated by carriers such as Intermedia. Together competitors have deployed some 673 route miles in the St. Louis LATA. See New Paradigm Resources Group and Connecticut Research, 1998 CLEC Report: Annual

(Footnote continued on next page)

TCG, AT&T has confirmed that it in fact intends aggressively to enter the local service market in St. Louis as well as in other major metropolitan areas. Indeed, in the Public Interest Showing filed in connection with their proposed merger, AT&T and TCI proclaimed that the merger “will expand and accelerate AT&T’s ability to compete with ILECs in providing local telephone service to residential customers” and “will provide AT&T with vital access to TCI’s cable facilities thereby benefiting consumers currently depending on ILECs for local service.”¹⁵⁵

Based on these undisputed facts, the record here pales in comparison with the evidence in BA/NYNEX, which established that Bell Atlantic planned to compete in NYNEX’s region as a facilities-based local exchange provider. In contrast to Ameritech’s plans simply to protect its residential cellular base in St. Louis with a bundled resale local service option, the Commission found that Bell Atlantic was poised to enter the “mass market” for local exchange service.¹⁵⁶ In addition, Bell Atlantic’s planned entry was not confined to only one medium-sized city, but instead contemplated a competitive invasion of a “number of locations in the NYNEX region.”¹⁵⁷

(Footnote continued from previous page)

Report on Local Telecommunications Competition (9th ed. 1998); Teleport Communications Group, TCG Facts, <<http://www.tcg.com/tcg/aboutTCG/TCGfacts.html>> (visited Nov. 12, 1998). Further, another potential local exchange competitor will be created when either SBC’s or Ameritech’s wireless business in St. Louis is divested.

¹⁵⁵ AT&T/TCI Application for Transfer of Control, Public Interest Showing at 14. The Public Interest Showing further stated that “AT&T and TCI anticipate combining their assets to invest in and develop advanced wireline facilities that will compete directly with ILECs to provide toll-quality voice and high-speed data communications to America’s homes.” *Id.* at 20. Specifically, AT&T projected that TCI would contribute its residential wireline network and architecture that serves approximately 12.7 million homes through TCI-controlled cable systems while AT&T would contribute its experience in providing toll-quality voice and data traffic, switching technology, a brand name that can compete with local telephone companies and capital to cover the significant costs of the upgrade of TCI’s facilities.” *Id.*

¹⁵⁶ BA/NYNEX ¶ 73.

¹⁵⁷ BA/NYNEX ¶ 73.

Finally, in contrast to Bell Atlantic's longstanding presence and name recognition in the New York area, Ameritech has only used its name in St. Louis for four years and only in connection with its wireless service. Prior to 1994, Ameritech used the CyberTel name for its wireless operations in St. Louis and had little or no name recognition among potential subscribers.¹⁵⁸ Moreover, while Ameritech's brand awareness may have grown over the last four years, that has been entirely as a cellular provider and any purchaser of the Ameritech (or SBC) wireless business in St. Louis could also readily build brand awareness, if its brand were not already familiar to St. Louis consumers. And, of course, AT&T, Sprint and MCI, which are all competing and have thousands of customers in St. Louis, have long-established and formidable brand names, as strong as, if not stronger than, Ameritech. Thus, under the Commission's existing standards, Ameritech cannot be considered a most significant market participant in the St. Louis local exchange market.¹⁵⁹

b. Other SBC Markets

With regard to markets other than St. Louis, the commenters make only broad and general claims that Ameritech is a potential competitor of SBC.¹⁶⁰ A few commenters allege that Ameritech's certification as a competitive local exchange carrier in California and Texas shows that Ameritech intended to be or could have been a most significant market participant in those states.¹⁶¹ Hundreds of firms, including ILEC affiliates, IXCs and others, are certificated and

¹⁵⁸ Schmalensee/Taylor Reply Aff. ¶ 19.

¹⁵⁹ See Schmalensee/Taylor Reply Aff. ¶¶ 16-19.

¹⁶⁰ See, e.g., AT&T at 22-25, 27; e.spire Communications at 8-9; MCI WorldCom at 26-35.

¹⁶¹ See Sprint at 18-19; Level 3 Communications at 31-33; MCI WorldCom at 33; Hyperion Telecomm. at 30-31; Texas Office of Public Utility Counsel at 7-8.

have interconnection agreements in SBC's states.¹⁶² The Commission has concluded that evidence of certification alone, however, is insufficient to make a firm a most significant market participant.¹⁶³ The Commission has also declined to label non-adjacent ILECs, as a class, to be most significant market participants,¹⁶⁴ and nothing in the record suggests a different conclusion in the case of Ameritech (or SBC). In the absence of any evidence that Ameritech had or has clear plans to compete significantly in these markets and that it had significant advantages in doing so not shared by numerous others, there is no basis for finding Ameritech to be a most significant participant in SBC's markets.

2. SBC Is Not A "Most Significant Market Participant" In Ameritech's Markets

The Applications demonstrated that SBC had no plans and had taken no steps to enter any local exchange market in which Ameritech is the ILEC, and would have no significant advantages in doing so. Nevertheless, commenters contend that SBC should be deemed a most significant market participant in Ameritech's markets.¹⁶⁵ For the most part, these general claims simply reassert that every large ILEC is a potential competitor of every other one.¹⁶⁶ Once again, such claims have no merit and have already been rejected by the Commission.

¹⁶² For example, 198 carriers have been certified as CLECs in Texas, and 139 in California. Number of State-Certified CLECs Triples in Year, Communications Daily, Sept. 10, 1998, available at 1998 WL 10697244. Further, state regulators have approved hundreds of interconnection agreements with SBC and Ameritech. Number of CLECs Exceeds Total Incumbent Telcos, Communications Daily, Sept. 22, 1998, available at 1998 WL 10697333.

¹⁶³ BA/NYNEX ¶ 81. See Carlton Reply Aff. ¶¶ 35, 37.

¹⁶⁴ BA/NYNEX ¶ 93.

¹⁶⁵ See, e.g., AT&T at 22; e.spire at 8; Telecomm. Resellers Ass'n at 6-7.

¹⁶⁶ See, e.g., Consumer Federation of America/Consumers Union at 20-21, AT&T at 22-23; MCI WorldCom, Baseman/Kelley Decl. ¶¶ 31-32; Texas Office of Public Utility Counsel, Shepherd Aff. at 25-26.

Other commenters suggest that because SBC has a cellular presence in Chicago, it should be considered a most significant market participant there.¹⁶⁷ In the Applications and the accompanying affidavit of Stan Sigman, we demonstrated that SBC had never formulated any plans to provide local exchange services in Chicago, and that following its unsuccessful efforts to use its cellular base in Rochester to market local exchange service it decided not to pursue any other such efforts.¹⁶⁸ These facts are undisputed, and there is no evidence from which the Commission could find SBC to be a most significant participant in Chicago or any of Ameritech's other local exchange markets.¹⁶⁹

B. The Merger Will Not Impede The FCC's Ability To Regulate

Sprint, AT&T and MCI WorldCom argue that the merger should not be approved because it will reduce the number of RBOC benchmarks available to the Commission.¹⁷⁰ This argument greatly exaggerates the importance of RBOC-to-RBOC benchmarks in the new era of competition. Strong, experienced competitors who expend considerable resources in monitoring ILEC performance are entering the local exchange business. These competitors will

¹⁶⁷ See Consumer Coalition, Baldwin/Golding Aff. ¶¶ 46-51; Hyperion Telecomm. at 32; Level 3 Communications at 33-34; Telecomm. Resellers Ass'n at 8 n.24.

¹⁶⁸ Sigman Aff. passim.

¹⁶⁹ See Carlton Reply Aff. ¶¶ 35, 37. Consumer Coalition affiants Baldwin and Golding cite Mr. Kahan's testimony in October 1996 suggesting that Chicago is a market where he thought it would make sense for SBC to enter the local exchange market using its cellular base as a platform. Consumer Coalition, Baldwin/Golding Aff. ¶¶ 46-47; see also Sprint at 19-20 (quoting August 1996 report of Dr. Gilbert). Mr. Kahan's 1996 testimony is consistent with the chronology set forth in Mr. Sigman's affidavit: SBC considered local entry in several out-of-region cellular markets, selected Rochester as a pilot project in early 1997 and abandoned all such plans when the Rochester experiment failed. See Sigman Aff. ¶¶ 5-17; Gilbert/Harris Reply Aff. ¶ 11; see also BA/NYNEX ¶ 90 (wireless carriers not considered significant market participants in mass market for local exchange services).

¹⁷⁰ See Sprint at 32-41; AT&T at 28-31; MCI WorldCom at 17-23.

simultaneously add to the information available to regulators while diminishing — indeed, ultimately eliminating — the need for such comparisons.

The most significant regulatory priority of the post-1996 Act era is the effective implementation of the Act's interconnection process for the exchange of traffic among competitors. And the final objective is, of course, not better regulation but full competition in local markets across the country. The merger will in no way retard the attainment of that objective in the 13 states where SBC and Ameritech are the incumbents and, in over 20 other states, the merger will immediately accelerate it, by adding SBC/Ameritech to the ranks of major, facilities-based competitors negotiating for interconnection from the CLEC side of the table.

Nationwide, thousands of Section 251 interconnection agreements have already been signed; hundreds more are under negotiation. Each interconnection agreement must meet the approval of a CLEC, an ILEC and the regulatory agency of the state in which the agreement takes effect. All agreements are made public upon filing or approval. Many are posted on PUC, public research and ILEC Web sites.¹⁷¹ Each individual agreement contains, *inter alia*, performance standards along with “a detailed schedule of itemized charges for interconnection and each service or network element included in the agreement.”¹⁷² Thus, state and federal regulators now have access to quantitative counts of collocation arrangements and data on

¹⁷¹ For example, the National Regulatory Research Institute established by Ohio State University has over 160 PUC decisions (from 47 states) on arbitrated interconnection agreements. See <<http://www.nrri.ohio-state.edu/interconnect.html>> (visited Nov. 13, 1998).

¹⁷² 47 U.S.C. § 252(a)(i).

average installation and repair times, OSS performance and many other measurements, allowing them to evaluate interconnection performance.

The ILEC that signs an interconnection agreement is the operating company in that state — the individual BOC, GTOC, or Sprint operating company, for example — not its parent holding company. Many of the commenters simply overlook or seek to minimize this fundamental regulatory fact.¹⁷³ Yet the Commission itself has emphasized that having a common owner does not transform independent operating companies into a common company. The Commission has recently noted, for example, that, “although Nevada and Pacific both are owned by Pacific Telesis Group, the two operating companies have separate and very different tariffs, and are treated separately in this Order.”¹⁷⁴ Though Sprint’s own experts make no mention of it, the Commission made the same observation about United and Central, both owned by Sprint.¹⁷⁵ The joint ownership of various operating companies also did not impede the Commission’s regulatory analysis in a more recent case Sprint cites, involving the penetration

¹⁷³ See Schmalensee/Taylor Reply Aff. ¶¶ 54-58, 62, 82. Sprint’s economists purport to show that a reduction in regulatory effectiveness will result from any reduction in the number of separately owned ILECs, based on a hypothetical decrease in variation among carriers, a hypothetical decrease in the Commission’s confidence in its own analyses, and a hypothetical decrease in the incentive of a merged firm to improve its own productivity. Sprint, Farrell/Mitchell Decl. at 10-13, 27-35, 38-40. As the reply affidavit of Drs. Schmalensee and Taylor explains, Farrell & Mitchell’s conclusions are speculative and unquantified, and they have failed to demonstrate that this merger will result in any regulatory costs, much less given the Commission any guidance as to the magnitude of these costs. Schmalensee/Taylor Reply Aff. ¶¶ 52-53, 62-72. Moreover, Farrell & Mitchell’s analysis ignores the increasing number and quality of benchmarks available to the Commission. See *id.* ¶¶ 54-63.

¹⁷⁴ In re Local Exchange Carriers’ Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport, Second Report and Order, 12 FCC Rcd. 18730, ¶ 3 n.5 (1997) (“Physical Collocation Second Report and Order”).

¹⁷⁵ Physical Collocation Second Report and Order 12 FCC Rcd. 18730 at ¶ 3 n.6.

rates of non-primary lines.¹⁷⁶ There, the Commission referred to an average penetration rate developed on the basis of data from each of 15 price cap LECs, including separate data from separate operating units of RBOC holding companies — from Bell Atlantic-North and Bell Atlantic-South, and from Southwestern Bell, Pacific Bell and Nevada Bell.¹⁷⁷

After the merger, each of the nine SBC and Ameritech operating companies will report all the same information to the same regulators as they do now.¹⁷⁸ Both state and federal regulators will still compare and contrast performance at the operating company or state level. The Commission relies heavily on data contained in the Automated Reporting Management Information System (ARMIS) reports¹⁷⁹ filed by the largest carriers for a variety of regulatory

¹⁷⁶ See Sprint, Farrell/Mitchell Decl. at 26-27.

¹⁷⁷ In re 1988 Annual Access Tariff Filings: Southwestern Bell Telephone Company Revisions to Tariff F.C.C. No. 73, Memorandum Opinion and Order, Order Designating Issues for Investigation and Order or Reconsideration, 13 FCC Rcd. 13977, ¶ 9 (1998).

¹⁷⁸ Moreover, the Commission ultimately relies on its own close analysis of carriers' data filings in reaching regulatory decisions. For example, in In re Telephone Number Portability, First Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd. 7236 (1997), the Commission concluded that interim number portability could be provided through the use of the Location Routing Number ("LRN") method. That decision was driven by the requirements of the statute, but the Commission also evaluated the economic arguments and projected cost data presented by various ILECs, as analyzed in opposing comments from MCI, AT&T, and others. Id., ¶¶ 32, 38-43. Contrary to Sprint's argument here, see Sprint at 34-35, Farrell/Mitchell Decl. at 4-15, Ameritech's prior decision to adopt that method was not determinative. Indeed, the Commission ruled that whether or not the LRN method produced long-term cost savings for ILECs, as it assumed Ameritech had concluded by adopting LRN voluntarily, the requirement would be imposed on all ILECs because of the superior competitive benefits it would offer. In re Telephone Number Portability, 12 FCC Rcd. 7236 ¶ 38.

¹⁷⁹ The reports are: (1) the Annual Summary Report; (2) the Uniform System of Accounts Report; (3) the Joint Cost Report; (4) the Access Report; (5) the Service Quality Report; (6) the Customer Satisfaction Report; (7) the Infrastructure Report; (8) the Operating Data Report; (9) the Forecast of Investment Usage Report; and (10) the Actual Usage of Investment Report. See Federal Communications Commission, What is ARMIS?, available at <<http://www.fcc.gov/ccb/armis/overview.html>> (visited Nov. 6, 1998).

purposes; that information will not change as a result of the merger, because it is reported principally on a study-area or carrier-specific basis.¹⁸⁰ The Commission's NPRM on OSS Measurement likewise contemplates reporting by geographic areas such as by state or LATA, so the merger will change nothing on this crucial issue either.¹⁸¹

In many instances the only necessary benchmark is supplied by the ILEC itself: the dispositive regulatory issue is whether an ILEC is treating competitors differently from itself.¹⁸² In such situations, as the Commission has emphasized, benchmarking requires no more than "direct comparisons between the incumbent's performance in serving its own retail customers and its performance in providing service to competing carriers."¹⁸³

Where cross-company comparisons remain important, there are plenty of comparisons to draw. As the Commission's orders have made clear, the operating company subsidiaries owned by the Regional Bells are not the only operating companies signing agreements that establish interconnection benchmarks. Numerous other incumbent LECs throughout the country — including Sprint's operating subsidiaries, ALLTEL, Frontier and Cincinnati Bell — are entering

¹⁸⁰ See, e.g., 47 C.F.R. § 43.21(a) (1997) (requiring reports on a carrier-by-carrier basis); In re Policy and Rule Concerning Rates for Dominant Carriers, Memorandum Opinion and Order, 12 FCC Rcd. 8115, ¶¶ 15-20 (1997) (service quality reported by study area). Sprint's experts are therefore mistaken when they suggest that such data will be unavailable to the Commission after the merger. See Sprint, Farrell/Mitchell Decl. at 28.

¹⁸¹ In re Performance Measurements and Reporting Requirements for Operations Support Systems, Interconnection, and Operator Services and Directory Assistance, Notice of Proposed Rulemaking, 13 FCC Rcd. 12817, ¶ 38 (1998) ("OSS Measurement") (seeking comment on whether to require carriers to report data for each performance measurement based on state boundaries, LATAs, metropolitan statistical areas (MSAs), or some other relevant geographic area); see also Common Carrier Bureau Seeks Comment in Local Competition Survey, Public Notice, 13 FCC Rcd. 9279, 9283-84 ¶¶ 9-10 (CCB 1998).

¹⁸² Schmalensee/Taylor Reply Aff. ¶ 60.

¹⁸³ OSS Measurement, 13 FCC Rcd. 12817 at ¶ 14.

into interconnection agreements with CLECs, too.¹⁸⁴ There are others: the Commission's recent Survey on the State of Local Competition elicited responses not only from the RBOCs and ILECs such as GTE, Frontier, Sprint and SNET, but also from multi-state CLECs such as Focal, Hyperion, ITC, MGC, RCN, Teleport and USN.¹⁸⁵ In the physical collocation services order cited by Sprint,¹⁸⁶ the Commission used one Sprint operating company, Central, as a benchmark, and would have used another Sprint operating company, United, if it had provided the relevant service.¹⁸⁷ In evaluating the reasonableness of LEC charges for physical collocation services, the Commission likewise relied on direct cost estimates of 14 LECs, not merely the 5 RBOCs that existed at that time.¹⁸⁸ SBC's subsidiaries — SWBT, Pacific Bell and Nevada Bell — were all separately measured, as was Ameritech. Sprint, too, served as a benchmark.

The 1996 Act expressly provides that every interconnection agreement entered into by an ILEC establishes a new benchmark for rates, terms and conditions of interconnection.

Section 252(i) extends "me-too" rights to all other telecommunications carriers negotiating

¹⁸⁴ See New Paradigm Resources Group and Connecticut Research, 1998 CLEC Report, ch. 7 (1998); Briefly, *Telephony*, Oct. 7, 1996, at 93.

¹⁸⁵ See Federal Communications Commission, Responses to the Second CCB Survey on the State of Local Competition and Responses to the First CCB Survey on the State of Local Competition, available at <http://www.fcc.gov.ccb/local_competition/survey/responses> (visited Nov. 7, 1998).

¹⁸⁶ Sprint, Farrell/Mitchell Decl. at 23-25.

¹⁸⁷ Physical Collocation Second Report and Order, 12 FCC Rcd. 18730 at ¶ 3 n.5. United was not included as a benchmark in the physical collocation pricing because it offered virtual collocation in lieu of physical location service, and because it never had a physical collocation customer. *Id.* ¶ 152.

¹⁸⁸ *Id.* ¶ 282. The Commission looked at Ameritech, Bell Atlantic, BellSouth, Central (Sprint), Cincinnati Bell, GTE, Lincoln, Nevada Bell, NYNEX, Pacific Bell, Rochester, SNET, SWBT and U S West. *Id.* ¶ 152 & n. 281.

interconnection agreements with that ILEC in the state.¹⁸⁹ For all practical purposes, this me-too benchmarking extends across operating companies as well.¹⁹⁰ For example, a CLEC that signs a favorable agreement with the Sprint-owned ILEC in Las Vegas will certainly invoke favorable terms in that agreement in its negotiations with the SBC-owned ILEC in Reno, and then with Nevada and federal regulators, if the negotiations break down. Similarly, CLECs routinely leverage agreements and arbitration rulings across state lines as well, effectively placing the burden on ILECs in other states to demonstrate to the CLEC — and if necessary to regulators — why they cannot agree to a provision that another ILEC has already found technically feasible and economically reasonable.¹⁹¹ As an incumbent provider of local exchange service, Sprint is in an unusually good position to influence the benchmarking process: all it has to do is sign superior interconnection agreements with CLECs in any of the 19 states where its own subsidiaries are ILECs.¹⁹²

¹⁸⁹ Some operating companies go even farther. SBC, for example, immediately applied a state arbitration ruling in Texas across the board to all ongoing negotiations and existing agreements involving the same issue. In fact, SBC has committed to simplifying the negotiation process by posting a template of adopted provisions and allowing CLECs to download and sign it. See Kahan Reply Aff. ¶ 38.

¹⁹⁰ Schmalensee/Taylor Reply Aff. ¶ 61.

¹⁹¹ For example, in an ongoing proceeding before the New York Public Service Commission concerning, inter alia, the feasibility of CLEC-to-CLEC interconnection in ILEC central office collocation space, Intermedia recently filed a brief in which it argued that “direct CLEC-to-CLEC interconnection is clearly technically feasible and indeed permitted by other LECs, such as Southwestern Bell Telephone in Texas.” Brief of Intermedia Communications, Inc., Case 95-C-0657, at 10 n.20 (filed Oct. 23, 1998).

¹⁹² See Schmalensee/Taylor Reply Aff. ¶ 55. A good example of Sprint’s opportunity to create benchmarks is demonstrated by the recent announcement that Sprint’s Florida ILEC subsidiary had signed a comprehensive interconnection agreement with US LEC Corp., a CLEC with operations in North Carolina, Florida, Georgia and Tennessee. See US LEC News Release, US LEC Signs Interconnection Agreement With Sprint (Nov. 4, 1998), available at Westlaw, 11/4/98 PRWIRE 09:16:00 (Nov. 4, 1998). In negotiating that agreement, US LEC had the advantage of knowing what it had bargained for and received in the various other states.

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The SBC/Ameritech merger will strengthen, not undermine, this process.¹⁹³ The merged company's operating subsidiaries will still negotiate state by state, sign agreements state by state, and seek PUC approval state by state.

Moreover, SBC/Ameritech's National-Local Strategy will give the combined company a major stake in the success of the interconnection process from the CLEC side of the bargaining table in over 20 other states. CLECs who negotiate with SBC/Ameritech's operating company subsidiaries in region will know precisely what SBC/Ameritech has successfully bargained for as a CLEC out of region. Other CLECs already play this dual role, and can readily establish benchmarks of their own. Sprint — as discussed above — Frontier, GTE, AT&T/TCG and MCI WorldCom are not just consumers of local exchange services, they are providers, too. AT&T already provides local service through TCG, and will provide still more. In addition, CLECs can and do create new interconnection benchmarks, by serving as wholesalers for other CLECs, just as long-distance carriers provide wholesale service to other long-distance carriers. By supplying wholesale services to other CLECs, TCG, TCI, MFS or Brooks Fiber can readily establish new benchmarks on their own initiative, and then present them to regulators as models for how ILECs ought to perform.

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Moreover, any particular attractive rates, terms or conditions in this agreement will now be the starting point for US LEC's negotiations with BellSouth and other ILECs in Florida and for Sprint's negotiations as a CLEC outside its service territories in Florida and elsewhere throughout the country.

¹⁹³ As the Reply Affidavit of Drs. Schmalensee and Taylor points out, SBC's entry into out-of-region markets as a CLEC will generate valuable data on costs and prices. See Schmalensee/Taylor Reply Aff. ¶ 57.

The emerging new environment is, in short, fundamentally different from the one in which the Commission first began to use benchmarking regulation.¹⁹⁴ At that time, local exchange carriers were actual and presumptive monopolies; local competition was not even legal in most states. As the attached affidavit of former Commissioner Henry Rivera points out, in that environment the Commission had little information upon which to measure whether interconnection with interexchange carriers was being provided on a fair and non-discriminatory basis.¹⁹⁵ The Commission was seeking ways to assure the development of competitive markets for complementary services.¹⁹⁶

It was in that context that the Commission addressed — and resolved — the major industry-wide issues presented in the decade after the Bell breakup. In the few instances where the Commission still uses company-wide or industry-wide averages, it does so quite deliberately, to advance objectives of price averaging or universal service, or to maintain incentives to increase productivity. And it does so using what are now well-settled methodologies. Sprint's comments, for example, dwell on the Commission's use of industry averages in revising the price cap carriers' productivity X-factor.¹⁹⁷ But the Commission indicated that it adopted industry-wide adjustment methodologies deliberately, for the specific purpose of encouraging the pursuit of cost reductions and new efficiencies of precisely the kind that this merger will

¹⁹⁴ See Rivera Reply Aff. ¶¶ 6-12.

¹⁹⁵ See Rivera Reply Aff. ¶ 4.

¹⁹⁶ It was in this context that Ameritech and SBC advocated the use of benchmarks over a decade ago in MFJ proceedings. Ameritech and SBC advocated the use of benchmarks when it was economically rational to rely on such data not, as AT&T contends, "when it has suited their purposes." AT&T at 29; see also Sprint at 36.

¹⁹⁷ Sprint, Farrell/Mitchell Decl. at 12-13, 39-41.

achieve.¹⁹⁸ The Reply Affidavit of Drs. Schmalensee and Taylor demonstrates, moreover, that Sprint's argument that the merger will distort the calculation of the "X Factor" for price cap LECs is incorrect.¹⁹⁹

As competition increases, the importance of many traditional types of regulation will diminish, and so too will the need for benchmarks. Indeed, the vast majority of the benchmarks being developed under Section 251 are best practices or parity benchmarks, not industry averages. As the number of horizontal competitors multiplies, the importance of averaged benchmarks such as RBOC access charges will decline, simply because long-distance carriers will increasingly reach customers through CLECs (including their own) rather than through ILECs. As Internet and enhanced-service traffic continues to rise — and it is rising very fast — the importance of benchmarking access charge rates will decline further.

Over the longer term, the inevitable consequence of interconnection and competition will be differentiation and price deaveraging. The 1996 Act expressly recognizes that the costs of providing service in urban Houston are very different from rural Oklahoma.²⁰⁰ The rise of competition will over time drive prices toward cost, increase efficiency, and lead to further

¹⁹⁸ See In re Price Cap Performance Review for Local Exchange Carriers, Fourth Report and Order in CC Docket No. 94-1 and Second Report and Order in CC Docket No. 96-262, 12 FCC Rcd. 16642, ¶¶ 180, 181 (1997). The Commission used industry-wide data, and derived the productivity factor as an average of multiyear averages, using data for the ten years beginning with 1986. Id. ¶¶ 134-141. The use of aggregated historical data obviously dilutes any effect of a recent merger.

¹⁹⁹ See Schmalensee/Taylor Reply Aff. ¶¶ 73-79.

²⁰⁰ See 47 U.S.C. § 251(f). The Commission itself recognizes this distinction, a fact reflected in its establishment of three tiers of UNE pricing. See In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, 11 FCC Rcd. 15499, ¶¶ 764-765 (1996) aff'd in part and vacated in part sub nom. Competitive Telecomm. Ass'n v. FCC, 117 F.3d 1068 (8th Cir. 1997), Iowa Utils Bd. v. FCC, 120 F.3d 753 (8th Cir. 1997).