

Turning again to the statutory language of Section 7-204(f) as the best indicator of legislative intent, the Commission finds that the only limitation put upon our discretion is that the conditions we attach be, in our good and informed judgment, of a type necessary to protect the interests of the company and of its customers. We believe, that it is the evidence of record in the proceeding, conducted pursuant to Section 7-204(b), which particularly informs our judgment and sets out the scope of our discretionary authority.

Having set out our construction of Section 7-204(f) we now proceed to detail the conditions we find necessary to impose in the instant proceeding. Consistent with our analysis above, each of these conditions has a basis in the record of this proceeding and is determined to be necessary to protect the interest of the public utility and its customers.

Conditions To the Approval of the Proposed Reorganization.

Agreed Conditions

In their Reply Brief, the Joint Applicants have made certain commitments based largely on the proposals of Staff and certain other Intervenors. We find that these commitments are reasonable and necessary such that each of them in their entirety and, as here modified, will be a part of the conditions to our approval.

1. Headquarters - SBC will maintain Ameritech's headquarters in Chicago and headquarters in each of Ameritech's traditional states for a minimum of 5 years;
2. Name - SBC will continue to use the Ameritech name in each state;
3. Charitable Contributions - SBC will continue Ameritech Illinois' historic levels of charitable contributions and community activities and will continue to support economic development and education consistent with AI's established commitments;
4. Development - SBC will continue to support economic development and education in Ameritech's region consistent with Ameritech Illinois' well established commitments in these areas;
5. Employment - SBC will ensure that, as a result of the proposed reorganization, employment levels in Ameritech Illinois' region will not be reduced due to this transaction for a minimum of 5 years;
6. Investment - SBC will continue to invest capital necessary to support AI's network consistent with Ameritech's past practices. To be specific, we give notice to the merged company that we require, at a minimum, that Ameritech Illinois go forward with its 5-year infrastructure network modernization program of \$3.0

billion; Further, AI will identify, for each reported investment which of its services and products benefit from the investment and will also identify the area in which the investment is made;

7. OOS Reports - AI will submit monthly OOS performance results to Staff for UNEs, resale and OOS; (See, also Condition No. 18 below);
8. LRSIC & TELRIC - AI will file revised LRSIC, TELRIC and shared and common cost studies within six months after the last regulatory approval of the proposed reorganization. It is noted that Staff is willing to work with AI to establish a priorities list for such updates; The Commission will utilize the updated studies in its analysis of the Company's request for rate rebalancing and in the two TELRIC investigations; Cost studies and pricing for CLEC and wholesale services should be required to be modified to maintain the cost-based pricing required by the 1996 Act and the Commissions's policies. See GCI Ex. 2.0 at 77 (TerKeurst);
9. Cellular Divestiture - The Joint Applicants will notify the Commission as to which cellular property is being divested and the identity of the buyer;
10. Cellular Notification - The Joint Applicants will provide the requisite 30 days notice to affected cellular customers regarding the pending merger and sale of the cellular property in compliance with Staff's reconstitution. They also should afford the purchaser the opportunity to participate in the specifics of such notice. Further, allow individuals that have cellular contracts a minimum of 90 days after the sale is completed to void the contract without any penalty;
11. 911 Service - The Joint Applicants agree that Ameritech Illinois will advise Staff of any changes to it 911 service, including staffing, as they occur;
12. Access - The Joint Applicants agree that Staff will have access to all books and records of SBC and Ameritech Corporation and their utility and non-utility parent, sister and subsidiary companies, as well as independent auditors' workpapers on the same terms as those set forth in the Commission's Orders approving the reorganization of Consolidated Communications Order in Docket 97-0300 (Dated September 24, 1997) and the Gallatin River exchanges of Sprint Communications. Order in Docket 97-0321 (Dated October 21, 1998);
13. CAM (a) Revisions: The Joint Applicants agree that Ameritech Illinois will file revisions to Cost Allocation Manuals ("CAM") within sixty (60) days of the date of receipt of the last regulatory approval required for the proposed merger;

(b) AIA - The Joint Applicants will provide Staff with a copy of each affiliate

service agreement and the relevant updated CAM pages to resolve any cost allocation issues in a complete and timely manner;

- (c) Updates: The Joint Applicants will continue to provide Staff with any and all relevant updates to the CAM before providing service under any new or revised affiliate agreements.
 - (d) Personnel Training: Applicants agree to inform all relevant company personnel that the CAM has been revised, provide easy access to the revised manual and train personnel as to its proper application;
- 14. TRI - The Joint Applicants agree to use Technology Resources, Inc. ("TRI") to work on accessibility issues for people with disabilities in Illinois;
 - 15. Universal Design - The Joint Applicants agree to implement SBC's Universal Design Policy in Illinois for people with various disabilities to provide input on telecommunications accessibility, service, features and design; We require Annual Reports on the details of enforcement;
 - 16. "Best Practices" Report - The Joint Applicants agree that AI will provide, for a period of up to three years after consummation of the merger, an annual report in which it identifies any proposed "best practices" whose adoption by SBC or its affiliates would affect the provisioning of intrastate telecommunications in Illinois. Such reports will include how each identified "best practice" would affect costs, revenues, employment, service quality, marketing, competition and CLECs, and the ability of the Commission to monitor and regulate intrastate telecommunications services. AI will explain how SBC is identifying "best practices," the results of any "best practices," and how they will be maintained over time. AI shall include its service quality measurements in the annual merger report to the Commission and post the complete report on the Internet.

Additional Conditions

The Conditions proposed by the Joint Applicants fail to bring the merger in compliance with Section 7-204. The record in this cause reveals that still other conditions need to be imposed in order to protect the interests of the Company and its customers.

The record raises serious issues with respect to service quality and conditions are needed to protect the interests of the public utility and its customers. ~~contains assurances that not only will the reorganization not diminish the Company's ability to provide service but that it will enable AI to improve the quality of service it provides. We will hold the Joint Applicants to these assurances.~~

17. We require Joint Applicants to correct the OOS>24 hours performance as hereinafter set forth.

While a noncompliance penalty structure was outlined in the Plan, and has been enforced continuously, this punitive measure obviously has not provided sufficient incentive for AI to cure the problem.

It is an express condition to our approval that within no more than 21 days from the date of this Order, AI provide the Commission and Staff with a written commitment and plan detailing the steps it will undertake to remedy the problem together with a timeline that includes a date certain for completion.

18. Concurrent with this Order we are issuing a Rule to Show Cause Order in Docket 98-0252 requiring AI to respond and show cause why AI has failed correct the OOS>24 hours performance to meet the standard in that docket. Also, the SOI penalty should be doubled each time it is missed so that AI no longer views missed service quality benchmarks as a cost of doing business —the penalty formula found in its Alt. Reg. Plan should not be increased consistent with the recommendations set out in Staff Ex. 8.01 at 16.

19. ~~Joint Applicants will be held responsible for recording all savings and all costs relating to the merger in the manner described herein with the ultimate result that 100% of the net merger savings be allocated to consumers as previously set forth in this Order. If however, the Company demonstrates that it is in full compliance with each of the foregoing conditions in these interim proceedings then 50% of the net savings will be allocated to customers. This incentive stems from our belief that savings alone, without fulfillment of the conditions we have set out here, is not the best way to protect the interest of the utility and its customers. It is the quality of service and the enhancement of services which will prove most meaningful in the end. Moreover, we note that this measure puts the burden on the Joint Applicants to affirmatively evidence compliance in all particulars thus conserving Staff's time and resources.~~

Joint Applicants will allocate 100% of the savings resulting from the proposed reorganization to ratepayers. A rate decrease, on a pre-tax basis of \$343 million should be applied each year for a 10 year period. The savings shall be allocated to consumers as perviously set forth in this Order.

20. Competition - Joint Applicants shall meet the conditions set out in Section 271 of the Telecommunications Act of 1996. A collaborative process shall begin immediately and open an expedited docket. The merger shall not be approved until the Commission is satisfied that the 271 checklist items have been met in Illinois.

21. FCC 271 approval - Joint Applicants shall, subject to Commission approval, provide a timetable for submission to the FCC for 271 approval. Failure to remedy in a timely fashion any deficiencies found by the FCC and the failure to make a timely submission to the FCC shall result in substantial automatic monthly penalties.
22. Joint Applicants shall demonstrate compliance with Sections 251 and 252 of the Telecommunications Act of 1996.
23. Best Practices - CLECs - Identification and adoption of "best practices" for interactions with CLEC customers. In the area of competition, the term "best practices" should be interpreted to mean the practice that best opens up markets to competition and best removes entry barriers.
24. Best Practices - Service Quality - Joint Applicants shall adopt a "best practices" approach in which AI maintains or improves its service quality in areas where it may exceed SBC's quality of service and where AI adopts SBC's practices and standards where they lead to service quality superior to Ameritech's.
25. AI account managers who work with Illinois CLECs shall remain in Illinois, and that they shall retain their current level of decision-making authority.
26. AI shall not change any of its competitive policies or practices without first obtaining agreement from the affected CLECs. If an agreement is not reached, then no changes shall be made without prior approval of the Commission.
27. Interconnection Agreements shall contain a self-enforcement mechanism.
28. Any multi-state "deals" that SBC may propose shall be nondiscriminatory.
29. Alternative Regulation: There shall be an expedited six-month review of the price cap docket. The prospect of a merger of this magnitude and its effects were clearly not contemplated when the docket and current caps were put in place.
30. Ameritech Illinois shall maintain its existing level of regulatory staffing within Illinois.
31. Service Quality Penalties - The SOI penalty shall be strengthened by increasing the penalty for missing a benchmark from the current 0.25% assessment against the price cap index to a 0.75% assessment. The SOI penalty for each missed standard shall be set at a monetary amount rather than the current percentage reduction in the price cap index.

32. Service Quality Reporting - Detailed reporting regarding quality of service, including the metrics and standards Charlotte TerKeurst recommends on page 36 of her direct testimony in addition to those already included in the Ameritech Illinois Price Cap Plan referenced on page 35 of Ms. TerKeurst's testimony. Id. at 9, 35, 36.
33. Additional service quality measurements be added to the service quality mechanism. The Commission should make the needed changes to the service quality index in this proceeding, rather than deferring them to the proceeding reviewing the alternative regulation plan.
34. Employment levels shall be maintained at adequate levels to provide high quality service. Customer service representatives shall remain in the Ameritech service region. AI shall in the annual report on implementation of the merger report any transfers of current employees out of Ameritech Illinois (by job title and years of experience), any changes in the number of Ameritech Illinois employees in any job classification, and the effects of such changes on telecommunications service in Illinois.
35. Demonstrate compliance with the Commission's previous order on Common Transport before merger is approved.
- 20-36. No later than July 12, 1999, the Joint Applicants shall notify the Commission pursuant to the provisions of Section 10-112 that the terms, conditions and requirements set out above are accepted and will be obeyed.

III. Findings and Ordering Paragraphs

The Commission, having considered the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Illinois Bell Telephone Company d/b/a Ameritech Illinois is a telecommunications carrier certified to provide local exchange and intraMSA interexchange services in Illinois; Ameritech Illinois does provide such services and provides both competitive and noncompetitive telecommunications services;
- (2) Joint Applicants request approval of a "reorganization" of Ameritech Illinois that would result from a business combination of SBC Communications Inc. and Ameritech Corporation, two Delaware corporations and holding companies; if that business combination is completed, Ameritech Corporation would become a wholly-owned first-tier subsidiary of SBC Communications Inc. and Ameritech Illinois would remain a wholly-owned subsidiary of Ameritech Corporation;

- (3) the Commission has jurisdiction over the parties hereto and the subject matter hereof;
- (4) the findings of fact and conclusions of law set forth in the prefatory portion of this Order are supported by the record herein and are hereby adopted as findings of fact and conclusions of law;
- (5) the proposed reorganization will not adversely affect the ability of Ameritech Illinois to perform its duties under the Illinois Public Utilities Act;
- (6) The merger as proposed fails to comply with various provisions of Section 7-204; however with the previously discussed conditions.²⁸ Joint Applicants have complied with the provisions in Section 7-204(b) (I) - (7), as follows:
 - (I) the proposed reorganization will not diminish Ameritech Illinois' ability to provide adequate, reliable, efficient, safe and least cost service;
 - (II) the proposed reorganization will not result in the unjustified subsidization of non-utility activities by Ameritech Illinois or its customers;
 - (III) costs and facilities are and will be fairly and reasonably allocated between utility and non-utility activities in such a manner that the Commission can identify those costs and facilities which are properly included by Ameritech Illinois for ratemaking purposes;
 - (IV) the proposed reorganization will not significantly impair Ameritech Illinois' ability to raise necessary capital on reasonable terms or to maintain a reasonable capital structure;
 - (V) Ameritech Illinois will remain subject to all applicable laws, regulations, rules, decisions and policies governing the regulation of Illinois public utilities;
 - (VI) the proposed reorganization is not likely to have a significant adverse effect on competition in those markets over which the Commission has jurisdiction; and

²⁸Exceptions 6 and 7 are provided as an alternative argument in the event the Commission approves the merger. Cook County does not waive any arguments previously raised in its briefs that Joint Applicants have failed to meet the requirements of Section 7-204 of the Public Utilities Act.

- (VII) the proposed reorganization is not likely to result in any adverse rate impacts on retail customers;
- (7) in order to provide the Commission with further assurances that the proposed reorganization satisfies the requirements of Section 7-204, the Joint Applicants have made 16 voluntary commitments previously set forth; each of the commitments made, is reasonable and necessary such that each will be a condition to our approval;
- (8) the provisions of Section 7-204(c) are being applied to the reorganization, so that 100% of the net merger-related savings allocable to Illinois will be allocated to the merged company's customers; ~~if however, full compliance with the conditions of our Order is demonstrated in the interim proceeding, the allocations of net savings to customers will be reduced to 50%;~~
- (9) for additional conditions as previously set forth are necessary to protect the public utility and its customers;
- (10) the materials submitted by the parties in this proceeding on a proprietary basis or for which proprietary treatment was requested are hereby considered proprietary and should continue to be accorded such treatment;
- (11) any petitions, objections or motions in this proceeding that have not been specifically disposed of should be disposed of in a manner consistent with the Commission's conclusions herein.

IT IS THEREFORE ORDERED, that the proposed reorganization of Ameritech Illinois, as set forth in the verified Joint Petition filed in this proceeding, should be, and hereby is, approved, subject to the conditions set forth in Findings (7) (8) and (9).

IV. CONCLUSION

For the above stated reasons:

- (i) the Commission should not approve this merger because the reorganization does not comply with Section 7-204 of the Act, and will adversely affect the utility's ability to perform its duties under the Act;
- (ii) If, however, the Commission approves the merger, it must, first, allocate savings to ratepayers and, second, condition its approval on mitigation of the areas of risk and adverse consumer/competitive impacts.

Respectfully submitted,

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Before the

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

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

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.)

Direct Testimony

of

LEE L. SELWYN

on behalf of the

Government and Consumer Intervenors (GCI):

The Citizens Utility Board,
the Cook County State's Attorney,
and the Attorney General of the State of Illinois

October 28, 1998

HIGHLY CONFIDENTIAL DATA
HAS BEEN DELETED

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AMERITECH CORPORATION,)
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1 INTRODUCTION

2
3 **Qualifications**

4
5 Q. Please state your name, position, and business address.

6
7 A. My name is Lee L. Selwyn. I am president of Economics and Technology, Inc., One
8 Washington Mall, Boston, Massachusetts 02108. Economics and Technology, Inc. (ETI) is
9 a research and consulting firm specializing in telecommunications economics, regulation,
10 management and public policy.

11
12 Q. Dr. Selwyn, please summarize your educational background and previous experience in the
13 field of telecommunications regulation and policy.

14
15 A. I have prepared a Statement of Qualifications, which is attached as Appendix 1 hereto.

16
17 Q. Have you previously testified before the Illinois Commerce Commission (Commission)?

18
19 A. Yes, I have testified before this Commission in a number of rate and policymaking
20 proceedings involving Illinois Bell Telephone Company dating back to the mid-1970s,
21 including Dockets 59666 (September, 1975), 76-0200 (October, 1976), 76-0409 (January,
22 1977), 77-0511 (March, 1978), 78-0034 (June, 1978), 80-0010 (July, 1980), 81-0478
23 (November 1981), 83-0142 (November, 1985 and January, 1986) and 92-0448 (July, 1993).
24 My more recent appearances have been in Docket 94-0315, the 708 NPA area code split

1 proceeding, in Docket 95-0371, the 312 NPA area code split proceeding, and in Dockets 97-
2 0192 and 97-0211, the 847 NPA area code relief proceedings, all on behalf of the Attorney
3 General of the State of Illinois, and in Dockets 98-0259, 97-0157, 92-0448, 93-0239,
4 involving the establishment of Illinois Bell wholesale rates, and Docket No. 95-0443, the
5 Ameritech Communications, Inc. proceeding, on behalf of AT&T Communications of
6 Illinois, Inc.

7
8 Q. Has your firm participated previously in analyses of affiliate transactions and, in particular,
9 in cases involving mergers of Regional Bell Holding Companies (RBHCs)?

10
11 A. Yes. In 1996, on behalf of the California Public Utilities Commission's Office of Ratepayer
12 Advocates, I submitted testimony on the then-proposed merger of SBC and Pacific Telesis
13 Group, California PUC Application No. 96-04-038. Also in 1996, on behalf of the State of
14 Maine Office of Public Advocate, I testified in Maine PUC Docket 96-338 on the proposed
15 merger of Bell Atlantic and NYNEX. Earlier this year, I presented testimony on the
16 proposed merger of SBC and SNET on behalf of the State of Connecticut Office of
17 Consumer Counsel in Connecticut DPUC Docket 98-02-20. All of these appearances
18 addressed public interest and competition issues pertinent to the proposed takeover
19 transactions, and the appropriate regulatory responses thereto.

20
21 I have also participated in a number of cases involving transactions and asset transfers
22 between Bell Operating Companies (BOCs) and non-BOC affiliates. These have included
23 the 1993 divestiture of Pacific Telesis Group's wireless services into what has now become
24 AirTouch Communications (California PUC Application 93-02-028) and the proposal by

1 Illinois Bell's intrastate operations that SBC will be paying as part of the \$62-billion
2 acquisition cost of Ameritech;

- 3
- 4 • Eliminate SBC as an actual potential competitor in the Illinois local telephone service
5 market;
 - 6
 - 7 • Fortify the Illinois local service market against significant competition by other service
8 providers;
 - 9
 - 10 • Retard and diminish the development of actual and effective competition in the Illinois
11 local service market;
 - 12
 - 13 • Force captive customers of Illinois Bell noncompetitive services to subsidize out-of-
14 region SBC competitive ventures, including its ambitious "National-Local Strategy";
 - 15
 - 16 • Permit SBC to raid Illinois Bell management and other experienced personnel recruited
17 and trained with funds provided by customers of noncompetitive services for
18 reassignment in out-of-region National-Local Strategy and other competitive ventures;
 - 19
 - 20 • Threaten service quality through diversion of Illinois Bell managers and crafts personnel
21 and other Illinois Bell resources for reassignment to out-of-region National-Local
22 Strategy and other ventures; and
 - 23

- 1 • Fail to satisfy the specific requirements set forth in Section 7-204(b) of the Illinois
2 Public Utilities Act (“PUA”).

3
4 For all of these reasons, the Commission should reject the Application and not permit the
5 takeover to go forward as presently structured. If, however, the Commission determines that
6 it will permit SBC to acquire Illinois Bell, it must condition its approval on elimination or
7 mitigation of the areas of risk and adverse consumer/competitive impacts through the
8 imposition of certain safeguards and other requirements. These mitigation measures fall into
9 two categories: (1) operational practices and safeguards, and (2) allocation of economic
10 benefits arising from the merger to customers of Illinois Bell’s noncompetitive services. Ms.
11 TerKeurst addresses the first category, and I will address the second.

12
13 Section 7-204(b)(3) of the PUA requires the Commission to find that “costs and facilities
14 are fairly and reasonably allocated between utility and non-utility activities in such a manner
15 that the Commission may identify those costs and facilities which are properly included by
16 the utility for ratemaking purposes.” Along the same lines, Section 7-204(b)(2) requires the
17 Commission to find “that the proposed reorganization will not result in the unjustified
18 subsidization of non-utility activities by the utility or its customers.” Section 7-204(c)
19 requires the Commission, if it otherwise determines that the merger should be approved, to
20 rule on “the allocation of any savings resulting from the proposed reorganization; and (ii)
21 whether the companies should be allowed to recover any costs incurred in accomplishing the
22 proposed reorganization and, if so, the amount of costs eligible for recovery and how the
23 costs will be allocated.” Thus, the amount corresponding to the reduction in Ameritech’s
24 regulated costs resulting from the allocation of any costs to non-utility activities as required

1 by Section 7-204(b)(2) and 7-204(b)(3), along with specific merger-driven savings pursuant
2 to Section 7-204(c), should be flowed through to customers of Illinois Bell noncompetitive
3 services. As discussed in detail later, the only offset to this amount would be a relatively
4 small portion of merger implementation costs, that is, a proportional share for Illinois Bell
5 intrastate noncompetitive services of the aggregate implementation costs. Net of this minor
6 adjustment for allocated implementation costs, a total of \$1.4-billion, reflecting the
7 allocations required by Sections 7-204(b)(2) and 7-204(b)(3) along with the Section 7-204(c)
8 savings, should be flowed through to customers of Illinois Bell intrastate noncompetitive
9 services. This flow-through should be accomplished through an amortization, calculated on
10 the basis of a 9.5% interest rate, over a ten-year period commencing with the closing date of
11 the acquisition. On an annual basis, this flow-through would amount to approximately
12 \$343-million per year.

13
14 While the Applicants argue that Section 7-204(c) does not apply to Illinois Bell because the
15 Company is not currently subject to rate-of-return regulation ("RORR"), they offer no
16 authoritative support for this contention. Indeed, inasmuch as a flow-through of required
17 allocations and savings would occur automatically (subject only to regulatory lag) were the
18 Company still subject to full RORR, Section 7-204(c) would merely restate, and not expand,
19 the utility's pre-existing regulatory obligations. Put differently, there would have been no
20 reason to revise the statute to add Section 7-204(c) other than to ensure that carriers not
21 subject to RORR were specifically required to flow-through these allocations and savings.

22
23 When confronted with similar regulatory proposals in both the Pacific Telesis and SNET
24 takeovers, SBC responded with public statements characterizing any flow-through to

1 ratepayers as a “tribute” to which ratepayers have no entitlement, coupled with a threat to
2 cancel the deal entirely if such a “tribute” payment is imposed. Such contentions are without
3 basis. If the transaction is consummated, both SBC and Ameritech shareholders stand to
4 realize gains in the range of at least \$13-billion for each group: Ameritech shareholders’
5 gain is immediate, while the benefit to SBC shareholders (including the then-former
6 Ameritech shareholders) will occur over the course of time as the integration of the firms
7 progresses and their various business initiatives are pursued. Neither firm would rationally
8 walk away from such an opportunity based upon a requirement that some \$343-million be
9 flowed through to Illinois intrastate ratepayers annually over a ten-year period.

10
11 The takeover as proposed, is inconsistent with applicable Illinois statutes and will disserve
12 the public interest generally, and for these reasons should not be permitted to go forward as
13 structured. However, if the Commission authorizes the change of control of Illinois Bell, the
14 various mitigation measures that I and Ms. TerKeurst have recommended will provide a
15 partial counterbalance to the otherwise decidedly adverse consequences of the proposed
16 transaction.

1 THE PROPOSED SBC/AMERITECH MERGER

2

3 **SBC will be paying a substantial premium to acquire Ameritech.**

4

5 Q. Dr. Selwyn, please describe generally your understanding of the transaction being proposed
6 by the Applicants herein, SBC and Ameritech.

7

8 A. As described in the Joint Application and under the proposed terms of the SBC-Ameritech
9 Merger Agreement, SBC will acquire Ameritech as a wholly owned subsidiary through a tax-
10 free fixed exchange ratio stock transaction. The Merger Agreement provides that each share
11 of Ameritech common stock shall be converted into shares of SBC common stock on the
12 basis of an exchange ratio. The merger is intended to qualify as a reorganization under the
13 provisions of Section 368(a) of the Internal Revenue Code of 1986 for federal income tax
14 purposes, with no taxable gain or loss being recognized by either participant. The merger is
15 considered by the Applicants as a "pooling-of-interests" for accounting and financial
16 purposes. As part of the agreement, Ameritech may receive up to five seats out of the 25
17 seats on the SBC board.¹

18

19 Q. What exchange ratio is contemplated by the merger agreement?

20

21 A. The Merger Agreement contemplates an exchange ratio of 1.316. That is, each share of
22 Ameritech Common Stock would be converted into 1.316 shares of SBC Common stock in
23 the merged company.

1. Amended Proxy Statement/Prospectus, September 21, 1998, at 12 and 62.

1 Q. What is the implied value of Ameritech shares based upon the exchange ratio as of the May
2 10, 1998 date of the merger announcement?

3

4 A. On Friday, May 8, 1998, the last day of New York Stock Exchange trading prior to the
5 merger announcement, Ameritech shares closed at \$43-7/8 and SBC shares closed at
6 \$42-3/8. Based on the exchange ratio, the implied value for Ameritech shares was \$55.77
7 per share (i.e., 1.316 times \$42-3/8), or approximately \$11.89 above the May 8 closing share
8 price. Multiplying by the 1.109-billion Ameritech shares outstanding, the implied value of
9 the acquisition is about \$62-billion. This represents a premium of about \$13.2-billion over
10 the market value of Ameritech as of the day preceding the merger announcement. In terms
11 of the \$15-billion *book value* of Ameritech,² SBC will be paying a premium of \$47-billion
12 over book.

13

14 **In order to obtain approval of the proposed transaction from the US Department of**
15 **Justice, the Applicants must demonstrate that the merger of the two firms will not diminish**
16 **competition.**

17

18 Q. What specific conditions must be satisfied in order for the merger to gain regulatory and
19 antitrust approval?

20

21 A. Three separate levels of approval are required, and each invokes somewhat different
22 approval standards:

2. Ameritech's book value is calculated by adding the Long Term Debt, Common Equity, Proceeds in Excess of Par Value, and the difference between the Form 10-K and ARMIS Net Asset Values. 1997 Ameritech Corporation Annual Report and FCC Statistics of Communications Common Carriers, 1997 edition.

1 *Antitrust review.* The merger is reviewed by the United States Department of Justice (DoJ)
2 and the Federal Trade Commission (FTC). It also may be reviewed by state Attorneys
3 General in the states in which the companies involved operate. The focus of the antitrust
4 review is, that the merger will not result in a diminution of competition or otherwise violate
5 applicable federal or state antitrust laws. Under the *Hart-Scott-Rodino Antitrust*
6 *Improvement Act*,³ both companies must file materials with the Antitrust Division of the DoJ
7 and the FTC that will facilitate review of the proposed merger's impact upon competition.
8 Each of these federal agencies has thirty days following their receipt of notification of the
9 merger to initiate action opposing the transaction under applicable antitrust law.⁴

10
11 *FCC approval.* SBC and Ameritech must also obtain authorization from the Federal
12 Communications Commission to transfer the control of certain operating licenses and
13 authorizations. The FCC is required to ensure that "the public interest, convenience and
14 necessity will be served" by the transfer of control,⁵ and it has determined that, consistent
15 with the broad aims of the Communications Act, "the public interest standard subsumes and
16 extends beyond the traditional parameters of review under the antitrust laws. In order to find
17 that a merger is in the public interest, we must, for example, be convinced that it will
18 enhance competition."⁶

3. Pub. L. No. 94-435, 90 Stat. 1390, codified as amended at 15 U.S.C. § 18(a).

4. On August 19, 1998, the DoJ requested additional information and documentation from the Applicants relating to the merger.

5. 47 U.S.C. Section 310 (d).

6. *In the Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries, File*
(continued...)

1 *State PUC approval.* The proposed Ameritech/SBC merger is subject to review by several
2 state public utilities commissions. The Illinois Commission must determine that the merger
3 will satisfy the public interest standards and other requirements of Section 7-204 of the
4 Illinois Public Utilities Act. In addition to Illinois, Ohio law also requires the Applicants to
5 obtain approval for the merger from the Public Utilities Commission of Ohio. While I am
6 not aware of any similar, merger-specific statute in Indiana, Michigan and Wisconsin, the
7 PUCs in those state presumably may determine that it is in the public interest to investigate
8 the proposed merger under their general supervisory authority, in order to ensure that the
9 merger will not have any adverse effects upon, for example, basic services or the
10 development of competition in the state. To the best of my knowledge, none of the PUCs in
11 SBC's current 7-state operating territory have opened a proceeding to review this
12 transaction.⁷

13
14 Q. What specific showings must the Applicants make in order to satisfy the public interest
15 requirements of Section 7-204 of the PUA?

16
17 A. Under the statute, the Applicants have the burden of establishing to the satisfaction of the
18 Commission that the merger is in the "...interests of the public utility and its customers." In
19 Illinois, both the Commission and the Legislature have given high priority to protecting the

6. (...continued)

No. NSD-L-96-10, Memorandum Opinion and Order, released August 14, 1997 (*BA/NYNEX Merger Order*) at ¶ 2.

7. Under the terms of the California PUC's decision authorizing the SBC takeover of Pacific Telesis, SBC is required to notify the California PUC of its intention to acquire any other regional Bell Holding Company. California PUC Decision No. 97-03-067, A. 96-04-038, March 31, 1997 at 93.

1 interests of Illinois consumers and at the same time fostering the development of
2 competition. Obviously, when a public service company with a long-standing presence in
3 the state changes hands and becomes a component of a largely unknown entity, there is a
4 significant exposure to the consumers who are served by the utility. The Commission thus
5 needs tangible assurances that the new owners of Illinois Bell will cooperate fully in the
6 transition to competition and otherwise comply fully with applicable statutes and
7 regulations. Specifically, the Commission is required to find that

- 8
- 9 • “the proposed reorganization will not diminish the utility’s ability to provide adequate,
10 reliable, efficient, safe and least-cost public utility service” [Section 7-204(b)(1)];
11
 - 12 • “the proposed reorganization will not result in the unjustified subsidization of non-
13 utility activities by the utility or its customers” [Section 7-204(b)(2)];
14
 - 15 • “costs and facilities are fairly and reasonably allocated between utility and non-utility
16 activities in such a manner that the Commission may identify those costs and facilities
17 which are properly included by the utility for ratemaking purposes” [Section 7-
18 204(b)(3)];
19
 - 20 • “the proposed reorganization will not significantly impair the utility’s ability to raise
21 necessary capital on reasonable terms or to maintain a reasonable capital structure”
22 [Section 7-204(b)(4)];
23

- 1 • “the utility will remain subject to all applicable laws, regulations, rules, decisions and
2 policies governing the regulation of Illinois public utilities” [Section 7-204(b)(5)];
3
4 • “the proposed reorganization is not likely to have a significant adverse effect on
5 competition in those markets over which the Commission has jurisdiction” [Section 7-
6 204(b)(6)]; and
7
8 • “the proposed reorganization is not likely to result in any adverse rate impacts on retail
9 customers” [Section 7-204(b)(7)].
10

11 The Applicants have each made perfunctory assertions that each and all of these conditions
12 are satisfied, indeed, that such a finding is, or should be, self-evident. In fact, it is far from
13 apparent that the proposed takeover would satisfy the statutory requirements and, more
14 specifically, that the purported benefits outweigh the substantial risks that the transaction
15 would confer upon Illinois consumers, competing telecommunications providers, and the
16 Illinois economy generally.

17
18 **The risks of the acquisition as proposed far outweigh the potential benefits for consumers.**
19

20 Q. Dr. Selwyn, what do you consider to be the most significant risks to consumers and to the
21 public interest generally if the proposed merger is approved?
22

23 A. There are several key areas of risk, all of which are in some manner expressly contemplated
24 in Section 7-204(b) of the PUA.
25

- 1 • The merger would lead both to diminished actual and potential competition in Illinois
2 and in the Ameritech region generally by removing SBC as a potential entrant and by
3 fortifying the merged company's ability to protect its entrenched position of market
4 dominance against competitive inroads.
- 5
- 6 • The merger has the potential to place significant upward pressure on the prices that
7 Ameritech charges for its noncompetitive services in Illinois, due to (a) the need for
8 SBC to recover the enormous (\$13.2-billion) acquisition premium it will be paying to
9 Ameritech shareholders, (b) the need to support financially the merged companies'
10 “National-Local Strategy” that SBC readily concedes will generate a *negative* cash flow
11 for approximately ten years, (c) the substantial additional risks that the merged company
12 will be taking on in pursuing its National-Local Strategy, which could “impair [SBC’s]
13 ability to raise necessary capital on reasonable terms or to maintain a reasonable capital
14 structure,” and (d) the reduced level of potential competition that the post-merger
15 Illinois Bell will confront within its core local service market.
- 16
- 17 • Following the merger, Illinois will represent only 12% of the new SBC’s ILEC
18 operations,⁸ and will be required to compete for capital with twelve other SBC ILEC
19 states, with its National-Local Strategy operations, its wireless business, and its various
20 international and other ventures. There is a strong possibility that SBC will actually
21 *extract* capital and managerial talent from the Illinois company to finance and otherwise
22 support its other activities outside of Illinois.

8. 1997 10K Reports of all SBC and Ameritech’s ILECs. 12% is calculated based on the combined Company’s operating revenues. Ameritech Illinois will represent 13 % and 12% of the combined Company’s access lines and total assets respectively.

- 1 • SBC has expressly stated its plan to effectively raid Ameritech managerial talent to
2 support its National-Local Strategy, citing that specific capability as one of the reasons
3 why the merger is claimed to be a necessary precondition for the National-Local
4 Strategy.
- 5
- 6 • The sheer lack of consequential price-constraining competition that SBC and its own
7 experts concede, characterizes the fact that, residential and small business segments
8 afford little assurance that post-merger SBC/Ameritech will be compelled to flow
9 through to customers *any* of the claimed cost savings and other synergy benefits that the
10 Applicants ascribe to the merger.

11

12 **SBC must be viewed as an “actual potential competitor” in the Ameritech region.**

13

14 Q. Please explain why the merger will result in less, rather than in more, competition within the
15 Illinois local service market.

16

17 A. The Applicants’ claim that the proposed merger would not result in diminished actual or
18 “actual potential” competition rests on the assertion that, prior to the merger, neither firm
19 had any plans to offer local wireline exchange service in the other’s home region. The
20 Applicants further contend that if *and only if* the merger is permitted to go forward they will
21 pursue a so-called “National-Local Strategy” in which the post-merger SBC will enter and
22 offer local wireline exchange service in each of the top 30 US markets outside of the (then)
23 13-state SBC/Pacific/SNET/Ameritech region, and that this “National-Local Strategy” will
24 in turn stimulate other RBOCs to enter and offer local services within the
25 SBC/Pacific/SNET/Ameritech footprint (see Table 1). Curiously, Mr. Kahan’s testimony

1 filed in this proceeding provides little more than mention of the National-Local Strategy;
 2 fortunately, his Affidavit filed with the SBC/Ameritech FCC Application offers a far more
 3 extensive and informative discussion, much of which has direct and serious implications for
 4 this Commission's responsibilities under Section 7-204(b).

Table 1
Top 50 markets sorted by rank

Rank	Out-of-Region Markets		Rank	SBC/Ameritech In-Region Markets	
1	New York	Bell Atlantic	1	Los Angeles	SBC
2	Philadelphia	Bell Atlantic	2	Chicago	Ameritech
3	Boston	Bell Atlantic	3	Detroit	Ameritech
4	Washington	Bell Atlantic	4	Dallas-Ft. Worth	SBC
5	Miami-Ft. Lauderdale	Bell South	5	Houston	SBC
6	Atlanta	Bell South	6	San Fransisco	SBC
7	Minneapolis-St. Paul	US West	7	San Diego	SBC
8	Phoenix	US West	8	St Louis	SBC
9	Baltimore	Bell Atlantic	9	Cleveland	Ameritech
10	Seattle-Everett	US West, GTE	10	San Jose	SBC
11	Denver-Boulder	US West	11	Kansas City	SBC
12	Pittsburgh	Bell Atlantic	12	Sacramento	SBC
13	Tampa-St. Petersburg	Bell South	13	Milwaukee	Ameritech
14	Portland	US West	14	San Antonio	SBC
15	Cincinnati	Cincinnati Bell	15	Indianapolis	Ameritech
16	Salt lake City-Ogden	US West	16	Colombus, OH	Ameritech
17	Orlando	Bell South	17	Harford/New Britian	SBC
18	Buffalo	Bell Atlantic	18	Oklahoma City	SBC
19	New Orleans	Bell South	19	Austin	SBC
20	Nashville-Davidson	Bell South	20	Dayton	Ameritech
21	Memphis	Bell South			
22	Las Vegas	Central, Sprint			
23	Norfolk-Virginia Beach	Bell Atlantic			
24	Rochester	Frontier, Ogden			
25	Greensboro-Winston-Salem	Bell South			
26	Louisville	Bell South			
27	Birmingham	Bell South			
28	Honolulu	GTE			
29	Providence-Warwick	Bell Atlantic			
30	Albany-Schenectady-Troy	Bell Atlantic			

Source: Attachment A, Kahan FCC Affidavit, ICC Data Request, RTY-1.02.

5

1 When viewed comprehensively, the narrative offered by Mr. Kahan and echoed (but
2 distinctly not independently corroborated) by several outside consultants strains credulity. If
3 one accepts as fact that SBC does intend to and will pursue a “National-Local Strategy,” the
4 various contentions that the Ameritech merger is a prerequisite for such an initiative are, on
5 the one hand, extremely difficult to swallow or, on the other, confirm that SBC’s national
6 market entry plans are themselves critically dependent upon SBC’s ability to remove one of
7 its key strategic competitors — Ameritech — from contention in this national local market
8 entry initiative.

9
10 It is difficult to accept SBC’s claims as to a lack of intention to enter local markets in the
11 five Ameritech states under a scenario in which the Company would pursue a National-Local
12 Strategy whether or not the Ameritech takeover is approved. As Mr. Kahan notes in his
13 FCC affidavit:⁹

14
15 SBC has progressed in its strategic thinking through three broad phases, with most of
16 the changes in strategy occurring in the last three years. These phases can be
17 summarized as:

18
19 Regional focus with opportunistic acquisitions.
20 The pursuit of scale and scope economies.
21 National and global ambitions.
22

23 Mr. Kahan explains that SBC’s “national and global ambitions” phase “really began in
24 earnest during the fall of 1997 after events in the industry compelled SBC to more

9. Kahan (SBC), FCC Affidavit, at ¶ 4.

1 aggressively seek to become a national, and ultimately an international, enterprise in order to
2 remain a viable contender for the many growth opportunities which we anticipated.”¹⁰

3
4 Mr. Kahan insists that SBC had “rejected the concept of de novo entry because we
5 concluded that such entry would be ineffective unless it was undertaken on a massive scale
6 (as reflected in our current National-Local Strategy)” because the Company “did not believe
7 that SBC, even after the Pacific Telesis merger, possessed the resources necessary for such
8 an effort.”¹¹ From Mr. Kahan’s affidavit, we learn that SBC clearly intended to pursue
9 markets outside of its (then) seven-state footprint; absent the Ameritech takeover, there
10 would be little question but that Chicago, Detroit, Cleveland, Columbus, Indianapolis and
11 Milwaukee, among others, would necessarily be high on SBC’s entry agenda. Even if one
12 accepts Mr. Kahan’s contention that SBC/Pacific/SNET without Ameritech “did not have
13 the management depth or ... the critical mass of major customers that we can follow to
14 establish a beachhead in out-of-region markets,”¹² it is simply inconceivable, in light of the
15 extreme importance that Mr. Kahan ascribes to the National-Local Strategy, that SBC would
16 simply roll over and play dead, i.e., would revert to its “phase two” regional local exchange
17 carrier focus. Indeed, Mr. Kahan readily admits that SBC “cannot remain idle while our
18 competitors capture the huge traffic volumes generated by a relatively small number of
19 larger customers.”¹³ Thus, while the acquisition of Ameritech may constitute one means for

10. *Id.*, at ¶ 10.

11. *Id.*, at ¶ 11.

12. *Id.*

13. *Id.*, at ¶ 13.

(continued...)

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1 pursuing a National-Local Strategy, it is by no means the only approach that SBC could
2 utilize *even if its contention that the 35-million access line, \$46-billion in combined assets*
3 *SBC/Pacific/SNET would lack the resources necessary to take on "competitors" who to date*
4 *have collectively failed to capture more than slightly over one percent of SBC/Pacific's local*
5 *exchange service market share.*

6
7 Unless one believes that without approval of this merger SBC would literally "shut down"
8 its aggressive market expansion plans, then SBC must be considered to be an "actual
9 potential competitor" to Ameritech within the five-state Ameritech region, as the term is
10 defined and used in the DoJ *Horizontal Merger Guidelines*.

11
12 Q. Does the mere fact of SBC's status as an "actual potential competitor" to Ameritech by itself
13 violate the *Horizontal Merger Guidelines*?

14
15 A. Not necessarily. SBC/Ameritech affiants Richard Schmalensee and William Taylor argue
16 that "it is generally recognized in antitrust economics that if three or more firms possess the
17 same or comparable advantages as possible entrants, the merger would be unlikely to have
18 adverse competitive effects"¹⁴ even if the companies involved are "actual competitors" or
19 "actual potential competitors." This "three firms equals a competitive market" theory is, of
20 course, not universally accepted among mainstream economists. For example, W. G.

13. (...continued)

14. Schmalensee/Taylor (SBC/Ameritech), FCC Affidavit at ¶ 42.

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1 Shepherd notes that “[t]he earlier literature used to require ten or more comparable firms, so
2 as to make collusion really unlikely. Under Chicago-School pressure, the mainstream now
3 has retreated to specifying only about five or more competitors, but that is an absolute
4 minimum. A few ‘new-Industrial Organization’ pure theorists and ‘contestability’ advocates
5 are willing to take extreme positions favoring just two or three competitors, but their work
6 has no basis in real-market research.”¹⁵

7
8 Moreover, as the FCC has recognized, the judgment about the Applicants’ intentions and
9 their potential to enter the other’s region as a formidable competitor cannot be made entirely
10 from the analysis of current and known conditions, since the market in question is in
11 considerable flux.¹⁶ The FCC has recognized this critical contextual distinction between the
12 analytical framework addressed in more typical applications of the *Horizontal Merger*
13 *Guidelines* and the somewhat more fluid framework that must necessarily apply to the
14 analysis of the competitive effects of ILEC mergers:

15
16 In some cases, however, the transaction will have a greater effect on future, rather
17 than present, market performance. This is especially true if a merger may be a
18 strategic response to declining entry barriers, in which an incumbent firm is seeking
19 to avoid competition by eliminating a potentially significant future competition. *In*

15. William G. Shepherd, “Deregulation: From Monopoly Only to Dominance?
Telecommunications, Railroads, and Electricity,” *NRRI Quarterly Bulletin*, Vol. 17, No. 2, at
152, at n. 11. The other two elements discussed in the article include the absence of single-firm
dominance and reasonably free entry into and among all segments of the market. Obviously,
neither of those conditions are present here.

16. The FCC similarly determined that “[i]t is, however, precisely because such competition is
just beginning at this time and uncertainties exist that care in evaluating the potential impact of
mergers in evolving markets is crucial to ensuring the development of a pro-competitive,
deregulatory national telecommunications industry structure.” *BA/NYNEX Merger Order*, at ¶
41.

1 *the case of local telecommunications markets, competition is only now emerging*
2 *and a merger between a current monopolist and one of the new competitors may*
3 *have a substantial adverse impact on future market performance even though the*
4 *new competitor currently has only a small number of customers.*¹⁷
5

6 Although SBC might not make a *de novo* entry into Ameritech's region as quickly as it
7 would an entry through acquisition, there is still (as discussed further below) a reasonable
8 likelihood that it would make such an entry in the future in light of its well-known and
9 readily-conceded plans to become a national/global player.¹⁸ What is certain is that the
10 completion of the proposed merger would unambiguously preclude such a possibility.
11

12 Q. Are there many, or any, other companies operating today that can be considered
13 "competitors," as defined by the Applicants?
14

15 A. Drs. Schmalensee and Taylor and various other of the Applicants' witnesses go on to
16 contend that there are numerous competitors operating in local exchange markets both
17 within and outside of the SBC/Pacific/SNET/Ameritech footprint, and as such that "SBC
18 and Ameritech have no unique advantages over other possible entrants in each other's local
19 exchange markets." That view is not, however, shared by Mr. Kahan, who sees the proposed

17. *BA/NYNEX Merger Order*, at ¶ 96, emphasis supplied.

18. This theme surfaces, for example, in one significant antitrust case. Justice Douglas stated "[t]hus, although Falstaff might not have made a *de novo* entry if it has not been allowed to acquire Narragansett, we cannot say that it would be unwilling to make such an entry *in the future* when the New England market might be ripe for an infusion of new competition. At this point in time, it is the most likely new competitor." In the same case, Justice Marshall stated, "Even if it is true that management has not present intent of entering the market *de novo*, the possibility remains that it may change its mind as the objective factors favoring such entry are more clearly perceived." *United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 559 (1973).

1 merger as permitting SBC to accomplish what no one else has or can, i.e., to be a national,
2 rather than a niche market player, and on a massive scale:

3
4 The advent of full competition has brought forth a plethora of new entrants into the
5 telecommunications industry while at the same time initiating a trend towards
6 consolidation. In SBC's view, this trend will likely result in an industry populated by at
7 least two types of firms. On the one hand, there will be a large number of nimble,
8 efficient and well-financed regional or niche players serving distinct geographic areas or
9 market segments. At the same time, there will be a smaller number of well recognized,
10 financially strong, technically capable, fully integrated national and global competitors
11 who will compete to serve the global needs of large business customers and, at the same
12 time, provide effective competition to the ILECs for medium and small business and
13 residential customers. As evidenced by SBC's actions to date and specifically by SBC's
14 commitment to the National-Local Strategy, SBC and Ameritech have chosen to
15 become such a national and global competitor.

16
17 Customers now see an opportunity to obtain what they want -- the option of having one
18 principal source of service, one source of contact and consolidated lines across the
19 nation and around the world. Telecommunication companies that are not satisfied with
20 being regional and/or niche competitors are moving to obtain the capabilities necessary
21 to provide such services around the world. In order to be effective in this global
22 marketplace, carriers must have significantly expanded scale and scope efficiencies and
23 geographic capabilities.¹⁹
24

25 Thus, we need not debate here the question as to whether it takes *three* or *five* firms to
26 constitute a sufficient level of competition in a market such that a merger of two actual or
27 actual potential competitors would work to diminish competition overall: In the instant
28 situation, *none* of the numerous competitors identified by Schmalensee, Taylor, Gilbert,
29 Harris, Carlton or any other SBC or Ameritech witnesses would satisfy Mr. Kahan's
30 definition of a "massive scale" player capable of providing a serious challenge to the
31 existing Illinois Bell monopoly. In fact, only SBC, through its established cellular presence,
32 has a national/global focus, the financial resources, and the pool of managers with specific

19. Kahan (SBC), FCC Affidavit, at ¶¶ 23-24.

1 experience *in the local telephone business, coupled with an existing customer base in the*
2 Chicago area. Take SBC out of contention, as the merger would do, and a uniquely
3 qualified actual potential competitor to Ameritech's Illinois local service monopoly
4 disappears.

5
6 Q. What is unique, and potentially threatening, about the National-Local Strategy put forth by
7 the Applicants?

8
9 A. The core of SBC's National-Local Strategy lies in its ability to focus upon large national and
10 multinational companies whose headquarters are located within the 13-state SBC/Pacific/
11 SNET/Ameritech footprint and to whom SBC/Pacific/SNET/Ameritech currently furnish
12 local exchange service in its capacity as the dominant incumbent local exchange carrier. Mr.
13 Kahan notes that SBC has "identified 224 Fortune 500 companies that are headquartered in
14 the 13 states served by SBC, Ameritech and SNET."²⁰ Dr. Dennis W. Carlton, testifying for
15 SBC in its FCC Application and citing Mr. Kahan's FCC affidavit, underscores the critical
16 importance that this relationship with nearly half of the 500 largest US corporations has in
17 SBC's national market strategy:

18
19 SBC and Ameritech have concluded that they now cannot adequately respond to these
20 changing conditions as regionally limited suppliers of local services. In particular, the
21 regional structure of SBC and Ameritech leaves them poorly situated to provide national
22 (or near national) coverage to large business customers. ...²¹

23
24 I have analyzed the ability of SBC and Ameritech to use their own facilities to serve
25 multilocation customers using estimates of telecommunications expenditures by MSA

20. *Id.*, at ¶ 49.

21. Carlton (SBC), FCC Affidavit, ¶ 14.

1 [Metropolitan Statistical Area] for each of the Fortune 500 companies. These data ...
2 reflect estimates of expenditures for local and long distance services [and] indicate that
3 SBC's eight home-state region is headquarters to 129 Fortune 500 companies.²²
4

5 SBC recognizes that it is important that it be able to provide a significant majority of the
6 telecommunications services these customers need -- as a sort of prime contractor -- but
7 that it is not essential that it be able to provide all of such facilities and services. The
8 ability to provide most services is necessary, from SBC's perspective, to provide overall
9 management and quality control of the services desired by customers. SBC believes
10 that it can successfully market "national" services to customers for which it directly
11 provides roughly 70 percent or more of their national expenditures.²³
12

13 The RBOCs, as they presently exist, are uniquely positioned to bootstrap their monopoly
14 local service relationship with national companies headquartered or otherwise maintaining
15 telecom-intensive operations within the RBOC region into out-of-region markets. No other
16 provider — not "AT&T/Teleport/TCI, MCI/WorldCom/MFS/Brooks Fiber/UUNet,
17 Sprint/France Telecom/Deutsche Telekom [or any] other global competitors" possess this
18 special near-monopoly relationship with large national/multinational customers. Yet SBC
19 apparently believes that, despite its present position as the third largest local exchange
20 carrier in the United States and the ninth largest in the world,²⁴ it "lacks a sufficiently broad
21 customer base to allow SBC to be competitive"²⁵ with firms such as "AT&T/Teleport/TCI,
22 MCI/WorldCom/MFS/Brooks Fiber/UUNet, Sprint/France Telecom/Deutsche Telekom and
23 other global competitors" *none of whom presently provide any consequential quantity of*
24 *local exchange service anywhere in the United States.* Extrapolating from this reasoning, if
25 SBC or Ameritech standing alone is too small to be an effective competitor, then no other

22. *Id.*, at ¶ 15, footnote omitted.

23. *Id.*, at ¶ 16, footnote omitted.

24. *1998 Fortune 500 and 1998 Fortune Global 500*, <http://www.pathfinder.com/fortune/>.

25. Kahan (SBC), FCC Affidavit, at ¶ 76.

1 existing RBOC or anyone else for that matter would be capable of competing effectively
2 against the incumbent LEC for the local service business of even the largest in-region
3 customers. Schmalensee and Taylor confirm this same conclusion:

4
5 No other ILEC or CLEC has announced an out-of-region local competition initiative of
6 comparable scope, and, in the U.S., the only carriers currently competing on a national-
7 local basis are the vertically-integrated IXCs (AT&T-TCG-TCI and MCI-WorldCom-
8 MFS-UUNet-Brooks Fiber).²⁶
9

10 Thus, if the merger is permitted, *there will be no other single entity capable of competing in*
11 *the SBC/Pacific/SNET/Ameritech footprint that would satisfy SBC's own criteria for what it*
12 *would take to effectively compete with incumbent LECs and with the various other non-ILEC*
13 *entities that Dr. Carlton has identified.*

14
15 Indeed, in the nearly fifteen years since the break-up of the former Bell System and the
16 nearly three years since the enactment of the 1996 federal legislation, *none of the regional*
17 *Bells has taken any significant steps at entering local exchange markets outside of each's*
18 *home region.* Whether the result of some form of market allocation or simply an
19 assessment by those most qualified to know that local entry is extremely difficult, the fact
20 remains that up to now local competition has been relegated to, as Mr. Kahan appears to
21 readily concede, niche players with extremely narrow geographic and/or market segment
22 focus. *Nobody has as yet embarked upon as ambitious a local entry strategy as SBC's*
23 *National-Local Strategy and, if SBC's assessment that its merger with Ameritech is essential*
24 *in order for the National-Local Strategy to be pursued and to succeed, it would appear to be*

26. Schmalensee/Taylor (SBC/Ameritech), FCC Affidavit, at ¶ 16.

1 *a virtual certainty that nobody other than SBC will be capable of sustaining this level of out-*
2 *of-region or non-incumbent market presence.*

3
4 Q. Aside from the out-of-region markets under consideration as entry points through the
5 National-Local Strategy, do the Applicants foresee an increase in competition in their in-
6 region markets, either through another RBOC's *de novo* entry or by a smaller, "niche"-filling
7 CLECs?

8
9 A. While speculating that, as a direct consequence of SBC's National-Local Strategy, "other
10 carriers will be motivated to take measures to compete for the lucrative business of major
11 national accounts by offering a comprehensive package of services, including the all-
12 important advanced data services, and including services within the SBC/Ameritech home
13 region,"²⁷ neither Mr. Kahan nor Dr. Carlton provide any explanation as to how such smaller
14 entrants can be expected to succeed where a stand-alone SBC or Ameritech would not even
15 consider entry in the first place. Presumably, in linking the possibility of other RBOCs
16 entering the SBC/Pacific/SNET/Ameritech region *de novo* directly as a response to the SBC
17 National-Local Strategy, Mr. Kahan seems to be conceding that the SBC/Ameritech entry is
18 a far more significant source of serious competition for incumbent LECs than all of the
19 competition that presently exists, in that none of the competition that presently exists seems
20 to have been sufficient to motivate *any* incumbent LEC to pursue *de novo* entry outside of its
21 home turf. By Mr. Kahan's very own reasoning, then, while the National-Local Strategy
22 may well give its out-of-region sister RBOCs a level of competition that they have not
23 previously seen, none will have the capacity to offer the expanded SBC any serious threat in

27. Kahan (SBC), FCC Affidavit, at ¶ 86.

1 its now even more highly-fortified 13-state territory. Hence, there will not be “three or more
2 competitors” within Illinois or any other part of the SBC/Pacific/SNET/Ameritech footprint
3 operating at a level sufficient to offer any real challenge to Illinois Bell’s existing market
4 dominance.

5
6 If, on the other hand, and despite the fact that none have thus far chosen to do so, other
7 RBOCs *are fully capable of a de novo out-of-region entry*, then the removal of SBC as an
8 “actual potential competitor” to Ameritech in Illinois represents a significant diminution of
9 potential competition within the state. Both as a result of geographic proximity and a stated
10 national market entry strategy, SBC is without doubt the RBOC that would be most likely to
11 attempt a *de novo* entry into the Illinois local exchange market absent its takeover of
12 Ameritech. SBC’s extensive cellular presence in the Chicago MSA, coupled with the large
13 number of national and multinational corporations that are headquartered in the Chicago area
14 and Chicago’s status as the nation’s “second city” strip SBC’s claimed lack of interest in
15 Chicago of all credibility.

16
17 Q. Does SBC offer any specific evidence to support its contention that it had no plans to
18 compete in the Ameritech region?

19
20 A. In fact, the only “evidence” that SBC offers to affirm its claim is the affidavit of Mr. Stan
21 Sigman, President and CEO of SBC Wireless, Inc. (“SBCW”), who attempts to extrapolate
22 from the failure of a less than full-effort SBCW market trial effort to offer local wireline
23 service in Rochester, New York that the parent SBC would not possibly consider a full-scale

1 local service entry in Chicago.²⁸ I will discuss the Rochester market trial in more detail later
2 in my testimony.

3
4 The essential point is that SBC cannot at the same time claim that it is unable to pursue a
5 National-Local Strategy without the merger while also claiming that the National-Local
6 Strategy will stimulate increased competition within the 13 states in which SBC/Pacific/
7 SNET/Ameritech would be the dominant incumbent LEC. If the National-Local Strategy
8 will be pursued only if the merger takes place, then the inescapable conclusion is that the
9 merger will reduce, and certainly not expand, the potential for effective competition in the
10 Illinois local exchange service market. As such, the SBC/Ameritech merger would violate
11 both the Department of Justice Merger Guidelines — because the proposed merger will
12 “create, enhance or facilitate exercise of market power” — as well as Section 7-204(b)(6) of
13 the PUA — because the merger is “likely to have a significant adverse effect on
14 competition.”

15
16 Q. Dr. Harris has characterized the proposed transaction as a “geographic market extension
17 merger” that does not diminish competition because neither firm could be viewed as an
18 actual or actual potential competitor to the other.²⁹ Do you agree with this characterization
19 and assessment?
20

28. Sigman (SBC), FCC Affidavit, at ¶ 17.

29. Harris (SBC/Ameritech), at 4-5.

1 A. No. Dr. Harris' assessment would seem to be based upon a view of the telecommunications
2 industry that his own client no longer shares. Mr. Kahan explained the evolution of SBC's
3 view of the industry in the period since the break-up of the former Bell System:

4
5 In [the] first phase [which "began with the AT&T divestiture in 1984 and lasted until
6 approximately six months prior to the enactment of the 1996 Act"], SBC regarded itself
7 as a regional telecommunications company. We were not interested in becoming, and
8 were not able to become, a true national or international integrated provider of
9 telecommunications services. ...

10
11 The second phase of the evolution of SBC's strategic thinking began in the fall of 1995,
12 when the passage of the Telecommunications Act of 1996 (the "1996 Act") was clearly
13 in view, and continued until approximately the fall of 1997. During this period, we
14 explored domestic expansion opportunities based on our existing assets. We focused on
15 the company's anticipated entry into the long distance business. We also analyzed
16 possible out-of-region local exchange entry through the use of our wireless platforms,
17 primarily as a defensive measure to retain cellular customers who would be solicited by
18 wireless carriers who also offered local service. ...

19
20 *However, the third (and current) phase really began in earnest during the fall of 1997*
21 *after events in the industry compelled SBC to more aggressively seek to become a*
22 *national, and ultimately an international, enterprise in order to remain a viable*
23 *contender for the many growth opportunities which we anticipated.*³⁰
24

25 Mr. Kahan's statements confirm that SBC views its regional market dominance as a stepping
26 stone into becoming a national and international player. That view does not square with Dr.
27 Harris' "geographic market extension" theory or with his notion that the combination of the
28 existing SBC/Pacific/SNET and Ameritech monopolies will not increase SBC's market
29 power overall.

30
31 In assessing whether the merger is "likely to have a significant adverse effect on
32 competition," this Commission must weigh the likelihood of actual SBC *de novo* entry into

30. Kahan (SBC), FCC Affidavit, at ¶¶ 5-6, and 10, emphasis supplied.

1 Illinois (absent the merger) against the likelihood of entry by other RBOCs into Illinois
2 assuming the merger occurs and the National-Local Strategy is pursued. For the reasons that
3 I have already discussed, the likelihood of a *de novo* SBC entry into the Chicago MSA is far
4 greater than the speculative possibility of an RBOC other than SBC entering this market,
5 which has not occurred in fifteen years, in the face of a far more powerful incumbent than
6 has existed up to the present time.

7
8 **Notwithstanding their current denials, both SBC and Ameritech have had specific plans**
9 **to pursue *de novo* local service entry into each other's region, and each possesses the**
10 **capacity to engage in this type of out-of-region competition.**
11

12 Q. Dr. Selwyn, earlier you referred to the affidavit of Mr. Sigman offered by SBC in the FCC
13 proceeding as support for its claim that it had no plans to pursue a *de novo* entry into the
14 Chicago local exchange market despite its long-standing cellular presence in that market.
15 Do Mr. Sigman's statements provide support for SBC's disavowal of any *de novo* entry
16 plans?

17
18 A. Hardly. In his testimony before the California PUC in the SBC/Pacific Telesis merger
19 proceeding, Mr. Kahan, in claiming (at that time) that SBC had no *de novo* entry plans for
20 California, described three "critical assets" that he said would be required for any out-of-
21 region local service entry: "existing brand name, infrastructure, and customer base."³¹ Mr.
22 Kahan elaborated further: "Absent this merger, we have concluded that it would make sense
23 to enter the local exchange market in Chicago but not in Los Angeles."
24

31. Calif. PUC A.96-02-028, Rebuttal Testimony of James S. Kahan (SBC), at 3.

1 Having conceded in his October, 1996 testimony before the California PUC that the
2 Company would consider *de novo* entry in Chicago (where it already has “existing brand
3 name, infrastructure, and customer base”), Mr. Kahan now explains that SBC has somehow
4 changed its mind as a result of a disappointing market trial in Rochester.

5
6 From the description of the Rochester market trial offered by Mr. Sigman, it’s hardly
7 surprising that SBC’s success was underwhelming. Before commenting specifically about
8 Mr. Sigman’s description of the Rochester effort, several things are worth mentioning at the
9 outset. First, SBC had acquired the “A” block (“non-wireline”) cellular license in Rochester
10 only recently;³² up until 1994 the Rochester system was operated by Associated
11 Communications, Inc., a Pittsburgh-based broadcaster that had divested all of its cellular
12 holdings (most of which were in upstate New York) by the end of 1994. By contrast, SBC
13 had acquired its ownership of the Chicago “A” block license in 1988, and thus has been
14 active in the Chicago telecommunications market for some eight or nine years. Second,
15 SBC was by no means the first large company to attempt to resell local exchange service in
16 Rochester. By the time that SBCW began offering resold Frontier (formerly Rochester
17 Telephone Company) service for resale “in early 1997,”³³ Time Warner and AT&T had
18 already tried and failed to make any serious inroads into the Rochester residential or small
19 business market, and both had ceased offering service to new customers. One reason for the

32. 1994 SBC 10K Report, at 6.

33. Sigman (SBC), FCC Affidavit, at ¶ 7.

1 extreme difficulty that these would-be entrants encountered was the unrealistically low
2 wholesale discount of 5% that Frontier offered resellers under its resale tariff.³⁴

3
4 In any event, one can only conclude from a reading of Mr. Sigman's narrative that the
5 Rochester effort was half-hearted at best and can hardly be put forward as definitive *proof*
6 that it had changed SBC's intentions with respect to the Chicago market. For example, Mr.
7 Sigman states that:

8
9 Rochester was chosen as the test market for two main reasons. First, *Rochester was the*
10 *smallest of our out-of-region markets*. We did not want to try this untested strategy in
11 our larger markets. We wanted to learn whatever lessons we could in Rochester before
12 deciding whether and how to deploy the strategy in our larger markets. Second,
13 regulatory developments favoring entry were further along there than in any of our other
14 out-of-region markets, (for example, resale rates were established in tariffs which
15 eliminated the need to engage in time consuming efforts to negotiate an interconnection
16 agreement and order flows) so we expected that entry would be easier in Rochester at
17 that time than it would be in the other out-of-region markets.³⁵
18

19 So while Mr. Kahan speaks of the need to enter the out-of-region local market "on a massive
20 scale," SBC *Wireless* deliberately picked the *smallest* market in which it was then operating
21 for its market trial. While Mr. Kahan emphasizes the enormous staffing needs of the
22 National-Local Strategy and, in particular, the need for managers experienced in the local
23 telephone business, Mr. Sigman describes an organizational strategy that is at best a minor
24 appendage on the existing SBC *Wireless* operation:

34. New York Public Service Commission, *Petition of Rochester Telephone Corporation for Approval of Proposed Restructuring Plan*, Case 93-C-0103; *Petition of Rochester Telephone Corporation for Approval of a New Multi Year Rate Stability Agreement*, Case 93-C-0033; *Opinion and Order Approving Joint Stipulation and Agreement*, Opinion No. 94-25, Issued and Effective November 10, 1994.

35. Sigman (SBC), FCC Affidavit, at ¶ 6, emphasis supplied.