SUPPLEMENTAL MEMORANDUM REGARDING THE IMPROVED SUPPORT OF LOCAL COMPETITION IN CALIFORNIA FOLLOWING THE SBC-PACBELL MERGER

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Submitted By

SBC Communications Inc.
and
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I. INTRODUCTION.

Sprint has repeatedly advanced an unprecedented and unsupported "negative spillover" theory that the merger of RBOCs necessarily increases the incentives to deny, delay and degrade competitive access by CLECs. The Commission should give no credence to this theory because it is entirely theoretical and completely contrary to the empirical evidence as Dr. Carlton's analysis shows.

In its latest effort to bolster this unsupported theory, Sprint has also submitted a so-called "Empirical Analysis of the Footprint Effects of Mergers Between Large ILECs" dated April 1, 1999, by Hayes-Jayaratne-Katz ("Sprint's April 1 Paper") and a Memorandum from Sprint's counsel arguing that there is "anecdotal evidence of degraded practices being exported from SBC to Pacific Bell after their merger." Sprint's April 1 Paper at 24. The anecdotes Sprint relies upon do not support the thesis that SBC Communication Inc. ("SBC") exported degraded practices to Pacific Bell ("PacBell") following the merger. See "Supplemental Memorandum Refuting Sprint's Alleged 'Anecdotal Evidence Of Degraded Practices Being Exported From SBC To Pacific Bell After Their Merger.'"

Not only is the claimed anecdotal evidence not supportive of the theory, but the facts following the merger unquestionably demonstrate that PacBell's staffing, funding, performance and policies in support of local competition have all greatly improved. In short, the California experience categorically refutes the theory that mergers such as these necessarily increase incentives to degrade performance and discriminate against rivals.

II. SINCE THE SBC MERGER, PACBELL'S SUPPORT OF LOCAL COMPETITION HAS NOT DIMINISHED, BUT IN FACT HAS GREATLY IMPROVED.

The facts show very clearly that PacBell's performance in supporting local competition in California has improved substantially following the merger as manifested in increased funding, increased staffing and improved performance. Some of these improvements are the result of increased staff and investment; but others, such as improvements in electronic interfaces reflect the exportation of improved practices from SBC to PacBell, and still others, such as improvements in collocation, reflect changes in corporate policy which enhanced support for local competition. These post-merger improvements in support, in performance and in policy are fundamentally inconsistent with any alleged post-merger degradation, particularly the Sprint theory that SBC exported degraded practices to PacBell.

Indeed, Governor Pete Wilson recently acknowledged SBC's superior performance in a December 31, 1998, letter to SBC Chairman Edward Whitacre, Jr. Governor Wilson pointed out that PacBell has had "an admirable brand of corporate citizenship" and that "since SBC's merger with Pacific Bell, that tradition has continued." Governor Wilson specifically noted "Pacific Bell's consistent focus upon the daily provision of superior customer service" and "the outstanding response and exceptional integrity of its network." Overall, the Governor concluded that SBC's merger with PacBell had achieved a "splendid record." A copy of Governor Wilson's letter is attached as Exhibit 1.

While PacBell has encountered many challenges during the opening of the California market to local competition, a number of the problems it faced early on were due in large part to the unforecasted and unprecedented demand for services from the CLECs in the state. This unforecasted and unprecedented increase in demand for services was not encountered in other states.

Following the merger, SBC and PacBell worked together to meet this increased demand. Perhaps the best measure of the impact of the SBC-PacBell merger is to compare PacBell's pre-merger and post-merger support of local competition, including its funding, staffing, performance and policies. The facts show that there has been a very substantial improvement in these areas which is fundamentally inconsistent with any alleged post-merger predation.

A. Resources Have Increased Since The Merger.

1. The Funding Components For Local Competition Have Increased Since The Merger.

Overall, from the beginning of 1996 through 1998, PacBell estimates that it has spent more than $715 million in capital and expenses to support local competition in California, including approximately $295 million for local number portability and $421 million for local competition (interconnection).

Perhaps the best hallmark of the increase in PacBell's support of local competition since the merger, however, is the investment in CLEC electronic interfaces in California. Prior to the merger, virtually all CLEC orders to PacBell were handled manually. Although PacBell had been working on new systems prior to the merger, as a result of the merger, it obtained access to several new, electronic systems developed or implemented by SBC, which have greatly enhanced the availability of electronic interfaces for CLECs in California.

In the fifteen months prior to the merger, for example, PacBell invested approximately $1.3 million to develop and implement electronic OSS interfaces. See Chart A. However, in the comparable period since the merger, PacBell has invested more than $59.4 million to develop and implement several state-of-the-art electronic systems for CLECs in California – an increase of more than 45-fold in only 15 months. See Chart A. These advanced systems now account for approximately half of all orders from CLECs in California and have dramatically improved the overall efficiency of PacBell's local competition support systems.

This is clearly not the conduct of a predator seeking to block local competition.

2. <u>Local Competition Support Staffing Has Increased Since The Merger</u>.

Following the merger, the staffing of services for local competition has also dramatically increased. For example, a few months before the merger, PacBell had 179 Local Service Center ("LSC") Service Representatives supporting CLEC entry into the local market. As of the end of December, 1998, it had 706 LSC Services Representatives, an increase of nearly four-fold. LSC Managers displayed a similar growth from 18 in December, 1996, before the merger, to 63 as of December 31, 1998. See Chart B. Staffing has leveled off in recent months due to the flattening of demand for resale lines, but PacBell believes that demand for UNEs will increase in 1999 and is planning accordingly.

This increase in staffing is also inconsistent with any alleged pattern of predation following the merger.

B. Key Performance Indicators Have Improved Since The Merger.

1. CLEC Order Capacity Has Increased Since The Merger.

Daily CLEC Order Capacity also has increased ten-fold following the merger from 590 in December, 1996, to more than 6,000 as of December, 1998. See Chart B.

Such an increase in capacity to support local competition is inconsistent with any alleged post-merger plan of degradation.

2. Resale Lines In Service Have Increased Since The Merger.

Not surprisingly, these increases in funding, staffing and order capacity have also manifested themselves in enormous leaps forward in resale lines in service. PacBell had approximately 86,100 resale lines in service in California the month before the merger closed, for example, compared to nearly 260,000 resale lines in service at the end of December, 1998. See Chart C. Since December 1997, the demand for resale lines has been relatively flat. This is due largely to the withdrawal of "the Big Three" (AT&T, MCI, and Sprint) from resale due to their discontent with the California Public Utilities Commission's ("CPUC") tariffed resale rates. In fact, AT&T and Sprint have admitted on the record that they would not serve the residential market even if the California Commission were to do "everything that's being asked." *See* Full Panel Hearing, R. 95-04-043, I. 95-04-044, February 24, 1998, Tr. 7227-7229.

Notably, however, during the same period that the Big Three have been cutting back on resale, smaller CLECs have increased their activity, capturing resale customers at a rate that almost exactly offset the withdrawal of the Big Three -- hence the relatively flat rate of growth in recent months.

One would not expect a firm bent on degradation to increase competitor's resale lines in service by more than three-fold following the merger.

3. <u>UNE Products In Service Have Increased Since The Merger</u>.

At the time of the merger in April, 1997, PacBell had approximately 6,900 unbundled network element ("UNE") products in service in California. These products include loops, cross connects, and switch ports. Following the merger, the number of UNE products in service has risen every month to 81,580 by December 31, 1998. See Chart D.

Here again, an eleven-fold increase in UNE products is not consistent with an alleged plan of degradation.

4. <u>Interconnection Products in Service Have Increased Since The Merger</u>.

At the beginning of April, 1997, the month of the merger, PacBell had approximately 27,154 interconnection products – including trunks, E911, and DA/OA -- in service in California. Following the merger, the number of interconnection products in service has increased every month to 347,652 as of December 31, 1998, an increase of more than thirteen-fold. See Chart E.

Such a huge increase in the interconnection products put in service for competitors is not consistent with any alleged predatory plan.

5. <u>Resale Firm Order Confirmation Has Improved Substantially Since The Merger</u>.

Resale firm order confirmations ("FOCs") within 24 hours had been running at a level of about 27% for the month before the merger, and had even dropped to 6% in April, 1997. Following the merger, PacBell's resale FOC within 24 hours has improved steadily and remained above 95% throughout all of last year. See Chart F.

Such a vast improvement in 24-hour order confirmation – from 6% the month of the merger to 99% in each of the last four months – is entirely inconsistent with any discriminatory plan.

6. <u>Resale Completion Notifications Have Improved Since The Merger</u>.

Resale notifications of completion to the CLECs within 24 hours had been 22% in January, 38% in February, and 49% in March, 1997 -- the three months preceding the merger. Following the merger, PacBell's confirmation of completion within 24 hours has dramatically and steadily improved to 90% within two months of closing the merger, and has remained over 90% throughout 1998. See Chart G.

This type of huge improvement in performance post-merger is not consistent with alleged post-merger degradation.

7. The Trouble Report Rate Has Improved Since The Merger.

PacBell has monitored the incidence of trouble reported per 100 lines for both resale and PacBell's retail lines for some time. Pre-merger, PacBell was experiencing almost twice as many trouble reports per 100 lines for resale lines than it did for its own retail lines. The high trouble report rate was due in part to the small sample size of CLEC orders as opposed to PacBell orders and to the fact that the CLECs reported troubles that were not PacBell's fault, but were in fact CLEC errors.

By December, 1998, PacBell reduced the incidence rate for both resale and retail lines to approximately 1.3 per 100 lines for retail, and 1 per 100 lines for resale. Indeed, since the merger, the trouble report rate for resale has been consistently below the trouble report rate for PacBell's own retail lines. See Chart H.[1]

Improving the trouble report rate for resale lines from a pre-merger level which was significantly below that for retail, to a post-merger level which is somewhat better than its own retail lines, is totally inconsistent with alleged degradation.

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1 PacBell's retail and resale trouble reports increased during the El Nino effects in California which took place in the January-March, 1998 time period. PacBell rapidly responded to these problems and restored the trouble report level very quickly. Chart H shows the rise in trouble reports for PacBell's service during this period and its restoration to pre-El Nino levels by April, 1998.

8. <u>The Repeat Trouble Report Rate Has Improved Since The Merger</u>.

PacBell monitors repeat trouble reports on a 30-day cycle. Thus, if a second trouble report is entered for the same line within 30 days of the initial trouble report, it is counted as a "Repeat Trouble Report (R30)." At the time of merger and for several months thereafter, PacBell was experiencing repeat trouble reports for resale lines which exceeded those for its own retail lines.

When PacBell investigated this, it discovered that the CLECs were reporting repeat troubles even though the trouble had been cleared and were reporting repeat troubles even though PacBell had not yet missed the repair commitment time. Both of these artificially inflated the repeat trouble report rate. Following the merger, the differences between repeat trouble reports for resale and retail have been reduced and, starting in July, 1998, resale and retail have achieved parity. See Chart I.

Parity of repeat trouble reports is also not consistent with alleged post-merger degradation.

9. <u>The Time To Clear Resale Trouble Has Remained Below That For Retail Since The Merger</u>.

At the time of the merger, the total number of hours required to clear a trouble report was slightly fewer for resale lines than for retail lines. See Chart J. Following the merger, the time to clear trouble for resale lines has consistently remained at or better than parity. See Chart J.

Parity or better in time to clear trouble is not consistent with alleged degradation of practices following the merger.

10. The Percentage Of Repair Commitments Met Has Improved Since The Merger.

Prior to the merger, the percentage-of-repair-commitments-met for resale lines had dipped below that for retail lines on occasion. See Chart K. Since the merger, the percentage-of-repair-commitments-met for CLEC resale lines has exceeded that for PacBell's own retail lines in 19 out of 20 months. Here again, following the merger, resale has sustained levels better than retail. See Chart K.

Improving the rate of meeting repair commitments for resale so that they are met more often than for retail is not consistent with alleged post-merger degradation.

11. The Provisioning Of Collocation Cages Has Improved Since The Merger.

At the time of the merger, PacBell had constructed approximately 193 collocation cages. By year-end 1998, PacBell had completed construction of approximately 814 collocation. See Chart L. Chart L shows this regular pattern of improvement following the merger. The most recent data, for the end of February, 1999, show 882 collocation cages completed in California.

In addition, from July, 1998, through year end 1998, PacBell has completed approximately 400 requested cages on time.

This four-fold increase in physical collocation cages since the merger and the change in on-time performance is not consistent with alleged post-merger degradation. In addition, the history of PacBell's collocation provisioning following the merger shows that rather than SBC degrading PacBell's practices – as Sprint asserts – SBC took concrete steps to improve PacBell's performance.

Pursuant to FCC and CPUC approved tariffs, PacBell has offered both physical and virtual collocation to CLECs in PacBell's central offices since 1992. PacBell offers a minimum of 100 square feet of physical collocation space, where such space is available, on a first-come, first-served basis, pursuant to tariffs and FCC regulations. These spaces are enclosed in cages constructed of wire mesh and provide the CLEC with a secure, lockable, facility within which to install and operate its own equipment. The equipment installed by a CLEC in its cage is maintained by the CLEC.

PacBell also offers CLECs "virtual" collocation in which there is no physical cage or separate space; PacBell places the CLEC's equipment in available space within PacBell's central office. In this form of "virtual" collocation, at the CLEC's request, PacBell maintains the CLEC-owned equipment; the CLEC monitors its equipment from a remote location and requests service from PacBell as needed.

At the time of the PacBell-SBC merger, in April, 1997, PacBell had constructed approximately 193 collocation cages. During 1996 and the first half of 1997, the demand for collocation cages was relatively low.

During the latter half of 1997, and the first quarter of 1998, the level of CLEC facilities-based activity in California suddenly surged. As a result, collocation requests to PacBell increased approximately 400% in the summer and early fall of 1997. Due to this unprecedented increase in demand, PacBell was unable to keep up with the rapidly escalating cage orders, and a number of cage commitments were not met within the tariffed intervals, normally a 120-day period.

In November, 1997, in an effort to address the unprecedented demand in California for collocation, SBC's management initiated a new "PacBell Collocation Team" to develop new collocation polices for California in order to "reduce response time to CLECs, [and] minimize CPUC complaints." See Exhibit 2, Memorandum dated November 25, 1997, from SBC Vice President Sandy Kinney. Under the direction of SBC personnel in Dallas, the group began work on plans to meet increased CLEC demand for collocation space in California. The SBC-PacBell Team developed a "Collocation Contingency Plan" in April, 1998 (Exhibit 3), which stated that:

> CLECs attempting to request physical collocation in California in central offices where space does not exist for the tariffed 100 square foot arrangement have filed complaints, formal and informal, with the California Public Utility Commission (CPUC). In an attempt to resolve at least some of these complaints outside the CPUC and provide space requested by CLECs, SBC offers the following Contingency Plan for its 7-state jurisdiction.

Ex. 3. This SBC Plan included several important changes in PacBell's pre-merger policies relating to collocation, including, the commitment to provide "baby" cages smaller than 100 square feet, permitting CLECs to sublease their cages to other CLECs, and allowing CLECs to share cages where space is limited. This is clearly not the conduct of a firm seeking to deny, delay or degrade rivals' access to the market.

In addition to these SBC policy changes to facilitate CLEC collocation in California, SBC also initiated a "Collocation Product Management Team" for the purpose of: "further refining and streamlining the collocation application process in California and Nevada." Exhibit 4. After months of work on these processes, on August 4, 1998, SBC's Vice President Sandy Kinney announced these new application-processing improvements which would now apply to California and Nevada. Exhibit 4.

With SBC's direction and guidance, in the Spring of 1998, PacBell also voluntarily went to the CPUC to obtain its consent to explore creative policy changes to meet this continuing surge in collocation demand. The company devoted extensive resources to surveying central offices to determine whether space was available, or could be made available – for example, by removing non-functioning equipment and reconstructing administrative space in order to provide space for collocation.

Moreover, beginning in March 1998, with the management support of SBC, PacBell installed new management, devoted additional staff and resources in a concerted effort to eliminate the backlog of collocation cage requests, and implemented new processes to manage collocation requests so that PacBell could deliver cages on time. Through these improvements, PacBell successfully cleared up the entire backlog of collocation orders by early July, 1998. In fact, many of the collocation requests were actually fulfilled in a voluntarily shortened time frame of only 90 days. From July, 1998 through year-end 1998, PacBell has constructed approximately 400 cages on time, increasing its portfolio from 416 at the end of June to 814 by the end of December, 1998. In fact, with the exception of 1 or 2 cages, all 400 cages constructed during the period have met the committed due date.

As Chart L shows, at year-end 1998, PacBell had completed construction of approximately 814 collocation cages. The latest data for the end of February, 1999, show 882 collocation cages completed in California. This level of provisioning is also consistent with the overall level of support for local competition following the merger – in terms of funding, staffing, resources, and overall performance – all of which have continued to increase substantially. See Charts A-L.

Not only has PacBell's performance in providing collocation cages improved substantially following the merger, but, with SBC's management direction, many of PacBell's collocation policies have also been changed to enhance the availability of physical collocation. Although some of these changes are mentioned briefly above, it is worth examining them in more detail in order to fully understand their pro-competitive nature:

a. <u>**"Baby" Cages & Non-Standard Dimension Cages**</u>.

For example, PacBell's CPUC-approved tariff does not permit CLECs to use cages smaller than 100 square feet (so-called "baby cages"). Further, PacBell's practice under the tariff had been to limit cages to those with standard 10 foot by 10 foot dimensions because these were the standard dimensions of available wire cage material.

The SBC-initiated "Collocation Contingency Plan" changed these two practices so that following the merger and adoption of the Plan in April, 1998, PacBell began making "baby" cages in crowded central offices available on a permissive basis to CLECs who were willing to accept less than the 100 square foot minimum in order to get into a particular central office. PacBell also began building cages of non-standard dimensions, again as a method of getting more CLECs into more central offices, particularly those popular offices in high population areas.

These changes in PacBell's policy have made more collocation arrangements available to CLECs in central offices where space is at a premium. Since the change in policy, PacBell estimates that it has constructed approximately 250 non-standard dimension cages and 15 to 20 "baby" cages.

b. <u>Common Cages</u>.

Another post-merger enhancement to the options available to CLECs is SBC's decision to direct PacBell to offer common collocation cages. The "Collocation Contingency Plan" initiated by SBC following the merger changed PacBell policy to permit common cage arrangements. Under this policy, for example, if there were space remaining in a particular central office for three cages, but five CLECs requested cages there, PacBell now offers to allow all five CLECs to work together and share a common cage. To date, no CLECs have come forward in this cooperative arrangement, but PacBell stands willing to build common cages if requested.

c. Sub-Leasing of Cages.

Prior to the merger, PacBell did not permit CLECs to sublease their cages. The SBC initiated "Collocation Contingency Plan" changed this policy to permit sublicensing to allow CLECs, for example, to share space through mutually acceptable sharing arrangements. As a result of the SBC "Collocation Contingency Plan," during the California section 271 workshops, PacBell offered to permit such sub-leasing. This new option was included in the CPUC's 271 Compliance Order, Order Instituting Rulemaking on the Commission's Own Motion Into Competition for Local Exchange Service, R.95-04-043, I. 95-04-044, R. 93-04-003, I. 93-04-002, Opinion Appendix B (Dec. 17, 1998) ("CPUC 271 Order").

d. Collocated Remote Switching Modules.

Prior to the merger, PacBell's policy was not to permit CLECs to install collocated remote switching modules ("RSMs"). This policy had been supported by the CPUC when it denied AT&T's and MCI's requests in their section 252 arbitration's to collocate RSMs. The RSM acts as a remote line concentrator. Calls from the CLEC's customers to customers of any other TELCOs are combined and sent back to the CLEC host switch for call completion to the other TELCOs.

Following the merger, PacBell has conformed its policy to SBC's and now permits CLECs to locate RSMs within the CLEC's physical collocation spaces for accessing UNEs (transmission uses) but not for switching, except subject to specific contractual agreements. Indeed the CPUC recently supported PacBell's limitation on the use of RSMs in collocation spaces. See CPUC 271 Order at 36.[2]

e. <u>"Super" Cages</u>.

Prior to the merger, PacBell did not have any collocation spaces that were larger than 100 square feet, even if requested by a CLEC, unless the CLEC had a cage augment at a later time. Since the merger, however, PacBell has agreed to allow CLECs to request "super" cages larger than 100 square feet at the initial application stage and is presently processing several applications for such cages and constructing such "super" cages to meet CLEC requests.

f. <u>"Walk Throughs"</u>.

Prior to the merger, PacBell's policy was not to allow inspections by non-PacBell personnel to confirm the absence of available space in a central office following PacBell's denial of a cage request. In October, 1997, at SBC's direction, PacBell offered Covad the opportunity to select an independent third party inspector to examine the denied central offices. PacBell expanded this offer to all CLECs during the 271 collaborative process in the spring and summer of 1998 .

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2 A March 31, 1999, FCC collocation order also permits collocation of switching or enhanced services functions. <u>Deployment of Wireline Services Offering Advanced Telecommunications Capability</u>, CC Dkt. No. 98-147, First Report and Order and Further Notice of Proposed Rulemaking ¶¶ 18-21 (rel. March 31, 1999)("FCC Advanced Service Order").

The CPUC incorporated the availability of Walk Throughs in the CPUC 271 Order, modifying the process to permit Walk Throughs by CLEC representatives together with representatives of PacBell. CPUC 271 Order at App. B, p. 8.[3]

g. **Surety Bond**.

PacBell has offered to change its policy with respect to the assurance of payment for the collocation cage. In the past, PacBell required all CLEC cage orders to be accompanied by the cash payment of at least 50% of the estimated cost of the cage. During the 271 workshops, PacBell changed its policy to allow CLECs to submit a surety bond to cover the costs.

Further, the collaborative process in PacBell's draft Section 271 application also identified a number of efficiency enhancing steps, which PacBell has agreed to take to further improve the collocation process. These include posting the up-to-date PacBell Collocation Service Handbook on the PacBell website with prospective dates of each update clearly indicated, providing cage-to-cage connections between collocation cages leased by two or more CLECs within 15 days of request, and accepting applications for unallocated, contiguous collocation cages. CPUC 271 Order at App. B. at 7-9.

In addition, the CPUC has now taken steps to improve performance through the adoption of new collocation regulations which mandate a 15 day time period for

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3 Subsequently, by order released March 31, 1999, the FCC also permitted CLECs to tour Central Offices in which they had been denied collocation space. FCC Advanced Services Order at ¶ 57.

response to collocation requests and the right of CLECs who are denied such a request to undertake a physical inspection of the site, all subject to review by the CPUC on an expedited basis. CPUC 271 Order at App. B. at 8, 10-12.

These developments show that although PacBell experienced problems in on-time collocation performance in late 1997 and early 1998, PacBell reacted promptly and its provision of collocation cages improved substantially both in terms of performance and in terms of policy following the merger. Indeed, SBC initiated many changes in policy, which enhanced the availability of CLEC collocation in California. Obviously, this conduct is inconsistent with any alleged discriminatory scheme.

III. CONCLUSION.

This brief review of the facts demonstrates that SBC's acquisition of PacBell did not reduce PacBell's support of local competition in California or cause the degradation of PacBell's performance. Indeed, following the merger, PacBell's funding, staffing, performance and many policies in support of local competition have all substantially improved.

In the fifteen months prior to the merger, for example, PacBell had invested approximately $1.3 million in CLEC electronic interfaces. In the same period following the merger, however, PacBell invested more than $59 million in such CLEC electronic interfaces. Chart A. This vastly increased investment in support of local competition is inconsistent with any alleged plan of degradation.

Similarly, when PacBell faced unprecedented increases in the demand for collocation cages, the SBC management team stepped in to provide new management direction and policies to facilitate collocation. With this effort, the backlog in demand was eliminated and cages are being provisioned on time. This is not the conduct of a firm determined to discriminate against rivals.

Overall, the facts show that support for local competition in California greatly improved following the merger. An examination of the developments in SBC's traditional five state area following the PacBell merger also shows that support for local competition improved. In the five state region, from the date of the merger in April, 1997, to February 1, 1999, for example, physical collocation cages have increased from 22 to 298, trunks have increased from 12,633 to 199,800, and resale lines in service have increased from 56,930 to 541,013.

The reality of what actually took place in California and in the five state region following the PacBell merger completely undermines any alleged anecdotes or theoretical concern that SBC either exported degraded practices to PacBell, or degraded its own practices. In fact, following the merger with PacBell, SBC's support of local competition has substantially increased.

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