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EX PARTE OR LATE FILED

April 19, 1999

Ms. Magalie Roman Salas  
Secretary  
Federal Communications Commission  
445 12<sup>th</sup> Street, SW  
Washington, D.C. 20554

RECEIVED  
APR 20 1999  
FCC MAIL ROOM

Re: *In the Matter of Applications for Transfer of Control to SBC Communications Inc.  
of Licenses and Authorizations Held by Ameritech Corporation, CC Docket No.  
98-141*

**Ex Parte Notice**

Dear Ms Salas:

Please be advised that on Monday, April 19, 1999 we sent the following documents to Robert Atkinson, William Dever, and Michelle Carey: the pre-filed direct and rebuttal testimony of Lee Selwyn and Charlette TerKeurst and related documents; a copy of the Cook County State's Attorney's Office's Initial Brief, Reply Brief and Brief on Exceptions -- all related to 98-0555 pending before the Illinois Commerce Commission.

We are interested in participating in the process referred to in Chairman Kennard's April 1, 1999 letter to Richard C. Notebaert and Edward E. Whitacre, Jr.

I spoke today with Jackie Hayes of the Common Carrier Bureau and requested a meeting to discuss our opposition and concerns with the pending SBC Ameritech merger. Allan Goldenberg, of my office spoke previously with Michelle Carey of your office about general matters and the possibility of a telephone meeting.

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Please feel free to contact us if you need additional information. I have provided an original and one copy of this notice.

Sincerely,

RICHARD A. DEVINE  
State's Attorney of Cook County



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Deputy Supervisor  
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cc: Robert Atkinson, Deputy Bureau Chief, Common Carrier Bureau  
Jackie Hayes, Assistant to Robert Atkinson  
Michelle Carey, Deputy Chief, Policy and Program Planning Division,  
Common Carrier Bureau  
William Dever, Legal Counsel  
Paul Mancini, SBC Communications Inc  
Kelly Welsh, Ameritech Corporation

STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION

SBC COMMUNICATIONS INC.,  
SBC DELAWARE INC.  
AMERITECH CORPORATION,  
ILLINOIS BELL TELEPHONE COMPANY  
d/b/a AMERITECH ILLINOIS, and  
AMERITECH ILLINOIS METRO, INC.

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APR 20 1999

Docket No. 98-0555  
FCC MAIL ROOM

Joint Application for approval of the reorganization of Illinois Bell Telephone Company d/b/a Ameritech Illinois, and the reorganization of Ameritech Illinois Metro, Inc. in accordance with Section 7-204 of The Public Utilities Act and for all other appropriate relief.

INITIAL BRIEF OF THE  
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February 24, 1999

ORAL ARGUMENT REQUESTED

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**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

SBC COMMUNICATIONS INC.,  
SBC DELAWARE INC.  
AMERITECH CORPORATION,  
ILLINOIS BELL TELEPHONE COMPANY  
d/b/a AMERITECH ILLINOIS, and  
AMERITECH ILLINOIS METRO, INC.

Docket No. 98-0555

Joint Application for approval of the reorganization of Illinois Bell Telephone Company d/b/a Ameritech Illinois, and the reorganization of Ameritech Illinois Metro, Inc. in accordance with Section 7-204 of The Public Utilities Act and for all other appropriate relief.

**INITIAL BRIEF OF THE PEOPLE OF COOK COUNTY**

The People of Cook County ("Cook County") *ex rel.* RICHARD A. DEVINE, State's Attorney of Cook County, hereby file this Initial Brief pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission ("ICC" or "the Commission"). 83 Ill. Admin. Code Section 200.800.

This brief addresses the issues raised by SBC's and Ameritech's ("Joint Applicants") Joint Application for approval of the reorganization of Illinois Bell Telephone. Cook County incorporates by reference all arguments previously addressed in the Response to Hearing Examiners' Notice of Ruling filed January 8, 1999. Response of the People of the State of Illinois, the People of Cook County, and the Citizens Utility Board to hearing Examiners' Notice of Ruling, filed January 8, 1999; Tr. 1800.

As directed by the Hearing Examiners, included in our brief is:

- i) an explanation of how the evidence adduced relates to the specific statutory

authority of the Commission to approve, disapprove or condition the approval of the proposed merger transaction;

- ii) the Commission's legal authority to impose conditions [on the merger]; and
- iii) the Commission's authority to impose fines or other penalties if those conditions are not met. Tr. 1799-1800.

A copy of this brief has also been provided to the Hearing Examiners on diskette in Word format. Tr. 1801.

#### **I. STATEMENT OF THE CASE**

On July 24, 1998, Joint Applicants SBC and Ameritech filed a Joint Application ("Joint Application") for approval of the reorganization of Illinois Bell Telephone Company d/b/a Ameritech Illinois, and the reorganization of Ameritech Metro, Inc. in accordance with Section 7-204 of the Public Utilities Act ("the Act"). Joint Application at 1. SBC and Ameritech make the following representations in their Joint Application. On May 10, 1998, Ameritech SBC and SBC Delaware entered into an Agreement and Plan of Merger ("Merger Agreement"). *Id.* at 5. The Merger Agreement provides for a business combination of SBC and Ameritech. The proposed transaction is structured as a merger of SBC Delaware, a newly-formed Delaware subsidiary of SBC created specifically for the purpose of consummating the transaction, and Ameritech. *Id.*

Pursuant to the Merger Agreement, SBC Delaware will merge with and into Ameritech and the separate corporate existence of SBC Delaware will cease. *Id.* Ameritech will be the surviving corporation, as a wholly-owned first tier subsidiary of SBC. The surviving Delaware corporation will continue under the name of Ameritech. *Id.* Ameritech will

continue to be the parent company of Ameritech Illinois and Ameritech Illinois “will not change in any manner.” Id.

The Merger Agreement provides that each shareholder of Ameritech common stock would receive under a fixed exchange ratio 1.316 newly-issued shares of SBC common stock in exchange for each of the issued and outstanding shares of Ameritech common stock, subject to adjustment to prevent dilution. Id. at 5-6 Upon consummation of the merger, SBC will own 100% of Ameritech’s outstanding common stock and the prior holders of Ameritech common stock will become shareholders of SBC, equating to approximately 44% ownership of SBC’s common stock. Id. at 6.

The following Joint Applicant testimony was admitted into evidence: James S. Kahan, Exs. 1.0, 1.1, and 1.2; W. Patrick Campbell, Ex. 2.0; David H. Gebhardt, Exs. 3.0, 3.1, and 3.2; Robert G. Harris, Exs. 4.0, 4.1, and 4.2; Karen E. Jennings, Ex. 5.1; Charles H. Smith, Ex. 6.0; Christopher J. Viveros, Ex. 7.0; Richard R. Galloway, Exs. 8.0 and 8.1; and Richard J. Gilbert, Ex. 9.0.

Illinois Commerce Commission Staff witness testimony admitted into evidence includes: Judith Marshall, Exs. 1.0 and 1.01; Robert Plaza, Ex. 2.0; Rasha Topozada Yow Exs. 3.0 and 3.01; Christopher L. Graves, Exs. 4.0 and 4.01; S. Rick Gasparin, Exs. 5.0 and 5.01; Deborah Prather, Exs. 6.0 and 6.01; Cindy Jackson, Exs. 7.0 and 7.01; Samuel S. McClerren, Exs. 8.0 and 8.01; and Dr. Carl E. Hunt Ex. 9.0.

The following testimony from government and public interest parties was admitted into evidence: The Illinois Attorney General’s Office; Cook County State’s Attorney’s Office; and the Citizens Utility Board (“CUB”) co-sponsored the testimony of Dr. Lee Selwyn,

Government and Consumer Intervenors (“GCI”) Exs. 1.0 and 1.1 and Charlotte TerKeurst, GCI Exs. 2.0 and 2.1; American Association of Retired Persons (“AARP”) Dr. Mark Cooper, Exs. 1 and 2.; and DSSA, Don S. Samuelson, Ex. 1.

Testimony from telecommunications industry witnesses admitted into evidence includes: AT&T, Joseph Gillan, AT&T Exs. 1.0 and 1.1; Bruce Bennett (AT&T Exs. 2.0 and 2.1); Kathleen Whiteaker (AT&T Exs. 3.0 and 3.1); and Sarah De Young (AT&T Exs. 4.0 and 4.1); Illinois Public Telecommunications Association, Martin Segal, Ex. 1.0; MCI Worldcom, Inc., David N. Porter Exs. 1 and 2; Nextlink Illinois, Daniel Gonzalez Exs. 1 and 2; and Sprint, David E. Stahly, Exs. 1.0, 1.0P, 1.1, and 1.1P. John Woodbury Exs. 2.0 and 2.1; and Paul A. Westcott Ex. 3.0.

## II. SUMMARY OF COOK COUNTY'S POSITION

The record demonstrates that the Joint Applicants have failed to prove that the proposed merger meets the requirements of Section 7-204 of the Public Utilities Act ("Act"). The Joint Applicants must satisfy all requirements of this Section in order for this reorganization to be approved. Having failed to satisfy the following sections, this merger should be denied. The evidence summarized below, and in section one of our brief, demonstrates that the proposed reorganization violates the following subsections of 7-204(b), and other sections of the Act:

**7-204(b)(1) the proposed reorganization will not diminish the utility's ability to provide adequate, reliable, efficient, safe and least-cost public utility service;**

The record demonstrates that:

- the proposed acquisition would threaten service quality through diversion of Illinois Bell managers and crafts personnel and other Illinois Bell resources and capital for reassignment to out-of-region National-Local Strategy and other ventures.

**7-204(b)(2) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by the utility or its customers;**

The record demonstrates that:

- the proposed acquisition will force captive customers of Illinois Bell noncompetitive services to subsidize out-of-region SBC competitive ventures, including its ambitious "National-Local Strategy".
- SBC will raid Illinois Bell management and other experienced personnel recruited and trained with funds provided by customers of noncompetitive services for reassignment in out-of-region National-Local Strategy and other competitive ventures.

**7-204(b)(3) costs and facilities are fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission may identify those costs and facilities which are properly included by the utility for ratemaking purposes;**

The record demonstrates that:

- unless the merged company files updated cost studies there is no assurance that ratepayers are not unfairly subsidizing non-utility activities including the financially risky “National-Local Strategy”.
- unless Staff has access to accounts, books, records, personnel and audit work papers there is no assurance that costs are properly allocated between utility and non-utility activities.

**7-204(b)(5) the utility will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;**

The record demonstrates:

- a continuing pattern of noncompliance with federal and state commission decisions by both Ameritech and SBC.

**7-204(b)(6) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction;**

The record demonstrates that:

- the proposed acquisition will eliminate SBC as an actual potential competitor in the Illinois local telephone service market.
- the proposed acquisition will fortify the Illinois local service market against significant competition by other service providers.
- the proposed acquisition will retard and diminish the development of actual and effective competition in the Illinois local service market.

**7-204(b)(7) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers.**

The record demonstrates that:

- SBC/Ameritech assurances that the residential rate freeze prevents increases in rates are useless due to the expiration of the residential rate freeze in the Alternative Regulation Order in ICC Docket Nos. 92-0448/93-0239 at 64.
- the proposed acquisition will place significant upward pressure on prices for Illinois Bell noncompetitive services as a consequence of the \$47 billion in premium over the regulatory-basis book value of Illinois Bell's intrastate operations that SBC will be paying as part of the \$62 billion acquisition cost of Ameritech.
- the Joint Applicants' intend to reclassify all services as competitive within three years and immediately raise rates despite the lack of effective price constraining competition.

For these reasons, the Commission should find that the merger will not serve the public interest, reject the Application and not permit the proposed merger

If, however, the Commission determines that it will permit SBC to acquire Illinois Bell, it must condition its approval on elimination or mitigation of the areas of risk and adverse consumer/competitive impacts through the imposition of safeguards. These mitigation measures fall into two categories, and are presented in section two of our brief: (1) operational practices and safeguards, and (2) allocation of economic benefits arising from the merger to customers of Illinois Bell's noncompetitive services.

### **III. ARGUMENT**

#### **A. THE RECORD DEMONSTRATES THAT THE JOINT APPLICANTS HAVE FAILED TO PROVE THAT THE PROPOSED MERGER MEETS THE REQUIREMENTS OF SECTION 7-204(b) OF THE PUBLIC UTILITIES ACT**

The record demonstrates that the Joint Applicants have failed to prove that the proposed merger meets the requirements of Section 7-204 of the Public Utilities Act (“Act”). The Joint Applicants have the burden of proof in this proceeding. The decision in this case must be based upon the record. 220 ILCS 5/10-103. The Joint Applicants failed to satisfy all requirements of this Section and therefore the reorganization should be denied. The Act defines “reorganization” as any transaction which results in a change in the ownership of a majority of the voting capital stock of an Illinois public utility; ... or by which two public utilities merge. 220 ILCS 5/7-204(a). The Joint Application provides that upon consummation of the merger, SBC will own 100% of Ameritech’s outstanding common stock and the prior holders of Ameritech common stock will become shareholders of SBC, equating to approximately 44% ownership of SBC’s common stock. Joint Application at 6.<sup>1</sup> Therefore, this merger clearly falls under the Commission’s jurisdiction.

The evidence demonstrates that the proposed reorganization violates the following subsections of 7-204(b), as well as other sections of the Act. The record compels a finding that the reorganization will adversely affect the utility’s ability to perform its duties under the

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<sup>1</sup> SBC falls within the definition of public utility because it is a corporation that, after the proposed merger will own, control, or manage a public utility within Illinois. 220 ILCS 5/3-105, 5/13-101.

Act, and therefore, the Commission should not approve this merger.

**1. The Proposed Reorganization Will Diminish the Utility's Ability to Provide Adequate, Reliable, Efficient, Safe and Least-Cost Public Utility Service**

The proposed reorganization would threaten service quality by diverting Illinois Bell investment capital, managers, personnel and other Illinois Bell resources from Illinois for reassignment to support the out-of-region National-Local Strategy and other ventures. Further, the importation of unduly aggressive marketing tactics used by SBC may further threaten Ameritech Illinois employees' ability to provide essential customer service functions such as promptly answering billing, repair, and service calls and fully informing customers about basic telephone service.

**i. Service Quality and Network Investment**

It is essential that Ameritech Illinois make the investments needed to maintain the quality of basic exchange services in Illinois and to upgrade the basic network infrastructure throughout its service territory so that all customers have access to a reasonable array of new products and quality services. The record demonstrates that Ameritech has missed the out of service over 24 hours standard for the past four years. GCI Ex. 2.0 at 40 (TerKeurst); Tr. at 815-16. Further, the record demonstrates that the proposed merger would cause service quality to deteriorate due to reductions in network investment, maintenance budgets, and personnel levels. GCI Ex. 2.0 at 11 (TerKeurst). SBC needs to recoup the \$13.2 billion premium it paid for Ameritech stock. Additionally, the enormous strain that financing the National Local Strategy ("NLS") would impose on Ameritech Illinois' revenue and investment funds would result in a deteriorating infrastructure here in Illinois.

Ameritech witness, Mr. Gebhardt, told the Commission that Ameritech will maintain network investment at its present level. SBC-Ameritech Ex. 3.0 at 7 (Gebhardt), Letter from Edward E. Whitacre, Jr. to Richard C. Notebaert (May 10, 1998). Applicants even assert that the merger would result in more advanced network infrastructure. SBC-Ameritech Ex. 3.0 at 38 (Gebhardt), GCI Ex. 2.0 at 12 (Terkeurst).<sup>2</sup> However, despite these representations, there is no guarantee that these expenditures will be used appropriately in Illinois. SBC has no substantive information about how Ameritech would maintain quality of service for its customers post-merger. GCI Ex. 2.0 at 11 (TerKeurst). Maintaining a high level of service quality in Illinois while simultaneously supporting the National Local Strategy ("NLS") is an enormous challenge. Given that the commitment to network investment is expiring in October 1999, there is no guarantee that this investment will continue, and given the competing demands from the National Local Strategy, the investment will diminish.<sup>3</sup>

Staff witness, Mr. Gasparin, notes that currently Illinois is on the cutting edge of communications advancement. Staff Ex. 5.0 at 9-10 (Gasparin). For example, all 1100 central offices ("COs") in Illinois utilize digital technology, while the 1997 ARMIS data shows that SBC still operates with antiquated, analog switches. *Id.* Mr. Gasparin is concerned that SBC will not continue to maintain the high level of advancement we have enjoyed in Illinois because

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<sup>2</sup> Citing SBC Response to ICC Staff data request CJ 2.01.

<sup>3</sup> According to the alternative regulation plan currently in effect, Ameritech Illinois is committed to invest \$3 billion in its intrastate network spread over five years. GCI Ex. 2.0 at 12 (TerKeurst). Ameritech Illinois files annual infrastructure investment reports with the Commission detailing projects and amounts invested in new technology in the prior year and providing the current year's budget. *Id.* Order at 64, ICC Docket Nos. 92-0448/93-0239 (Consol.).

SBC will divert Illinois resources to replace out-dated facilities in its home-region. Id.

Given SBC's risky expansion plans and the company's incentive to update its old facilities, SBC will neglect Illinois networks. Staff Ex. 5.0 at 9 (Gasparin). In an attempt by the merged entity to maintain overall cash flow in the face of large capital investments elsewhere in its thirteen state footprint, Illinois service will suffer. Id. Such a concern is even more acute for areas in Illinois facing the least amount of competitive pressures.

It is incumbent upon the Commission to ensure that proper safeguards exist to prevent a utility from skimping on investment in infrastructure especially in areas where natural competitive forces are not in place to provide protection through the market. The Commission should not accept Ameritech's assertion that tracking by individual products and services on a geographic basis cannot be done "except in certain rare circumstances where the investment is single-product related." SBC-Ameritech Ex. 3.1 at 107 (Gebhardt). Although Ameritech claims "the costs of tracking and reporting those expenditures on a geographic basis would exceed the informational value," Ameritech fails to explain or *quantify* those alleged costs. Id. The Commission should give no weight to Ameritech's claim absent any quantification of the alleged burdens.

Similarly, Mr. Kahan provides only self serving testimony that service quality in Illinois will not be diminished as a result of the merger. SBC-Ameritech Ex. 1.1 at 11 (Kahan). Absent a Commission mandate, SBC will change its priorities for network investment. Network investment for large corporate customers does not translate into improved residential service.

As discussed below, there is little similarity between the California and Illinois mergers. Second, if SBC is serious about adequately investing in Illinois post-merger, then it should have

no problem agreeing to a Commission imposed condition on investments. Mr. Gebhardt's and Mr. Kahan's assertions are contradicted by the testimony of SBC's other witness, Dr. Harris. Far from believing it "inconceivable," Dr. Harris warns of one particular scenario that could lead to reduced network investments in Illinois:

For example, to reduce costs beyond what could be achieved by merger efficiencies, Ameritech likely would be pressured to significantly reduce the number of employees throughout the organization. *This could have the undesired effect of constraining service quality in order to constrain costs or reducing Ameritech's incentives to invest in Illinois.*

SBC-Ameritech Ex. 4.1 at 47 (Harris) (*emphasis added*), GCI Ex. 2.1 at 8 (TerKeurst). While Dr. Harris posits that investment constraints could arise if the Commission requires merger synergies to be shared with customers, the point is that outside financial pressures arising from SBC's NLS would further diminish SBC's incentive to invest in Illinois where Ameritech already enjoys monopoly status and CLEC penetration is very low. Specifically, Mr. Kahan admits the NLS would entail "billions of dollars of new spending." SBC-Ameritech Ex. 1.1 at 57 (Kahan). For SBC to meet its obligations to its shareholders, SBC would clearly need to recoup these enormous costs in some way. Mr. Kahan's statements to the FCC corroborate this assertion:

*. . . SBC will experience significant earnings dilution and increased risks as a result of the start-up costs and losses during earlier years of the National-Local Strategy. This dilution cannot be borne by SBC alone. By spreading that dilution and risk across a broader base of shareholders, the combined SBC/Ameritech can continue to provide investors with appropriate returns notwithstanding the costly National-Local Strategy. . . .*

*Indeed, the business plan contemplates having a cumulative negative cash flow for nearly ten years. The remaining business*

*operations of the new SBC must carry these negative cash flows . . . Again, SBC on a stand-alone basis could not reasonably accept those short-term and medium-term losses, particularly given the rapidly changing nature of the industry that makes more distant gains less certain. GCI Ex. 1.0 at 55 (Selwyn)(emphasis added).<sup>4</sup>*

By SBC's own admission, even with potential increased revenues gained from expansion, SBC expects negative cumulative cash flows for nearly ten years. GCI Ex. 1.0 at 57 (Selwyn). Therefore to recoup these billions of dollars, skimping on infrastructure investments in Illinois is a probable solution. Another solution is increased rates in Illinois. Again, by SBC's own admission, it needs the Ameritech acquisition to provide a core revenue base for the NLS, and in the case of Illinois, that core revenue base will come from extensive noncompetitive services that Illinois Bell will continue to provide and dominate within its operating areas. *Id.* at 56. Whether SBC's solution is reduced network investments in Illinois, higher rates, or a combination of both, Illinois consumers lose out. Therefore, the inevitable result of the proposed merger is to diminish the utility's ability to provide adequate, reliable, efficient, safe, and least-cost telecommunications service in Illinois.

**ii. Job Creation and Retention**

It is essential that Ameritech Illinois retain highly effective, experienced managers and other personnel to maintain the quality of basic exchange services throughout its service territory. The proposed merger will result in a relocation of the best and the brightest Ameritech Illinois managerial talent as well as other personnel outside Illinois to support SBC's National Local Strategy. This will lead to service quality deterioration in Illinois as lesser-qualified personnel

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<sup>4</sup> Citing Kahan, FCC Affidavit at par. 79-80, (*emphasis added*)

would be left to attend to business in Ameritech Illinois' home region. Given the lack of competition here in Illinois contrasted to the huge barriers SBC would face out-of-region, common business sense dictates SBC would use its best personnel to staff its risky and ambitious NLS. Further, the NLS will result in the transfer of employees trained with ratepayer resources.

SBC claims that employment levels in Ameritech's region will not be reduced due to the merger and, in fact, claims that it expects the number of employees in Ameritech's region to increase. GCI Ex. 2.0 at 14-15 (TerKeurst).<sup>5</sup> Mr. Kahan says that Ameritech will continue to be operated "to the fullest extent possible" by the current management team. *Id.* at 14-15. However, SBC offers no explanation whatsoever as to what that "extent" might be. This is not evidence that adequate, reliable, least cost public utility service will be maintained.

Notwithstanding Mr. Kahan's "assurances," the reality is that SBC, in its efforts to cut costs in Illinois, may: reduce employee levels below those needed to maintain adequate service quality; relocate management out-of-state; redeploy the most experienced and valuable employees to its out-of-region expansion efforts; and redirect the employee count away from maintenance of high quality telecommunications services to activities the sole aim of which is enhancing profitability. GCI Ex. 2.0 at 15 (TerKeurst). In fact, SBC has admitted that it will rely on the merger to staff its expansion plans:

[T]he merger creates a much deeper pool of management and employee talent that is essential to carrying out this National-Local strategy. The necessity for extraordinary management and employee depth is particularly compelling when you consider the training and hiring demands that will be placed on a company to generate over 8,000 broadly dispersed, highly skilled jobs on such

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<sup>5</sup> citing May 10th Letter from Edward E. Whitacre Jr.

a rapid basis. . . .

. . . Even with Ameritech, we will be challenged to meet the personnel requirements of the strategy . . . It has generally been our experience that *staffing new ventures with a significant number of existing managers is preferable to relying extensively on newly hired managers.*

GCI Ex. 2.0 at 15-16. <sup>6</sup>

In the face of the business realities Mr. Kahan describes, Ms. Jennings disagrees with the suggestion that Ameritech Illinois stands to lose its best and brightest corporate talent to the NLS. SBC/Ameritech Ex. 5.1 at 10 (Jennings). Given the considerable risks involved in launching the National Local Strategy, and how much SBC has invested in the success of the NLS, contrasted to limited risks involved in maintaining Ameritech's customer base here in Illinois, it becomes clear that SBC will have a powerful incentive to raid the best and brightest of Ameritech corporate talent to man the NLS.

**iii. Risks of the National Local Strategy**

Mr. Kahan claims that the NLS is a direct result of SBC and Ameritech's judgment that the two monopolies must merge and become a national and global provider of telecommunications services to thrive in the new telecommunications industry. SBC Ameritech Ex. 1.0 at 6 (Kahan). Mr. Kahan claims that neither company could successfully launch the NLS on its own and that is one of the main reasons for merging. *Id.* at 5-7. Thus SBC claims that the only way to "withstand the competitive onslaught each faces in-region" is to combine strengths and embark on the NLS. *Id.* Thus by SBC's own admission, the success of the NLS is essential

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<sup>6</sup> Citing Kahan, FCC Affidavit at 28-29 (*emphasis added*).

to its long-term survival. Mr. Kahan also admits that the NLS will entail billions of dollars in new spending. SBC-Ameritech Ex. 1.1 at 57 (Kahan). This coupled with the fact that SBC is already paying a \$13.2 billion premium over the market value of Ameritech demonstrates the astronomical financial pressures that the plan imposes on SBC. GCI Ex. 1.0 at 9 (Selwyn). It is no surprise that SBC and Ameritech project negative cumulative cash-flows and earnings for a decade as a result of this project. Id.

SBC has represented to the FCC that it will staff its National Local Strategy from Ameritech. GCI Ex. 1.0 at 62-63.<sup>7</sup> SBC's staffing guidelines indicate that SBC, like any effective business organization, it places the best qualified people in new positions as well as in incumbent positions. Moreover, especially for new, high profile positions, employee qualifications are paramount in the SBC organization. Tr. 649-50; See Proprietary Cross Ex. 41 at SBCAMIL 023817, 023838, 023823. Considering that the NLS will create new managerial positions in the top thirty U.S. markets where SBC will encounter fierce competition from other RBOCs, such positions will be high-profile with fertile opportunities for advancement. Therefore, common business sense as well as SBC policy indicate that SBC would likely staff its National Local Strategy with the best and the brightest managers and employees available. Based on SBC's preference for staffing new ventures "with a significant number of existing managers" rather than relying on newly hired management, it is likely that Ameritech Illinois will lose many of its experienced, corporate managers and personnel, which in turn, will lead to diminished service in violation of the Act.

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<sup>7</sup> Citing Kahan (SBC) FCC Affidavit at Para. 78.

**iv. The Experience in California Subsequent to SBC's Acquisition of Pacific Telesis Demonstrates that Service Quality and Employment Levels in Illinois Will Be Diminished**

SBC witnesses, Mr. Kahan and Ms. Jennings point to experience in California subsequent to SBC acquiring Pacific Telesis Group attempting to alleviate any Commission concern that service quality and employment levels will be adversely affected by the instant acquisition. Subsequent to the Pac Tel/ SBC merger, the record demonstrates that large numbers of employees previously devoted to customer service shifted their focus to sales. First, the employment increases in California reported by SBC occurred disproportionately in the unregulated, competitive side of PacTel's businesses, not in the regulated, local exchange company. Second, even if the Commission believes that an adequate level of service quality in California has been maintained since the SBC/PacTel merger, the dynamics surrounding that acquisition and the instant one are so drastically different that one cannot expect similar performance here in Illinois. Therefore the Commission should reject SBC's arguments about California.

Mr. Kahan reports that the company's overall employment in California and Nevada is up 2200 from April 1, 1997 to August 14, 1998. SBC-Ameritech Ex. 1.0 at 20 (Kahan, revised). While these numbers represent an overall increase of 4.3%, the growth is spread unevenly among subsidiaries, with the basic service operations getting the short end of the stick. GCI Ex. 2.0 at 16 (TerKeurst). As of August 14, 1998, employment by PacBell, the local exchange company in California, had increased by only 205 jobs since the merger, which is less than 0.5 percent of its total employee level. Id. More importantly, the vast majority of these increases were in the competitive services end of PTG's business, not in the regulated end of the business. Id.

Specifically, almost 60% of the reported increases were in Pacific Bell Mobile (1300). *Id.* Ms. Jennings, while not denying the accuracy of Ms. Terkeurst's figures, responded to these facts by stating that the number of network service employees and customer service representatives at PacBell had increased by 1485 as of August 14, 1998. SBC Ameritech Ex. 5.1 at 11 (Jennings).<sup>8</sup>

While PacBell has added a small number of positions, as of August 14, 1998, more than 825 PacBell positions have been shifted to a focus on sales and marketing, resulting in a reduction in the network operations workforce. GCI Ex. 2.0 at 17 (TerKeurst).<sup>9</sup> This shift in allocation of human resources from network service positions to sales and marketing positions, is corroborated by PacBell President and CEO, Edwin A. Mueller's statements:

Let me clarify this point . . . our guidance with regard to force levels at Pacific remains consistent with what we've told you in the past. *What we're doing is redirecting our force increases to bring on more people who can help us generate . . . sales while we're reducing back-room operations.*

GCI Ex. 2.0 at 17 (TerKeurst).<sup>10</sup> While a corporation has a duty to its shareholders to generate profits, that should not come at the cost of a deterioration in service quality for Illinois consumers. A business plan that favors reducing "back-room operations" while increasing the force of telemarketers and sales personnel is not one that promises that quality, basic

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<sup>8</sup> The "1485" figure was updated to 1848 during cross examination of Ms. Jennings. Tr. at 628.

<sup>9</sup> The "825" figure was updated to 915 during cross examination of Ms. Jennings. Tr. at 628.

<sup>10</sup> *The Opportunity at Pacific Bell*, Presentation by Edward A. Mueller, New York Analyst Conference at 4, 8, 10 (June 23, 1998)(*emphasis added*).

telecommunications service will be maintained.

The pattern in California is the pattern the Commission should expect in Illinois leading to diminished service quality in violation of the Act and the merger should therefore be denied. However, even if the Commission were to accept that basic, regulated, telecommunications service quality has been maintained in *California*, the results of the proposed merger in *Illinois* would be far different. The dynamics of the PacTel acquisition were so dramatically different from the instant merger that the experience in California is not at all instructive of what we can expect in Illinois. First, the size of PacTel at the time SBC acquired it was smaller than Ameritech's current size, the acquiree in the instant merger. Prior to the merger, PacTel's region covered only two states, while Ameritech's region covers five states. PacTel owned 15.8 million access lines prior to the merger, while Ameritech owns more than 20.5 million access lines prior to the announcement of the instant merger.<sup>11</sup>

Second, SBC was not burdened with the enormous financial pressures associated with the Ameritech acquisition when it acquired Pacific Telesis. Specifically, SBC did not pay a mammoth \$13.2 billion premium to acquire PacTel. GCI Ex. 1.0 at 9 (Selwyn). More importantly, at the time of the PacTel merger, SBC had no plans to launch a risky, out-of-region venture into the top thirty U.S. markets. Tr. at 639-40. In other words, it had no plans to launch the National Local Strategy. *Id.* Without repeating the numerous risks and financial pressures

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<sup>11</sup> *In the Matter of the Joint Application of Pacific Telesis Group and SBC Communications, Inc. for SBC to Control Pacific Bell Which Will Occur Indirectly as a Result of Telesis' Merger With a Wholly Owned Subsidiary of SBC, SBC Communications Inc.*, 177 P.U.R. 4<sup>th</sup> 462 at \*18, 1997 Cal. PUC LEXIS 629 \*18 (March 31, 1997); Attachment to SBC-Ameritech Ex. 2.0, 1997 Ameritech Annual Report at 15.

that the NLS will impose on SBC, the fact that SBC was not burdened with these enormous pressures when it acquired PacTel demonstrates that any SBC performance regarding increased capital investments or increased staffing subsequent to the PacTel merger cannot be expected to be duplicated in Illinois. Nor can SBC's previous level of investment and employment increases be expected to continue in California. Indeed, Ms. Jennings made no promise that the number of Ameritech Illinois employees relocated outside Illinois post-merger would not exceed the number of Pactel employees relocated outside California as a result of that merger. Tr. 638-39.

Given the huge burdens the NLS would impose on SBC's finances and employee resources, massive relocation of Ameritech Illinois personnel is all too probable. The inevitable result is deterioration in service quality if the Commission were to approve the merger. Therefore, the Commission should reject SBC's contention that its performance here in Illinois post-merger would not prove worse than its already dubious track record in California absent strict service quality conditions.

**v. Marketing Practices**

Ms. TerKeurst raises serious concerns that some of what SBC perceives as "best practices" will lead to overly aggressive marketing tactics being adopted in Illinois. GCI Ex. 2.0 at 30 (TerKeurst). Some of these practices are misleading in that certain optional products and services are held out as basic services and customers purchase such items based on mistaken information. *Id.* at 30, 31. Ms. TerKeurst is not alone in her concern over SBC's overly aggressive marketing practices. Several complaints and other filings regarding PacBell's marketing practices have been registered with the California Public Utilities Commission

(CPUC) since SBC acquired Pacific Telesis. Id.<sup>12</sup> All these complaints make similar allegations: For example, Pacific Bell's practices of having optional feature packages with "basic" in the brand name is confusing to customers and likely results in customers purchasing more or higher-priced products than a consumer truly wants. GCI Ex. 2.0 at 31 (TerKeurst). Moreover, Pacific Bell offers only the highest-priced inside wiring plans to customers without informing customers that they can obtain inside wire services elsewhere. Id.

The inside wiring practice case illustrates Pac Bell's aggressive marketing practices. Pacific Bell combines the residential inside wire maintenance plan which carries a regulated price of \$0.60 per month with an unregulated, optional service. Id. at 32. The combined package is offered for \$2.25 per month, with no mention that the inside wire portion, by far the most valuable portion of the package, is available for one-fourth of the combined price. Id. Further, representatives do not inquire whether the customer rents, and do not inform the customer that California law makes landlords responsible for inside wiring in rental situations. The inequitable result is that a larger percentage of renters subscribe to the inside wire maintenance program than do homeowners, even though renters do not need the service at all. Id.

One report by the California Public Utilities Commission ("CPUC") states, for example,

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<sup>12</sup> The Utility Consumers' Action Network v. Pacific Bell, C. 98-04-004; Greenlining Institute and Latino Issues Forum v. Pacific Bell, C.98-06-003; The Utility Consumers' Action Network v. Pacific Bell, C.98-06-027; Motion of the Office of Ratepayers Advocates for Authorization to Publicly Release Its Report on Pacific Bell's Handling of Residential Service Ordering (filed on June 4, 1998 in I.90-02-047); Telecommunications International Union, California Local 103, International Federation of Professional and Technical Engineers, AFL-CIO (TIU), on Behalf of TIU Members, as Consumers of Pacific Bell Services and Employees Responsible for Customer Service, v. Pacific Bell, Pacific Telesis, and Southwestern Bell Communications (C.98-06-049).

that PacBell directs its service representatives to offer a \$12.95 package of optional features under the brand name, "Basic Saver Pac," before attempting to sell customers individual features included in the package. Cross Ex. 12 at p. 8, Tr. at 748. On cross examination, Charles H. Smith, President of Pacific Bell Network Services, disagreed that this was the practice employed by PacBell service representatives. Tr. at 748-50. However, it became clear upon questioning by Examiner Goldstein, that Mr. Smith had no basis to disagree with this report by the CPUC because he had never listened to customer service calls since the merger. Tr. at 753. Mr. Smith then admitted that he was unaware of what text PacBell service representatives use when they actually receive calls from customers. Tr. at 753-54. The Commission should find that diminished service quality will result from this pattern of marketing abuse and therefore should not approve this merger.

Such unfair and time-consuming sales techniques could negatively affect Ameritech Illinois' ability to provide essential customer service functions such as promptly answering customer billing, repair, and service calls and fully informing customers about basic telephone service. GCI Ex. 2.0 at 33. The cases pending in California are but one indication of the additional workload the Commission may expect as a result of the proposed merger absent strict conditions that would mitigate the negative effects of SBC's unfair and unduly aggressive marketing practices.

**2. The Proposed Reorganization Will Result in the Unjustified Subsidization of Non-Utility Activities by the Utility or its Customers;**

Following the merger, Illinois will represent only 12% of the new SBC's ILEC operations, and will be required to compete for capital with twelve other SBC ILEC states,

with SBC's National-Local Strategy operations, its wireless business, and various international and other ventures. GCI Ex. 1 at 14 (Selwyn). SBC has stated its plan to raid Ameritech managerial talent to support its National-Local Strategy, citing that specific capability as one of the reasons why the merger is a necessary precondition for its National-Local Strategy. The removal of capital and managerial talent, paid for by Illinois ratepayers will result in the unjustified illegal subsidization of non-utility activities by the utility in violation of the Act. 220 ILCS 5/7-204(b)(2).

The proposed reliance upon post merger SBC ILEC core revenues to buttress the National Local strategy violates both the Section 254(k) of the Federal Telecommunications Act because "a telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition," and Section 7-204(b)(2) of the Public Utilities Act requiring the Commission to determine that "the reorganization will not result in the unjustified subsidization of non-utility activities." GCI Ex. 1.0 at 61 (Selwyn); 47 U.S.C.S. § 254(k); 220 ILCS 7-204(b)(2). SBC plans to flow revenues from its core services to make up the ten years' worth of losses it expect to sustain from the National Local Strategy. Id. Additionally, SBC intends to exploit and raid assets and other resources of Illinois Bell acquired and funded through revenues from its noncompetitive services. Id. at 61-62<sup>13</sup> Both Mr. Kahan and Dr. Carlton indicate that SBC will staff its National Local Strategy from Ameritech. Id. at 62-63. Recruitment and training of ILEC management personnel is costly and time consuming, the costs of which have been funded by the revenues from core

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<sup>13</sup> Citing Kahan (SBC) FCC Affidavit at Para. 78.

monopoly services. GCI Ex. 1.0 at 63 (Selwyn). Allowing the nonregulated CLEC affiliates comprising the National-Local Strategy to raid ILEC managerial resources constitutes cross subsidization that is not permitted by federal or state law.

The large commitment of capital and other resources will increase the overall portfolio risk of a merged SBC/Ameritech. Capital costs are allocated among the various SBC ILECs on an average basis rather than in relation to the specific risks peculiar to each line of business. An increase in Illinois Bell's cost of capital due to the inclusion of the highly risky National-Local Strategy could cause Illinois Bell to report poorer financial performance overall as part of an attempt to revise the price cap plan. *Id.* at 64-65. In adopting price cap regulation in its 1994 ruling, the Commission expressly linked its review of the price cap plan to IBT's performance and earnings over the initial five-year period. Therefore, the inclusion of the high-risk National-Local Strategy in the IBT cost of capital could eventually, if not immediately, translate directly into higher rates for IBT services. *Id.*

Further, cross subsidization is also impermissible under Section 254(k) of the federal Telecommunications Act of 1996. 47 U.S.C.S. § 254(k). By failing to allocate to Illinois Bell ratepayers the merger savings and an offset that corresponds with the reduction in Illinois Bell's regulated costs that support competitive activities, Illinois Bell is permitted to earn excessive profits which can be used to finance the money losing National Local Strategy for up to ten years. This type of cross subsidy is expressly prohibited under Section 254(k). GCI Ex. 1.0 at 76 (Selwyn).

**3. Costs and Facilities Are Not Fairly and Reasonably Allocated Between Utility and Non-Utility Activities in Such a Manner that the Commission May Identify Those Costs and Facilities Which are Properly Included by the Utility for Ratemaking Purposes**

Any use of SBC ILEC book and non-book assets and other resources by SBC's National-Local Strategy CLECs (or other competitive ventures) requires a cost allocation between utility and non-utility ventures. GCI Ex. 1.0 at 65 (Selwyn). SBC's plans to finance relatively risky ventures based upon the financial strength and stability of its ILEC entities will require the filing of updated cost studies to ensure that ratepayers are not unfairly subsidizing non-utility activities. While Mr. Gebhardt agreed that he will follow affiliate rules to ensure that ratepayers are not unfairly subsidizing non-utility activities, the Commission cannot monitor these activities without access to accounts, books, records, personnel and audit work papers. Access to these records is necessary to assure that costs are properly allocated between utility and non-utility activities, and to prevent any subsidization of non-utility activities. Tr. at 866-71. Additionally, the Commission should require updated cost allocation manuals to be filed as a condition of this merger to comply with Commission procedures. 83 Ill. Admin. Code Part 711; ICC Ex. 1.0 at 12-13, 15-16 (Marshall). Unless the Commission adopts Staff's recommendation, improper allocation of costs will lead to subsidization of non-utility activities and the improper allocations will remain undetected by Staff. ICC Staff Exs. 1.00 at 12-22, 1.01 at 11-20 (Marshall).

**4. The Evidence Demonstrates A Pattern of Noncompliance with Commission Orders**

While the Act requires that the utility will remain subject to all applicable laws,

regulations, rules, decisions and policies governing the regulation of Illinois public utilities, the evidence demonstrates a clear pattern of noncompliance by SBC and Ameritech with Commission Orders. Following is a sample of that noncompliance. An example of a utility's failing to follow applicable law until ordered to do so can be offered than SBC Ameritech's argument that Section 7-204(c) does not apply to this case, or SBC's argument that the savings provision under California law did not apply. Tr. 510. The statute is clear on its face yet the utility flaunts the clear language of the statute to avoid giving ratepayers their due. Both the Commission, the FCC, and the United States Court of Appeals for the Eighth Circuit have directed Ameritech to offer common transport to new local exchange carriers. ICC Staff Ex. 5.0 at 4 (Gasparin).<sup>14</sup> Ameritech is currently defying these directives and not offering the service. Staff witness Marshall also testifies that Ameritech failed to comply with Commission Orders regarding Bands B and C business rates and operator assistance/credit card charges, and reciprocal compensation. ICC Staff Ex. 1.0 at 17-18; ICC Docket Nos. 95-0584; 97-0404; 97-0519; 97-0525. Given this pattern of noncompliance, the Commission should not find that future behavior will be different, and therefore, should not approve this merger.

The record is also replete with examples of SBC's actions to undermine the authority of regulators. ICC Staff Ex. 3.0 at 17-20 (Yow); AARP Exs. 1.0 at 29-31; 2.0 at 3 (Cooper).<sup>15</sup>

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<sup>14</sup> Citing ICC Docket No. 96-0486/96-0569 Consol. at 104-107; ICC Docket No. 96-0404 at 58; FCC Third Order on Reconsideration - August 18, 1997; Southwestern Bell v. FCC, 153 F.3d 597 (8<sup>th</sup> Cir. August 1998).

<sup>15</sup> Citing Investigation of Southwestern Bell Telephone Company's Entry into the InterLATA Telecommunications Market, Public Utility Commission of Texas, Project No.

SBC refused to comply with the Texas Public Utility Commission order to provide physical and virtual collocation arrangements. *Id.* SWBT was ordered to file and revise its proposed physical collocation tariff three different times. AARP Exs. 1.0 at 30, 2.0 at 2-3 (Cooper).

In addition to the evidence demonstrating regulatory noncompliance, as Mr. Kahan testified, SBC's headquarters in San Antonio, Texas will be dictating the general corporate goals, commitments and business principles that Ameritech Illinois managers will have to follow. Given the evidence of regulatory noncompliance, the Commission should determine that this merger will make continued effective regulation of an out-of-state headquartered monopoly nearly impossible.

Further, while compliance with Section 271 of the Telecommunications Act of 1996 is voluntary, both SBC's and Ameritech's actions are consistent with an obstructionist litigious posture. SBC unsuccessfully challenged Section 271 of the Telecommunications Act. *SBC Communications, Inc., et al. v. FCC, et al.*, 981 F. Supp. 996 (5<sup>th</sup> Cir. 1998), (cert. denied) U.S. ;1999 U.S. LEXIS 735; 142 L. Ed. 2d 788; 67 U.S.L.W. 3458. Ameritech has continually contested Section 271 of the Telecommunications Act of 1996. AARP Ex. 2.0 at 3-6 (Cooper). Whenever Ameritech disagrees with the FCC or the state PUC, it insists that regulators reconsider their position. *Id.* Three years after the Telecommunications Act of 1996 was passed, Ameritech is still debating the framework of Section 271. *Id.*

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16251, April 1, 1998, pp. 11-12; The Commission should also consider the evidence of SBC's inflexible and restrictive interpretations of the interconnection agreements with parties.

**5. The Proposed Reorganization is Likely to Have a Significant Adverse Effect on Competition in Those Markets Over Which the Commission has Jurisdiction**

Contrary to Joint Applicants' representations, the merger would lead both to diminished actual and potential competition in Illinois and in the Ameritech region generally by removing SBC as a potential entrant and by fortifying the merged company's ability to protect its entrenched position of market dominance against competitive inroads. ICC Staff Exs. 3.0 at 13 (Yow), 4.0 at 1-42 (Graves), 5.0 at 4 (Gasparin), 8.0 at 17-24 (McClerren); AARP Ex. 1.0 at 4-6, 11-43 (Cooper). According to Dr. Hunt, the path without the merger will lead to more competition than the path with the merger. Tr. 1703-04. The record demonstrates the abysmal state of residential and small business competition. And, as Mr. Kahan conceded, the state of competition for the average residential or small business customer is not expected to change as a result of this merger. Tr. 505.

The following statements from both SBC and Ameritech witnesses should be given far more weight by the Hearing Examiners than the self serving testimony. First, SBC witness Mr. Kahan stated in his FCC affidavit that SBC's National and global ambitions" phase "really began in earnest during the fall of 1997 after events in the industry compelled SBC to more aggressively seek to become a national, and ultimately an international, enterprise in order to remain a viable contender for the many growth opportunities which we anticipated." Kahan (SBC), FCC Affidavit at Paras. 4, 10; GCI Ex. 1.0 at 17-18 (Selwyn). Mr. Kahan's sworn FCC statement demonstrates SBC's intent to become a national and international provider.

Moreover, Mr. Kahan's FCC affidavit is also consistent with his October 1996

testimony before the California PUC that the Company would consider *de novo* entry in Chicago (where SBC already has “existing brand name, infrastructure, and customer base”) GCI Ex. 1.0 at 30-31(Selwyn).<sup>16</sup> These statements of intent combined with the facts concerning SBC’s resources demonstrate that SBC is a potential actual competitor of Ameritech. GCI Ex. 1.0 at 22-23 (Selwyn). Second, Ameritech witness Mr. Gebhardt admitted that SBC was a potential Ameritech competitor until merger talks began with SBC in February 1998. Tr. 934.

The above statements are far more credible and reliable than self serving pre-filed testimony made for the express purpose of demonstrating that the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction as required by the Act. 220 ILCS 5/2-204(b)(6). Both as a result of geographic proximity and a national market entry strategy, SBC is the RBOC that would be most likely to attempt a *de novo* entry into the Illinois local exchange market absent its takeover of Ameritech. GCI Ex. 1.0 at 27 (Selwyn). SBC’s extensive cellular presence in the Chicago MSA, coupled with the large number of national and multinational corporations that are headquartered in the Chicago area and Chicago’s status as the nation’s “second city” strip SBC’s claimed lack of interest in Chicago of all credibility. GCI Ex. 1.0 at 27(Selwyn); ICC Staff Ex. 4.01 at 7.

Not only are the above statements, the national market entry strategy, and the geographic proximity persuasive evidence that SBC is an actual potential competitor of

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<sup>16</sup> Citing Cal. PUC A.96-02-028, Rebuttal Testimony of James S. Kahan (SBC) at 3.

Ameritech, SBC applied for and was issued a certificate of local exchange authority in Illinois. GCI Ex. 1.1, Appendix 2 (Selwyn).<sup>17</sup> As early as 1995, SBC had plans to enter Ameritech's market. Therefore, the Commission should disregard Applicants' testimony indicating a convenient change of mind for purposes of the merger based on easily refuted "evidence".

The Department of Justice and Federal Trade Commission 1992 Horizontal Merger guidelines and the April 8, 1997 revisions can provide a useful framework for analyzing competition. However, the applicable standard that is controlling in Illinois is set out in 7-204(b)(6) of the Act. Even the FCC *In the Applications of NYNEX Corporation Transferor, - and - Bell Atlantic Corporation Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985, 1997 FCC LEXIS 4349, FCC 97-286 (Adopted August 14, 1997) noted the novel features of the telecommunications market:

"We therefore see no reason to apply mechanically the 1984 Merger Guidelines' provisions on potential competition to the novel features of telecommunications markets, and will evaluate the number of most significant market participants and the competitive effects of mergers among them, even where three other potential competitors with equivalent competitive capabilities to the merger parties remain." *Id.* at Para. 68.

Also, the FCC in the opinion and order *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor To AT&T Corp., Transferee.*, Memorandum Opinion and Order, FCC 99-24,

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<sup>17</sup> SBMS Illinois Services, Inc. Application for a Certificate of Local Exchange Service Authority and Certificate of Service Authority to Resell Local and IntraMSA Interexchange Telecommunications Services Within Those Portions of Market Service Area 1, ICC Docket 95-0347, filed July 21, 1995, Granted 12/29/95, Expanded 5/21/97; ICC Staff Ex. 4.0 at 27-28 (Graves).

CS Docket No. 98-178 (Adopted: February 17, 1999, Released: February 18, 1999) states:

This analysis must include, among other things, consideration of the possible competitive effects of the transfer. [footnote omitted] Our public interest analysis is not, however, limited by traditional antitrust principles. [footnote omitted] In the telecommunications and cable industries for which we have statutory responsibility, as in most others, competition is shaped not only by antitrust rules, but by the regulatory policies that govern the interactions of firms inside the industries. An antitrust analysis -- such as that undertaken by the Department of Justice in this case -- focuses solely on whether a proposed merger will harm competition. Our public interest analysis, however, also encompasses the broad aims of the Communications Act... Id. at Para. 14.

However, in Illinois the Commission is applying the standards set out in the Public Utilities Act and leaving it to the DOJ and FCC to address the Federal standards. The Illinois Commission's analysis in this case should encompass the broad aims of the Illinois Public Utilities Act. The Commission here in Illinois is free to adopt its own framework to examine whether the proposed reorganization is not likely to have a significant adverse effect on competition. As the evidence shows and the analysis in this brief highlights, the Commission should find that this merger will likely have a significant adverse effect on competition and deny the merger.

As discussed below, the record demonstrates that SBC is an "actual potential competitor in the Ameritech region". "An actual potential competitor is a firm that does not currently compete in the relevant market but would enter sometime in the near future, either independently or in combination with another entity." 1997 Cal. PUC LEXIS 629,\*86; 177

P.U.R. 462<sup>18</sup> The record in the instant case is clear that SBC would enter the Ameritech market in the near future. The Applicants' claims that neither SBC nor Ameritech had any plans to offer local wireline exchange service in the other's home region should be disregarded. Applicants' claim that if and only if the merger is permitted to go forward will they pursue a National-Local Strategy in which the post-merger SBC will enter and offer local wireline exchange service in each of the top 30 US markets outside of the 13-state SBC/Pacific/SNET/Ameritech region; and that this National-Local Strategy will in turn stimulate other RBOCs to enter and offer local services within the SBC/Pacific/SNET/Ameritech footprint should also be disregarded as speculative. ICC Staff Ex. 4.01 at 5-6.

SBC's evidence that it had no plans to compete in the Ameritech region should be disregarded. For the same reasons that Ameritech is such an ideal partner for the National Local Strategy, if the merger were not approved, SBC would find an alternate way to enter Ameritech's service territory on its own. As Mr. Kahan conceded, SBC does not intend to remain a regional provider. Tr. 556-57. The only evidence offered is the affidavit of Mr. Stan Sigman, President and CEO of SBC Wireless, Inc. ("SBCW") who extrapolates that because a less than full effort SBCW market trial to offer local wireline service in Rochester, New York, that SBC would not possibly consider a full scale local service entry in Chicago.

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<sup>18</sup> Re Pacific Telesis Group, Joint applicant: SBC Communications, Inc.; Decision No. 97-03-067, Application No. 96-04-038 (California Public Utilities Commission, March 31, 1997).

GCI Ex. 1.0 at 27-28 (Selwyn).<sup>19</sup> SBC picked the smallest market in which it was then operating for its market trial. *Id.* at 32. Mr. Sigman's affidavit describes an organizational strategy that was a minor appendage on the existing SBC Wireless operation including training installation personnel and purchasing two vans to allow SBC personnel to make customer premise visits. *Id.* SBC's evidence is that because SBC found it unprofitable to operate a lemonade stand in Rochester, it concluded that the only way it could succeed is to acquire Walmart. *Id.* at 31-34. SBC had acquired the "A" block ("non-wireline") cellular license in Rochester only recently, up until 1994, the Rochester system was operated by Associated Communications, Inc., a Pittsburgh-based broadcaster that had divested all of its cellular holdings (most of which were in upstate New York) by the end of 1994. *Id.* at 31.

By contrast, SBC had acquired its ownership of the Chicago "A" block license in 1988, and thus has been active in the Chicago telecommunications market for eight or nine years. *Id.* SBC was not the first large company to attempt to resell local exchange service in Rochester. *Id.* By the time that SBCW began offering resold Frontier (formerly Rochester Telephone Company) service for resale "in early 1997," Time Warner and AT&T had already tried and failed to make any serious inroads into the Rochester residential or small business market, and both had ceased offering service to new customers. *Id.* For all of these reasons, the Rochester trial is hardly evidence demonstrating a good faith effort at entry into another market. Comparing their smallest market with very few resources to a well established Chicago market with between 900,000 and 1,000,000 current cellular customers, holding

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<sup>19</sup> Citing Sigman (SBC) FCC Affidavit at Para. 17.

nearly three million individual telephone numbers in the five Chicago area codes, is irrelevant to the issue of whether SBC had plans to enter the Ameritech market.

Similarly, Ameritech sought to package out-of-region local exchange service with its cellular service. GCI Ex. 1.0 at 34 (Selwyn); Cross Ex. 29. While Ameritech claims that this was a trial for its employees, the advertisement placed in the Saint Louis telephone book advertising Ameritech local service proves that this trial was not limited to its employees. Cross Ex. 29; Tr. 1091-99. The two month trial began January 26, 1998 and ended March 1998. The merger talks began on February 24, 1998, a month after the trial began, guaranteeing a speedy conclusion to Ameritech's plans to offer local telephone service within SBC's region. GCI Ex. 1.0 at 36 (Selwyn). Therefore, Ameritech's testimony regarding the problems with this trial should be given very little weight due to the near simultaneous timing of the trial and the merger.

By taking SBC out of contention, as the merger would do, a uniquely qualified actual potential competitor to Ameritech's Illinois local service monopoly disappears. GCI Ex. 1.0 at 23 (Selwyn); ICC Staff Ex. 9.0 at 23 (Hunt). The record demonstrates that only SBC, through its established cellular presence, has a national/global focus, the financial resources, and the pool of managers with specific experience in the local telephone business, coupled with an existing customer base in the Chicago area. *Id.* at 22-23. Only the RBOCs, as they presently exist, are uniquely positioned to bootstrap their monopoly local service relationship with national companies headquartered or otherwise maintaining telecom-intensive operations within the RBOC region into out-of-region markets. *Id.* at 24. No other provider - not "AT&T/Teleport/TCI, MCI/WorldCom/MFS/Brooks Fiber/UUNet, Sprint/France

Telecom/Deutsche Telekom [or any] other global competitors” possess a special near-monopoly relationship with large national/multinational customers. *Id.* None of these firms presently provide any consequential quantity of local exchange service anywhere in the United States. *Id.*

The impact of combining two RBOCs and the subsequent effects on competition must be examined notwithstanding the Joint Applicants’ claim that the combination of SBC/Pacific/SNET and Ameritech monopolies will not increase their market power overall. The FCC’s reasoning in the *Bell Atlantic/Nynex* decision is directly applicable to the instant case and provides additional justification for disapproving this merger.<sup>20</sup> While the FCC granted the application in the *Bell Atlantic/Nynex* case, it noted that:

Granting this application subject to conditions does not mean that applicants will always be able to propose pro-competitive public interest commitments that will offset potential harm to competition. *Id.* at 19993. ... A merger that in the relevant markets, eliminated a competitor with even greater assets and capabilities than [sic] Bell Atlantic would present even greater competitive concerns. *Id.* at 19993-94.

The SBC/ Ameritech merger is exactly such a case where SBC is a competitor with greater assets and capabilities. SBC is the third largest local exchange carrier in the United States and the ninth largest in the world.<sup>21</sup> No amount of pro-competitive public interest commitments

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<sup>20</sup> *In the Applications of NYNEX Corporation Transferor, - and - Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, 12 FCC Rcd 19985, 1997 FCC LEXIS 4349, FCC 97-286 (Adopted August 14, 1997)

<sup>21</sup> GCI Ex. 1.0 at 24; 1998 Fortune 500 and 1998 Fortune Global 500, <http://www.pathfinder.com/fortune/>.

will offset potential harm to competition in the instant case.

Further the FCC stated:

We also note that we are concerned about the impact of the declining number of large incumbent LECs, on this Commission's ability to carry out properly its responsibilities to ensure just and reasonable rates, to constrain market power in the absence of competition, and to ensure the fair development of competition that can lead to deregulation. During the transition to competition it is critical that the Commission be able effectively to establish and enforce its pro-competitive rules and policies. As diversity among carriers declines, both this Commission and state commissions may lose the ability to compare performance between similar carriers that have made different management or strategic choices. We often rely, for example, on cross-carrier comparisons as strong evidence as to technical feasibility or reasonableness. The Bell Companies, being of similar size, history, and regional concentration have, to date, been useful benchmarks for assessing each other's performance. Reducing the number of Bell Companies makes it easier to coordinate actions among them, and increases the relative weight of each company's actions on average performance. Because we approve this merger with conditions, thereby reducing the number of independently controlled large incumbent LECs, *future applicants bear an additional burden in establishing that a proposed merger will, on balance, be pro-competitive and therefore serve the public interest, convenience and necessity.* *Id.* at 19994. (emphasis added)

The concerns raised by the FCC in *Bell Atlantic/NYNEX* are applicable to the SBC/Ameritech merger. The combination of the two RBOCs in the instant case will have a significant adverse effect on competition in Illinois.

The Applicants' claim that the FCC's concerns over the slow progress toward achieving local competition expressed in the *BellAtlantic/Nynex Merger* Order would no longer apply. This claim is consistent with Applicants' pattern of offering unsupported testimony as "evidence" in this proceeding. The concrete evidence in this docket demonstrates major

dissatisfaction with the inadequacy of ILEC operations support systems. GCI Ex. 1.0 at 51 (Selwyn). ILECs continue to be unwilling and/or unable to provide combinations of UNEs without unwieldy and expensive physical collocation arrangements. *Id.* at 51-52. CLECs are having a difficult time sustaining any significant level of entry in the residential and small business markets. *Id.* at 52. The Commission should give far more weight to this evidence in determining that this merger is likely to have a significant adverse effect on competition.

Despite its present position as the third largest local exchange carrier in the United States and the ninth largest in the world, SBC whines that it “lacks a sufficiently broad customer base to allow SBC to be competitive” with firms such as “AT&T/Teleport/TCI, MCI/WorldCom/MFS/Brooks Fiber/UUNet, Sprint/France Telecom/Deutsche Telekom and other global competitors”. GCI Ex. 1.0 at 24 (Selwyn), citing Kahan (SBC), FCC Affidavit at Para. 76. As noted above, none of these firms provide any consequential quantity of local exchange service anywhere in the United States. Therefore, SBC’s claims should be disregarded.

Further, in the nearly fifteen years since the break-up of the former Bell System and the nearly three years since the enactment of the 1996 federal legislation, none of the regional Bells has taken any significant steps at entering local exchange markets outside of each Bell’s home region. GCI Ex. 1.0 at 25 (Selwyn). It is only through SBC’s near monopoly status with large national/multi-national customers that it believes its National Local Strategy will succeed. A total of 129 Fortune 500 companies have headquarters in SBC’s eight home-state region. *Id.* at 23-24. If the merger is allowed, the number of Fortune 500 companies in SBC’s thirteen state region increases to 224. *Id.* at 23. This statistic alone should confirm that

RBOCs, particularly the third largest RBOC in the United States, and the ninth largest in the world, is uniquely situated to bootstrap their monopoly local service relationship with national companies headquartered or otherwise maintaining telecom-intensive operations within the RBOC region into out-of-region markets.

If the National-Local Strategy will be pursued only if the merger takes place, then the merger will reduce, not expand the potential for effective competition in the Illinois local exchange market. The proposed SBC/Ameritech merger violates both the Department of Justice Merger Guidelines because the proposed merger will “create, enhance, or facilitate exercise of market power” and Section 7-204(b)(6) of the Public Utilities Act because the merger is “likely to have a significant adverse effect on competition.” 220 ILCS 5/7-204(b)(6); ICC Staff Exs. 4.00 at 39-42; 4.01 at 6, 18; 9.0. Common sense tells the Commission this is the bully on the playground with \$30 billion in total assets and more than 33 million access lines.

The Commission should weigh the merger’s effect on competition carefully in light of the current state of competition. Extending Ameritech or SBC’s near monopoly status with business customers will further harm the already dismal state of competition for all customers. Despite the Applicants’ citation of statistics to prove rapidly growing competition, the only accurate statistics the Commission should examine are the penetration results presented by Mr. Kahan. Again, as Dr. Selwyn testified, “... counting up all of the lemonade stands in the country teaches nothing about the comparative total retail market share of these (perhaps tens of thousands of) pre-teen enterprises relative to that of one Walmart.” GCI Ex. 1.0 at 43 (Selwyn). According to Mr. Kahan, only slightly over 1% of the 32 million plus access lines

being furnished by SBC represent facilities-based CLEC services. *Id.* at 39. Mr. Kahan identified a total of 1,017,883 CLEC lines across the seven state SBC operating territory. Of this amount, only 367,921 lines, or slightly over 1% are facilities based CLECs. The remaining 649,962 CLEC lines are identified by Mr. Kahan as resold SBC services. *Id.* SBC continues to furnish the 649,962 resold CLEC lines and they cannot be excluded from the near 99% market share that SBC continues to hold. *Id.* at 40.

The data demonstrates that SBC has very effectively limited competitive losses in the markets in which it operates. GCI Exs. 1.0 at 40 (Selwyn); 2.0 at 42, 44 (TerKeurst). About 1.5%, or 274,099 CLEC lines of the roughly 17.7 million Pacific Bell and Nevada Bell access lines are facilities based. GCI Ex. 1.0 at 40 (Selwyn). SBC did not take over these Pacific Telesis states until April 1997. In the five SWBT states, facilities based CLEC lines represent only 0.6% of the roughly 15.7 million SWBT access lines. GCI Exs. 1.0 at 40 (Selwyn), 2.0 at 44-46 (TerKeurst). The extent of facilities based CLEC penetration is more than two and one half times as much in the two states that SBC did not control until last year, California and Nevada, than in the five states that SWBT (Texas, Oklahoma, Kansas, Missouri, and Arkansas) has dominated since the formation of SBC in 1984. *Id.* First, the Commission should note that CLEC market shares are barely above zero anywhere, despite passage of the Telecommunications Act of 1996. Second, the even more dismal SWBT results demonstrates that SBC is not committed to opening its marketplace to competition.

Similarly, the state of competition within Ameritech's operating areas is dismal. GCI Exs. 1.0 at 41 (Selwyn); 2.0 at 43-47 (TerKeurst). Based on the results of the Common Carrier Bureau's Local Competition Survey, only about 2.0% of Ameritech lines were being

resold on a “bundled” (total service resale of TSR) basis, about 0.3% of local service lines were being provided over UNE loops purchased by CLECs, and about 0.3% of local numbers had been “ported” by ILECs to competing local service providers via interim local number portability. *Id.*<sup>22</sup> In Illinois, only about 3.0% of lines were being resold on a “bundled” (total service resale or TSR) basis, about 0.3% of local service lines were being provided over UNE loops purchased by CLECs, and about 0.2% of local numbers had been “ported” by ILECs to competing local service providers via interim local number portability. GCI Exs. 1.0 at 42 (Selwyn); 2.0 at 43-47 (TerKeurst). Out of a total of 283 serving wire centers identified by Ameritech Illinois, only 24 had a physical collocation arrangement with at least one CLEC utilizing UNE loops. *Id.* CLECs have obtained a very small share of the local market, and approval of this merger will guarantee a stranglehold on competition by the monopolists.

The Commission should also consider that despite SBC’s claimed commitment to compete aggressively in the residential and small business segments in the 30 out-of-region National-Local Strategy markets that SBC plans to enter, SBC anticipates only a 4 percent overall penetration rate of residential customers in all 30 markets. GCI Exs. 1.0 at 43-44

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<sup>22</sup> The number of unbundled loops being sold to CLECs is an important direct indicator of the extent to which the incumbent carrier is providing interconnection and access to its facilities on reasonable terms and conditions. While resale is a critical aspect of local competition, it is not as important as facilities based competition in evaluations of progress toward sustainable competition. Resale is not an effective force in disciplining the market. As long as a reseller can obtain capacity only from the incumbent carrier, it remains in many respects hostage to the incumbent, e.g., regarding prices, quality of service, ordering and provisioning, technologies used, and the services (including calling scopes and billing plans) it can offer its customers. Because of this, BOCs could take steps to make resale unattractive to CLECs and their customers and could eliminate gains achieved to date. GCI Ex. 2.0 at 45-47 (TerKeurst); See also ICC Staff Ex. 9.0 at 37-39 (Hunt).

(Selwyn); 2.0 at 54, 61-63 (TerKeurst). Therefore, even if SBC's claim about retaliatory entry is correct, ILECs will only achieve a 4% competitive market share, leaving 96% of these segments to the ever expanding SBC monopoly. GCI Ex. 1.0 at 44 (Selwyn). These figures hardly support Applicants' claim that all services would be determined to be competitive within three years. Further, Dr. Selwyn testified that major segments of the industry will remain monopolistic for an extended period of time. Tr. 1180-81. Therefore, regulation must correctly recognize the degree to which competition replaces the forces of regulation in constraining monopoly behavior. Tr. 1180. As Dr. Selwyn indicated:

And I believe that this industry will over time become more competitive, but there will be situations of the type I've just described that will need to be continued to be regulated and monitored closely in order to make sure that everybody has equal access and that nobody is able to leverage control over that element to dominate adjacent markets. Tr. 1183.

In addition to dismal competition results, the Commission should also consider that SBC has not yet demonstrated compliance with the competitive checklist contained in Section 271 of the Telecommunications Act of 1996 in any state in SBC's current region. In addition to this failure to demonstrate concrete evidence of actual competition, the Commission should also consider SBC's unsuccessful litigation efforts to invalidate Section 271. The dismal competitive market share results, SBC's failure to demonstrate compliance with Section 271, and its efforts to invalidate Section 271 provide ample evidence that this is not a monopoly committed to competition. This Commission should consider SBC's failed attempts at 271 compliance at the FCC, as well as in Texas and in California as concrete evidence of bad

behavior in the marketplace, and behavior that is not acceptable in Illinois.<sup>23</sup> Based upon this evidence, the Commission should determine that the merger is more than likely to have a significant adverse effect on competition.

SBC/Ameritech witnesses Kahan, Harris, and Gebhardt fail to acknowledge that the average residential and small business customer currently have a lack of meaningful residential service options and will continue to have a lack of service options after the merger. Ameritech's recent pattern of reclassifying small business services and increasing rates, for some services as much as 60%<sup>24</sup> demonstrates little fear of marketplace retribution. Further, the merger will have a significant adverse effect on competition. GCI Ex. 2.0 at 52-58 (TerKeurst). The path without the merger will provide more meaningful options for

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<sup>23</sup> GCI Exs. 1.0 at 45-49 (Selwyn), and 2.0 at 48-51 (TerKeurst), citing:

Application of SBC Communications Inc. Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-region, InterLATA Services in Oklahoma, CC Docket No. 97-121, *Memorandum Opinion and Order*, FCC 97-228, released June 26, 1997 ("Oklahoma Order") at para. 17.

Public Utility Commission of Texas Project No. 16251, *Investigation of Southwestern Bell Telephone Company's Entry into the Texas InterLATA Telecommunications Market*, Order No 25, June 1, 1998, Attachment 1 (Commission Recommendation), at 2.

On March 31, 1998, SBC-Pacific Bell filed a draft application with the California Public Utilities Commission to become a long distance provider pursuant to Section 271 of the Telecommunications Act of 1996. The *Final Staff Report* represents the conclusions of the California PUC Telecommunications Division staff regarding SBC-Pacific's application.

<sup>24</sup> GCI Ex. 1.1 at Appendix 1, Attachment 2; Illinois Commerce Commission Telecommunications Division Staff Report on Service Reclassification.

competition than the path with the merger.

Without the merger, a company like SBC would be a meaningful potential competitor in the Chicago market. The fact that they claim to have no current plans to do that, needs to be weighed against the evidence and the reasonable inferences from the evidence. SBC is a major competitor in the Chicago Cellular Market through its Cellular One subsidiary. Business survival and common sense lead one to the inescapable conclusion that SBC will not ignore the major business customers in the Chicago market with or without the merger.

**6. The Proposed Reorganization is Likely to Result in Adverse Rate Impacts on Retail Customers**

The record indicates that the proposed reorganization is likely to result in adverse rate impacts on retail customers due to: (a) the need for SBC to recover the enormous \$13.2 acquisition premium it will be paying to Ameritech shareholders; (b) the need to financially support the merged companies' National Local Strategy that SBC readily concedes will generate a negative cash flow for approximately ten years; (c) the substantial additional risks that the merged company will be taking on in pursuing its National-Local Strategy, which could impair" [SBC's] ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure; and (d) the reduced level of potential competition that the post-merger Illinois Bell will confront within its core local service market. GCI Ex. 1.0 at 53-61 (Selwyn). Further, the evidence demonstrates a continued reclassification of noncompetitive services as competitive prior to effective price constraining competition.

SBC will need to generate additional revenues from Illinois consumers in all market segments in which it does not face price-constraining competition. GCI Ex. 1.0 at 53

(Selwyn). Allocating the premium paid to acquire Ameritech<sup>25</sup> over book value specifically to Illinois Bell, SBC would need to recover \$19.7 billion in overall investment in Illinois Bell. Ameritech's net investment in Illinois Bell is about \$5.5 billion, SBC will have invested an additional \$14.2 billion that it will need to recover from its Illinois operations. *Id.* Illinois Bell would be expected to generate \$1.7 billion in additional annual intrastate pre-tax earnings for a period of ten years to offset the \$6.7 billion intrastate portion of the total \$14.2 billion in premium over book value that SBC will pay to acquire Illinois Bell. GCI Ex. 1.0 at 54 (Selwyn). Recovering this additional \$1.7 billion in annual pre-tax earnings implies a significant overall increase in Illinois Bell intrastate revenues relative to the current levels adjusted for the effects of the 1998 price cap adjustment. *Id.* at 54.

Further, Mr. Kahan stated that SBC will use revenues derived from its core SBC/Pacific/SNET/Ameritech in region core noncompetitive service markets to finance and support the National Local Strategy and other out of region competitive ventures. *Id.* at 55.<sup>26</sup> By SBC's own admission, it needs the Ameritech acquisition to provide a core revenue base for the National Local Strategy, and in Illinois, that core revenue base is the extensive residential and small business noncompetitive services that Illinois Bell will continue to provide and dominate. *Id.* at 56.

Under Illinois Bell's current price cap mechanism, the annual price change is

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<sup>25</sup> SBC paid \$13.2 billion over the pre-announcement market value of Ameritech stock, and \$47 billion over the net book value of Ameritech's assets to acquire Ameritech. GCI Ex. 1.0 at 53.

<sup>26</sup> Citing Kahan (SBC) FCC Affidavit at Paras. 79-80.