

1 We began reselling local exchange service from the ILEC, Frontier in Rochester in early
2 1997. *As a part of our Rochester entry efforts, we hired and trained installation*
3 *personnel and purchased two vans to allow SBC personnel to make customer premise*
4 *visits.* We established an internal order flow process and trained our internal sales and
5 other personnel on how to interact with both the customers and the ILEC to activate
6 customers and undertook all other efforts necessary to enter the local exchange business
7 in Rochester. Even with all of this effort, the results were not what we anticipated.
8 Although we marketed our local exchange services only to our existing or new cellular
9 customers, *most of our local exchange customers were neither existing Cellular One*
10 *customers nor were they new customers signing up for both our cellular and local*
11 *exchange services.* We therefore did not achieve the critical objective of our plan:
12 selling more services to our wireless customers. *This development meant that local*
13 *exchange entry had no measurable effect on reducing our wireless churn rate and did*
14 *not help us in attracting new wireless customers.* It also meant that customer
15 acquisition costs were not effectively reduced because those costs were not being
16 allocated among multiple services per customer.³⁶
17

18 The experience of SBC Wireless in Rochester at best teaches that SBC Wireless may not be
19 the appropriate entity to pursue a *de novo* local wireline entry, but in view of the paucity of
20 resources that SBCW had committed to its Rochester effort, it's not clear that even this
21 conclusion could be drawn. Indeed, extrapolating from Mr. Kahan's statement that SBC's
22 "current overall cellular penetration [is] 12.2 percent,"³⁷ it is likely that SBC Wireless has
23 between 900,000 and one million current cellular subscribers in its Chicago-area system,³⁸
24 thus providing a sizable existing customer base that certainly has sufficient mass to support a
25 full-blown local wireline service market entry. Thus, taken at face value, what Mr. Kahan

36. *Id.*, at ¶ 7, emphasis supplied.

37. Kahan (SBC), FCC Affidavit, at ¶ 73.

38. The actual number of SBC cellular customers in the Chicago area may well have been a good deal greater than this estimate, which is based upon companywide cellular penetration rates. As of January 1, 1998, SBC Cellular One had a total of 292 NXX codes, representing *nearly three million* individual telephone numbers, assigned to it in the five Chicago-area NPAs (312, 773, 708, 847 and 630). Bellcore, *Local Exchange Routing Guide*, January 1, 1998. See also Late Filed Exhibit 2.1 in Illinois Commerce Commission Dockets 97-0211/97-0192

1 appears to be suggesting is that because SBC found it unprofitable to operate a lemonade
2 stand (its two-van effort in Rochester), it concluded that the only way it could succeed is to
3 acquire Walmart (the Ameritech merger and the National-Local Strategy). Clearly, there are
4 a myriad of entry opportunities and strategies between a venture that is staffed with
5 installation personnel that required *de novo* training and equipped with all of two vans for
6 customer premises visits and one that could not even be considered except by a company
7 with \$30-billion in total assets and more than 33-million access lines in service.

8
9 Q. Has Ameritech initiated any plans to pursue a *de novo* entry and offer local telephone service
10 within SBC's region?

11
12 A. Yes. Like SBC, Ameritech recently sought to package out-of-region local exchange service
13 with its cellular service. Project Gateway was "developed by Ameritech Cellular primarily
14 as a defensive strategy in response to a perception in early 1997 that other wireless
15 competitors in St. Louis ... were planning to offer local services to cellular subscribers as
16 part of a bundling strategy ..."39 As described by Ameritech, "[a]t its core, Project Gateway
17 was a discrete and limited initiative designed to protect the value of Ameritech's cellular
18 business in St. Louis against erosion caused by the anticipated introduction of bundled
19 services offerings by wireless competitors in that market."⁴⁰ Ameritech started a trial

39. Osland (Ameritech), FCC Affidavit, at ¶ 4.

40. *Id.*

1 involving 390 employees and their families on January 26, 1998 and ended the trial by the
2 end of March 1998.⁴¹

3
4 Through the trial, Ameritech ostensibly identified problems with the new business: it
5 encountered significant order processing errors; the bill format was confusing; the pricing
6 plan provided value to some but not to others; and increased competition put “greater than
7 anticipated” pricing pressure on cellular and long-distance rates — reducing the appeal of
8 the package and undercutting business assumptions.⁴² Project Gateway is now on hold,⁴³
9 and, according to Ameritech, “[t]he decision to put the trial on hold was solely and
10 unilaterally reached by Ameritech.”⁴⁴

11
12 Q. Do the kinds of problems that Ameritech claims it encountered in attempting to do business
13 in St. Louis justify its decision to pull out of that market — and, for that matter, all *de novo*
14 local service initiatives — altogether?

15
16 A. No. In fact, it is not surprising that, in attempting to enter a new line of business, a company
17 would encounter problems; indeed, given the legacy of problems that virtually everyone
18 attempting to enter the local telephone business has confronted, it is difficult to imagine how
19 or why Ameritech might have thought that things would somehow be different for its own
20 out-of-region pursuits. The decision to cut-and-run cannot be held out as demonstrating that

41. *Id.*, at ¶ 8.

42. *Id.*

43. *Id.*, at ¶ 10.

44. *Id.*, at ¶ 14.

1 Ameritech would have abandoned its attempts at out-of-region entry absent the merger with
2 SBC; none of the specific “problems” that Mr. Osland has identified would be a basis to
3 abandon the kind of competitive effort that the Applicants contend are being aimed at
4 themselves, unless of course one accepts the ultimate futility of all efforts to introduce
5 competition into the local exchange market. Thus, absent the merger, Ameritech could be
6 expected to have attempted to troubleshoot and to overcome those problems. Other firms
7 venturing into new areas that have encountered similar difficulties might seek to simplify a
8 confusing bill format, to modify the pricing plan to suit customer needs, and to correct order
9 processing errors. If every start-up CLEC gave up as quickly as Ameritech, local
10 competition would not be a factor in the telecommunications landscape. Of course, if the
11 merger occurs, the Commission will never know whether Ameritech would have tried harder
12 and pursued its out-of-region offerings on its own.

13
14 Q. What is the relationship of the timing of Ameritech’s decision to withdraw from St. Louis
15 and the timing of its merger discussions with SBC?

16
17 A. These events were occurring at roughly the same time, and indeed the timing of Ameritech’s
18 decision to abandon its out-of-region efforts may be more than coincidental. Ameritech’s
19 business decisions to curtail its resold business local exchange service and Project Gateway
20 occurred just as it was working out the final details of the proposed merger. SBC’s and
21 Ameritech’s chief executive officers first met on February 24, 1998, and discussed the
22 possibility of merging.⁴⁵ The merger was announced on May 10, 1998 and in an affidavit
23 dated July 21, 1998, Mr. Weller asserted that “Ameritech has no plans to become an out-of-

45. Amended Proxy Statement/Prospectus, September 21, 1998 at 23.

1 region CLEC, and, absent the merger, would not do so.”⁴⁶ Between February and July 1998,
2 Ameritech discontinued its out-of-region ventures. At the end of March 1998, Ameritech
3 ended its Project Gateway trial (the experiment in bundling landline and cellular service in
4 out-of-region markets). On June 25, 1998, Ameritech halted its out-of-region resold local
5 business service. Had the merger negotiations never occurred, Ameritech may well have
6 attempted to modify its resold local business service strategy and its cellular-based strategy
7 to overcome the specific problems it encountered when it first attempted to establish an out-
8 of-region toehold.

9
10 Most significantly, however, the merger is certain to harm the development of local
11 competition in the Applicants’ two home regions. Whether their entry can be shown to have
12 been imminent or whether it would have been somewhat more remote in time,⁴⁷ the fact
13 remains that the threat of competitive entry by either of these major regional ILECs into the
14 other’s home region would be a major factor affecting the competitive performance of both
15 the ILEC and other entrants. SBC is an actual potential competitor of serious consequence
16 in the Ameritech region; Ameritech should also not be discounted as an actual potential
17 competitor in the SBC region.⁴⁸ The sheer size of the SBC/Ameritech mega-ILEC, whose
18 in-region market dominance will be fortified by even greater financial/managerial/technical/

46. Weller (Ameritech), FCC Affidavit, at ¶ 31.

47. In its *BA/NYNEX Merger Order*, regarding its interpretation of the potential competition doctrine, the FCC stated that “there is case law holding that such entry must be certain” “[w]e choose, however, to follow the larger and, in our opinion, more reasonable line of cases holding that entry need only be reasonably likely.” *BA/NYNEX Merger Order*, at footnote 260, cites omitted.

48. As the FCC recognized, case law distinguishes between actual potential competition and perceived potential competition. *BA/NYNEX Merger Order*, at n. 148.

1 customer resources and scope of operations, is likely to deter some CLECs who had
2 previously committed to entering one or more of the seven major markets in the Ameritech
3 region, being acquired by SBC through the merger. Moreover, as I shall discuss below, the
4 new SBC will confront more intense financial pressure than ever before to protect its
5 dominance in the consolidated home region, in order to protect the stream of noncompetitive
6 service revenues that it admits are necessary to provide the financial stability underlying its
7 new, risky out-of-region venture.

8
9 **SBC retains overwhelming market power throughout the seven states in which its**
10 **incumbent LEC subsidiaries currently operate.**

11
12 Q. In arguing against providing Illinois ratepayers with any significant portion (or, for that
13 matter, with *any* portion) of the potentially substantial savings that SBC forecasts will result
14 from the merger, Mr. Kahan states that SBC “assumed that virtually all, if not all, of
15 Ameritech Illinois’ services would be determined to be unregulated or competitive within
16 three years of the date that we close the SBC/Ameritech merger.”⁴⁹ Does the current level of
17 competition in the Ameritech and SBC regions warrant such an expectation?

18
19 A. No, it certainly does not.⁵⁰ Moreover, if other ILECs who might seek to compete in SBC’s
20 expanded region obtain no more than the bare minimum level of competitive penetration in

49. Kahan (SBC), at 74.

50. I assume Mr. Kahan is not merely referring to the statutory compliance that would allow a service to be declared competitive, but to the existence of actual price-constraining competition. This distinction is important because, for example, while IBT has reclassified intraLATA toll services as competitive in 1996, it has since then steadily increased rates for that service. Comments of the Citizens Utility Board and the People of the State of Illinois, ICC Docket No. 97-0157, at 14-15.

1 the out-of-region residential and small business segments that SBC itself has said it expects
2 to achieve through its National-Local Strategy, then the actual competition that SBC and
3 Ameritech can expect to confront as incumbent providers of local exchange service will not
4 significantly affect their dominant control over these critical segments of the local exchange
5 market.

6
7 Q. What is the present level of competition that SBC and Ameritech confront in their respective
8 operating areas?

9
10 A. There are several sources of this information, including an extensive survey of local
11 competition that was conducted by the FCC's Industry Analysis Division earlier this year.
12 But one need look no further than the data and testimony provided by Mr. Kahan in this
13 proceeding to appreciate the minimal amount of competition that SBC has experienced to
14 date and that it anticipates will arise in the local service market in the future.

15
16 In Table 3 in his Illinois testimony, Mr. Kahan identifies a total of 1,017,883 "CLEC lines"
17 across the seven-state SBC operating territory. However, of this amount, only 367,921 lines,
18 or slightly over 1%, of the 32-million-plus access lines being furnished by SBC represent
19 *facilities-based* CLEC services. The remaining 649,962 "CLEC lines" are identified by Mr.
20 Kahan as "resold" SBC services. Only a monopolist would characterize its own services
21 furnished via alternative retail distribution channels as constituting "competitive losses;" in
22 most other industries, producers nurture and cultivate their retail distribution channels,

1 without which their products might well languish on the loading dock.⁵¹ In fact, SBC
2 continues to furnish these 649,962 resold “CLEC lines,” and they cannot be excluded from
3 the near-99% market share that SBC continues to control.

4
5 SBC’s effectiveness in limiting competitive losses in the markets in which it operates can
6 also be demonstrated by comparing the rates of facilities-based penetration in the five SWBT
7 states to that in the two Pacific Telesis states, which SBC did not take over until April, 1997.
8 Mr. Carter’s data, provided in his FCC affidavit, identifies a total of 274,099 facilities-based
9 CLEC lines in California and Nevada,⁵² or about 1.5% of the roughly 17.7-million Pacific
10 Bell and Nevada Bell access lines. In stark contrast, Mr. Kahan identifies only 93,822
11 facilities-based CLEC lines in the five SWBT states, representing only 0.6% of the roughly
12 15.7-million SWBT access lines. While both the 1.5% California/Nevada and 0.6% Texas/
13 Oklahoma/Kansas/Missouri/Arkansas CLEC market shares are barely above zero, one
14 cannot help but observe that the extent of facilities-based CLEC penetration is more than
15 two-and-one-half times as much in the two states that SBC did not control until last year
16 than in the five states that the Company has dominated since the formation of SBC in 1984.
17 Indeed, just comparing the results for the two most populous SBC states — California and
18 Texas — underscores the extent of SBC’s effectiveness in curtailing even the most modest
19 levels of facilities-based entry. California’s 261,051 facilities-based CLEC lines represent
20 1.5% of Pacific Bell’s 17.4-million lines, whereas Texas’ 59,082 facilities-based CLEC lines
21 represent about 0.6% of the 9.3-million access lines that SWBT furnishes in that state.

51. For example, Mr. Sigman correctly notes that in the wireless business it is common for facilities-based carriers to employ independent sales channels, such as “car audio equipment dealers,” to sell these services at retail. Sigman (SBC), FCC Affidavit, at ¶ 12.

52. Kahan (SBC), Table 3, at 54.

1 Considering the high rate of economic growth and reputation for entrepreneurial activity that
2 Texas has consistently demonstrated, the lack of significant CLEC penetration speaks
3 volumes about the effectiveness of SBC's policy of keeping the competitive "welcome mat
4 smaller than anyone else's."⁵³

5
6 Q. What is the current state of local competition within Ameritech's operating areas and, in
7 particular, within Illinois?

8
9 A. Contrary to Mr. Kahan, Mr. Harris and Mr. Gebhardt's assertions, the reality of the situation
10 in Illinois territory today — not in some speculative future environment — is that local
11 competition has gotten off to a very disappointing start. Based on the results of the Common
12 Carrier Bureau's Local Competition Survey,⁵⁴ only about 2.0% of Ameritech lines were
13 being resold on a "bundled" (*total service resale* or *TSR*) basis, about 0.3% of local service
14 lines were being provided over UNE loops purchased by CLECs, and about 0.3% of local
15 numbers had been "ported" by ILECs to competing local service providers via interim local
16 number portability.⁵⁵

53. "Pick of the Litter: Why SBC Is the Baby Bell to Beat," *Business Week*, March 6, 1995.

54. Common Carrier Bureau Survey of Local Competition, FCC CC Public Notice regarding responses to the Common Carrier Bureau Survey on the State of Local Competition, March 27, 1998, www.fcc.gov/ccb/local_competition/survey/responses.

55. Local numbers must be "ported" when an ILEC's existing local service customers take service from a CLEC that is providing its own switching and desire to keep their local phone number. The total quantity of such numbers provides a reasonable proxy for the total number of CLEC lines provided over CLEC, as opposed to ILEC, facilities. While the number does not include CLEC-provided local service lines where the customer did not desire to keep the same phone number (e.g., new service installations, out-going only trunks, computer and fax lines), it does include some percentage of lines that are also included in the UNE loop counts (situations

(continued...)

1 In Illinois specifically, only about 3.0% of lines were being resold on a “bundled” (*total*
2 *service resale* or *TSR*) basis, about 0.3% of local service lines were being provided over
3 UNE loops purchased by CLECs, and about 0.2% of local numbers had been “ported” by
4 ILECs to competing local service providers via interim local number portability. Out of a
5 total of 283 serving wire centers identified by Ameritech Illinois, only 24 had a physical
6 collocation arrangement with at least one CLEC utilizing UNE loops. Accordingly, and as
7 Ms. TerKeurst discusses in her testimony, CLECs have only obtained a small share of the
8 local market and there is no indication for improvement in the near future.

9
10 Q. Mr. Kahan, Mr. Harris and Mr. Gebhardt all cite seemingly large numbers of interconnection
11 agreements, certificated carriers, trunks furnished to CLECs, and volume of traffic
12 interchanged as evidence of rapidly growing competition. Aren't these data of perhaps
13 greater significance than the static market penetration figures that you have just been
14 discussing?

15
16 A. No. In fact, these “head count” types of numbers teach far less about the effectiveness of
17 competition than the type of hard penetration results that Mr. Kahan has himself presented.
18 Moreover, it is critically important that all of these data be evaluated in the context of the
19 total market size and the service delivery capability of the individual providers. For
20 example, the failed effort that SBC Wireless undertook to offer local service in Rochester,
21 New York still required that it apply for and be awarded a certificate to provide the service:
22 indeed, Mr. Sigman testified that SBCW had applied for and had obtained certification as a

(...continued)

where the CLEC combines an ILEC UNE loop with its own switching).

1 local wireline carrier in Illinois, but that it nevertheless had “never commenced
2 interconnection negotiations with Ameritech or took any other concrete steps toward
3 entry.”⁵⁶ Similarly, Drs. Schmalensee and Taylor stated that SBC and Ameritech (and, one
4 must presume, other RBOCs as well) currently “provide full service to their in-region calling
5 card customers when they travel out-of-region,” but admitted that “SBC and Ameritech have
6 almost negligible market presence as long distance carriers in out-of-region states.”⁵⁷
7 RBOCs offering out-of-region long distance service may often require a state PUC-issued
8 certificate of public convenience and necessity (CPCN) or its equivalent, which would likely
9 be included in the “head counts” that the various SBC/Ameritech witnesses cite. To return
10 for a moment to an analogy I used earlier, counting up all of the lemonade stands in the
11 country teaches nothing about the comparative total retail market share of these (perhaps
12 tens of thousands of) pre-teen enterprises relative to that of one Walmart.

13
14 Perhaps even more revealing about the potential extent of actual competition in the local
15 exchange market of the future is SBC’s own assessment of its penetration of the residential
16 and small business segments under the National-Local Strategy. Mr. Kahan states that

17
18 *By competing successfully for the traffic of large businesses, SBC will also retain the*
19 *ability in-region to offer affordable, high quality and innovative products and services*
20 *to our residential and smaller business customers. In addition, our investments in out-*
21 *of-region markets, although initially made to accommodate major national accounts,*
22 *will also provide the foundation with which we can compete with the incumbent(s) for*
23 *residential and small business customers. Indeed, the business case for our*

56. Sigman (SBC), FCC Affidavit, at ¶ 10.

57. Schmalensee/Taylor (SBC/Ameritech), FCC Affidavit, at ¶ 29.

1 *National-Local Strategy assumes that penetration of the residential and small business*
2 *segments will begin in the first year following implementation of the strategy.*⁵⁸
3

4 But despite this stated commitment to compete aggressively in the residential and small
5 business segments in the 30 out-of-region National-Local Strategy markets that SBC plans to
6 enter, Mr. Kahan candidly concedes that the Company does not expect these efforts to result
7 in consequential share losses for the incumbent LECs in those areas:

8 SBC will begin offering service to residential customers within one year of the closing
9 with Ameritech, and plans to offer service to a majority of the households in the 30 out-
10 of-region markets within four years of closing. *We anticipate that we will achieve an*
11 *overall penetration rate of 4 percent of the residential customers in all of these 30*
12 *markets. ... We anticipate achieving similar results in the small business segment.*⁵⁹
13
14

15
16 Even if, as Mr. Kahan contends, SBC's National-Local Strategy will motivate other ILECs
17 to initiate correspondingly aggressive market entry plans within the SBC/Pacific/SNET/
18 Ameritech region, and even if such an effort is equally successful in attracting SBC/Pacific/
19 SNET/Ameritech residential and small business customers as SBC expects in its own out-of-
20 region National-Local Strategy (i.e., a 4% competitive market share), that would still leave
21 the remaining 96% of these segments (except for the occasional scraps that the niche players
22 can pick up) to the still-exclusive domain of SBC. Notwithstanding Mr. Gebhardt's
23 assessment as noted by Mr. Kahan, it seems highly unlikely "that virtually all, if not all, of
24 Illinois Bell' services would be determined to be unregulated or competitive within three

58. Kahan (SBC), FCC Affidavit, at ¶ 14, emphasis supplied.

59. *Id.*, at ¶ 63, emphasis supplied.

1 years of the date that [SBC and Ameritech] close the SBC/Ameritech merger.”⁶⁰ Note also
2 that the potential for a 4% out-of-region ILEC penetration rate in the Illinois local service
3 market is probably a “best case” scenario, inasmuch as, by SBC’s own assessment, few if
4 any other entrants would be financially and organizationally capable of mounting a similar
5 National-Local Strategy to that which SBC plans to pursue.

6
7 Q. Mr. Kahan claims that SBC has taken numerous steps to open its markets to competition,
8 and that competitive activity is flourishing throughout its region.⁶¹ Do you agree with his
9 portrayal of SBC’s actions in facilitating competition within its home region?

10
11 A. No, I do not. As I have shown earlier, by any appropriate measure, competition is far from
12 taking hold in the local exchange market in any state in SBC’s current region. Furthermore,
13 SBC has not yet demonstrated for any of its current in-region states that it has fully complied
14 with the requirement of the competitive checklist contained in Section 271 of the *Act*. In its
15 only Section 271 filing with the FCC to date, SBC relied upon a competitor’s very limited
16 employee service trial as the basis for its claim that it faced facilities-based residential
17 competition.⁶² After floating this extremely weak trial balloon, SBC has not returned to the
18 FCC to demonstrate its compliance with Section 271 in any of its seven states. In fact, as a
19 fall-back to working toward meaningful compliance efforts, SBC has gone so far as to try,

60. Kahan (SBC), at 74.

61. Kahan (SBC), at 43-52.

62. 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 ¶ 17.

1 unsuccessfully thus far, to obtain the complete legal invalidation of Section 271 through
2 creative constitutional theories that undercut the bedrock policy compromise upon which the
3 1996 legislation was fashioned.⁶³

4
5 Q. Have other state PUCs examined SBC's record of opening its market to CLEC entry?

6
7 A. Yes. The Public Utility Commission of Texas, in its investigation of SWBT's Section 271
8 application, determined, among other things, that "SWBT needs to show this Commission
9 and participants during the collaborative process by its actions that its corporate attitude has
10 changed and that it has begun to treat CLECs like its customers."⁶⁴ The PUC Chairman
11 stated during an open hearing:

12
13 If I felt the lack of competition were from a lack of interest or commitment on the
14 part of the new entrants, it would be easy to dismiss their concerns, but for most of
15 the participants in this hearing, that is not the case. This is potentially the richest
16 telecom market in the country. Legal and regulatory barriers to local market entry
17 have been eliminated and we have approved countless applications for new
18 authority and interconnection agreements. But a piece of paper doesn't mean much
19 if the incumbent really isn't interested in making this work.⁶⁵

63. SBC has attempted to prevent the Commission from enforcing Section 271 of the Act, characterizing it as an unconstitutional "bill of attainder." While a federal district court in Texas upheld SBC's claim (*SBC Communications, Inc. et al. v. FCC, et al.*, Civil Action No. 7:97-CV-163-X, U.S. District Court (N.D. TX), December 31, 1997) that decision was recently reversed on appeal by the U.S. Court of Appeals for the Fifth Circuit (No. 98-10140, September 4, 1998, revised September 23, 1998).

64. 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.

65. Statement of Chairman Pat Wood, III, May 21, 1998.

1 One of the other Texas PUC Commissioners raised as an issue “whether any of these
2 providers is or can become a true competitive alternative to SWB, in light of SWB’s lack of
3 cooperation and efforts to frustrate the CLEC’s efforts to enter the market.” She further
4 elaborated that “[t]he record is replete with examples of SWB’s failure to meaningfully
5 negotiate, reluctance to implement the terms of the arbitrated agreements, lack of
6 cooperation with customers, and evidence of behavior which obstructs competitive entry.”⁶⁶

7 Another Commissioner, in addressing public interest concerns, stated:

8
9 ... no matter what safeguards and protective measures we recommend, we cannot be
10 assured that competition will become irreversible in Texas until SWB is committed
11 to treating CLECs as customers rather than as competitors.⁶⁷

12
13 Q. What about the situation in California — how has Pacific Bell’s attitude toward local
14 competition been affected by the 1997 change of control?

15
16 A. SBC has also failed to eliminate barriers to local competition in its newly acquired
17 California territory. On October 5, 1998, the staff of the Telecommunications Division of
18 the California PUC issued its Final Staff Report on the *Pacific Bell and Pacific Bell*
19 *Communications Notice of Intent to File Section 271 Application For InterLATA Authority*

66. Statement of Commissioner Judy Walsh Regarding Southwestern Bell’s § 271 Request to Enter Long Distance Market, May 21, 1998, at 1.

67. Opening Statement of Commissioner Patricia A. Curran, Public Utility Commission of Texas, Docket No. 16251, Investigation into Southwestern Bell Telephone Company’s Entry into In-Region InterLATA Services Under Section 271 of the Telecommunications Act of 1996, May 21, 1998, at 5.

1 *in California* (“*Final Staff Report*”),⁶⁸ in which it identified several substantive areas in
2 which SBC has failed to comply with the competitive mandate embodied in the *1996 Act*.
3 One conclusion in the *Final Staff Report* pertains to interconnection agreements. The staff
4 determined that “interconnection agreements are not performing as intended by either the
5 [California Public Utilities] Commission or parties to the agreements in question,”⁶⁹ and
6 identified three types of problems hindering interconnection agreements from performing as
7 envisioned:

8
9 [T]he provisions in interconnection agreements that allow CLECs to incorporate new
10 network elements and services have not produced timely results. CLECs have found
11 this process too slow for a competitive marketplace and lacking in tangible results.
12 Second, the process for resolving contractual disputes is burdensome, time consuming
13 and inconclusive. Third, when CLECs seek to amend interconnection agreements, it
14 becomes apparent that they have unequal bargaining power and no recourse to a neutral
15 third party that can authoritatively resolve disputes.⁷⁰
16

17 The California PUC Staff also concludes that “Pacific has not opened its market to an extent
18 that allows CLECs a reasonable expectation of serving the mass market.”⁷¹ In explaining
19 how Pacific has failed to accommodate such mass market entry, the Staff determined that:

20
21 Many carriers plan to enter the mass market through the combining of network elements
22 or use of unbundled loops. Unfortunately, Pacific has not demonstrated that it has in
23 place a workable method for CLECs to order and provision combined elements.

68. 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.

69. *Final Staff Report*, at 2.

70. *Id.*

71. *Id.*

1 Unbundled loops require termination in a collocation cage; Pacific has not made
2 adequate collocation options available for Unbundled Network Element (UNE)
3 combinations or unbundled loops. Further, Pacific does not yet have an automated
4 system for processing those orders. Many of these issues are described in the report as
5 “gating” factors. Gating factors are those barriers to robust competition that Pacific has
6 erected through the policies and procedures it has adopted.

7
8 Pacific proposes a process for combining network elements that is labor intensive at
9 best and completely infeasible at worst. Pacific did not demonstrate the feasibility of its
10 proposed method of combining network elements through actual data or a test. Other
11 new entrants plan to use unbundled loops; this requires collocation at Pacific’s
12 locations. However, collocation space is limited in many central offices, and Pacific has
13 not explored certain types of collocation (e.g. cageless collocation) which would
14 alleviate space constraints and make it possible for more carriers to collocate.⁷²
15

16 The California PUC Staff also determined that “Pacific does not yet have Operations
17 Support Systems (OSS) in place for network elements that afford CLECs a meaningful
18 opportunity to compete.”⁷³ According to the *Final Staff Report*, “Pacific often chooses
19 solutions based on Pacific’s determination of whether it complies with Section 271
20 requirements, not based on how effective they might be in promoting competition.”
21 Furthermore, the Staff concluded that “it appears ... that Pacific designs solutions only to
22 meet perceived legal requirements of Section 271. In staff’s opinion, while Section 271 does
23 contain specific legal requirements, it also contains the larger requirement that Pacific open
24 its market to meaningful competition.”⁷⁴
25

26 Q. What other arguments have SBC and Ameritech raised in support of their contention that the
27 local exchange market is now, or is soon to become, effectively competitive?

72. *Id.*, at 4.

73. *Id.*, at 5.

74. *Id.*, at 11.

1 A. The Applicants have attempted to distract the debate with visions of technological revolution
2 whose existence portends the imminent arrival of competition. Specifically, in their FCC
3 affidavit, Professors Gilbert and Harris go on at length about *prospective* competition driven
4 by various forms of technological change, in various stages of development and application
5 in the telecommunications industry.⁷⁵ The BOCs began proffering similar arguments in
6 support of deregulation long before the *1996 Act* was even passed, but the slow pace of
7 development for local competition belies the claim that technology alone is *presently* a
8 sufficient force to overcome the ILECs' dominance in the local exchange market.⁷⁶

9
10 Moreover, as the FCC explicitly recognized in the *BA/NYNEX Merger Order*,

11
12 Even upon hypothetical full implementation of the Telecommunications Act of
13 1996, significant barriers to entry into the local telecommunications marketplace
14 will remain. Entrants must still be able to attract capital, as well as to amass and
15 retain the technical, operational, financial and marketing skills necessary to operate
16 as a telecommunications provider in the local market. For mass market services,
17 entrants will have to invest in establishing the brand name recognition and, even
18 more importantly, the mass market reputation for providing high quality
19 telecommunications services. These consumer "goodwill" assets take significant
20 amounts of time and resources to acquire. An unknown entrant's attempts to build
21 "goodwill" by providing reliable, high quality service relies heavily on the
22 cooperation of the incumbent LEC that provides interconnection, unbundled
23 elements, resold services or transport and termination, and can be frustrated by the
24 incumbent LEC if that carrier engages in discriminatory conduct affecting service
25 quality, reliability or timeliness. For all these reasons, we cannot at this time
26 simply assume that implementation of the Telecommunications Act of 1996 and the
27 potential for development of competition will eliminate any concerns about

75. Gilbert/Harris (SBC/Ameritech), FCC Affidavit at ¶¶ 11-21.

76. While it is conceivable that at some future point, new technologies will be deployed in a manner that allows CLECs to overcome all of the major entry barriers in the local market, sound public policy should not rely on the possibility of a future condition whose actual impact and timing are completely unknown and unknowable.

1 potential competitive effects of mergers, particularly the effects on the pace of the
2 development of competition.⁷⁷
3

4 The FCC's clear understanding of the challenges facing new entrants thus stands in stark
5 contrast to the vision of rampant competition and anticipated deregulation conjured up in the
6 Applicants' affidavits.
7

8 The Applicants have also suggested that the FCC's concerns over the slow progress toward
9 achieving local competition, expressed in the *BA/NYNEX Merger Order*, would no longer
10 apply. The implication is that advances during the past year were *so substantial* as to
11 obviate any such concerns. Yet SBC and Ameritech provide no specific evidence to support
12 this claim, and it is likely that none exists. Major dissatisfaction continues with the
13 inadequacy of ILEC operations support systems.⁷⁸ ILECs continue to be unwilling and/or
14 unable to provide combinations of UNEs without unwieldy and expensive physical

77. *Bell Atlantic/NYNEX Merger Order*, at ¶ 42.

78. The inadequacy of OSS continues to be a major stumbling block in ILECs' attempts to satisfy the requirements of Section 271. See, *Application of BellSouth Corporation, et al., Pursuant to Section 271 of Communications Act of 1934, as amended, to Provide In-region, InterLATA Services in Louisiana*, CC Docket 97-231, *Memorandum Opinion and Order*, FCC 97-228, February 4, 1998, at ¶¶ 1, 20-58; *Application of BellSouth Corporation, et al., Pursuant to Section 271 of Communications Act of 1934, as amended, to Provide In-region, InterLATA Services in South Carolina*, CC Docket No. 97-208, *Memorandum Opinion and Order*, FCC 97-418, released December 24, 1997, at ¶¶ 101-81; *Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-region, InterLATA Services in Michigan*, CC Docket No. 97-137, *Memorandum Opinion and Order*, FCC 97-298, released August 19, 1997, at ¶¶ 128-221. Ironically, the FCC did not reach the issue of OSS compliance with regard to SBC's one Section 271 filing, because of serious threshold deficiencies that made it unnecessary for the FCC to even analyze the specific elements of checklist compliance. See, *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, at ¶ 66.

1 collocation arrangements.⁷⁹ CLECs are having a difficult time sustaining any significant
2 level of entry in the residential and small business markets.⁸⁰ Indeed, as I have previously
3 discussed, in their own out-of-region entry initiatives, both SBC and Ameritech encountered
4 precisely the same kinds of difficulties and roadblocks whose existence they seek to deny
5 within their own combined service areas. Indeed, the Applicants have themselves contended
6 that out-of-region entry can only occur when attempted “on a massive scale” as, for example,
7 in the so-called “National-Local Strategy” which itself could not, the Applicants aver, be
8 pursued by any entity smaller than the size of SBC and Ameritech combined.

9
10 In sum, there is a direct conflict between the merger philosophy reflected in the Applicants’
11 statements and actions, on the one hand, and their claims that competition is flourishing (or,
12 at a minimum, poised to take off and fulfill some inevitable and irreversible economic
13 destiny). On the one hand, the Applicants contend that entry barriers for their actual and
14 potential competitors — only one of which is even remotely as large as the proposed SBC/
15 Ameritech combination — are not particularly high. Yet, at the very same time, the
16 Applicants take the position that their combination is a necessary condition of their being
17 able to launch broad-based out-of-region competitive entry.

79. The magnitude of this problem was evidenced at the full-day forum held by the Common Carrier Bureau on June 4, 1998.

80. “MCI has Stopped Pursuing Residential Customers,” *The New York Times*, April 15, 1998.

1 **There is a serious risk that the SBC/Ameritech merger will result in higher prices for**
2 **noncompetitive local telephone services in Illinois.**
3

4 Q. Dr. Selwyn, Section 7-204(b)(7) of the PUA requires that the Commission affirmatively
5 determine that the merger “is not likely to result in any adverse rate impacts on retail
6 customers.” Does the evidence offered by SBC and Ameritech in this and in the FCC
7 proceeding suggest otherwise?
8

9 Q. Indeed it does. In fact, SBC will confront strong incentives to generate additional revenues
10 from Illinois consumers in all market segments in which it does not face consequential price-
11 constraining competition. As a threshold matter, SBC will be paying an enormous premium
12 to acquire Ameritech — \$13.2-billion over the pre-announcement market value of
13 Ameritech stock, and \$47-billion over the net book value of Ameritech’s assets. Allocating
14 the premium over book value specifically to Illinois Bell, SBC would need to recover some
15 \$19.7-billion in overall investment in Illinois Bell (including \$5.5-billion in net book value
16 rate base plus an additional \$14.2-billion in premium⁸¹). Thus, whereas Ameritech’s net
17 investment in Illinois Bell is about \$5.5-billion,⁸² SBC will have invested an additional
18 \$14.2-billion that it will need to recover from its Illinois operations.
19

20 Q. Is it possible to calculate the potential additional revenue burden that SBC might feel
21 compelled to recover as a result of this \$14.2-billion above-book premium?
22

81. This value was derived by applying the ratio of [Illinois Bell book value / Ameritech Corporation book value] to the total premium over book value paid by SBC.

82. FCC Statistics of Communications Common Carriers, 1997, at Table 2.9.

1 A. Yes, such a calculation can be made. The additional investment affects primarily the Return
2 and Tax components of the Company's revenue requirement objectives.⁸³ Limiting our
3 calculation to the intrastate component only and using the same 9.5% discount rate that Mr.
4 Gebhardt has recommended be used in calculating the net present value of merger-driven
5 cost savings⁸⁴ and applying a composite 37% federal and state income tax rate, Illinois Bell
6 would be expected to generate \$1.7-billion in additional annual intrastate pre-tax earnings
7 for a period of ten years to offset the \$6.7-billion intrastate portion⁸⁵ of the total \$14.2-billion
8 in premium over book value that SBC will pay to acquire Illinois Bell. That figure assumes
9 no amortization of the premium itself, only the ongoing cost of money and taxes. Further, if
10 we assume, again conservatively, that the Company incurs no other costs and experiences no
11 demand elasticity effects as a result of the higher rates it would need to collect in order to
12 recover this additional \$1.7-billion in annual pre-tax earnings, that would imply a significant
13 overall increase in Illinois Bell intrastate revenues relative to the current levels adjusted for
14 the effects of the 1998 price cap rate adjustment.

15
16 Q. Are there other factors that would cause SBC to attempt to increase rates for Illinois Bell
17 noncompetitive services following the merger?

83. Under the Illinois price cap regime, the Company's aggregate revenue level is established by the price cap formula (which applies to "noncompetitive" services) and by market conditions (which presumably govern the pricing of "competitive" services). While the concept of a "revenue requirement" may not specifically apply under a price cap regime with no sharing or earnings ceiling, it is nevertheless a convenient metric for estimating the earnings objectives of a firm such as SBC that will have just invested \$62-billion to acquire Ameritech Illinois.

84. Gebhardt (Ameritech), at 31.

85. The Illinois intrastate portion of the premium over book is calculated by applying the "Regulated," "Noncompetitive" and "Intrastate" factors as developed by Ameritech witness Gebhardt. Gebhardt (Ameritech), at Schedule 1.

1 A. Yes. Mr. Kahan has stated quite unambiguously that SBC will need, and will use, revenues
2 derived from its core SBC/Pacific/SNET/Ameritech in-region core noncompetitive service
3 markets to finance and support the National-Local Strategy and other out-of-region
4 competitive ventures:

5
6 *... SBC will experience significant earnings dilution and increased risk as a result of the*
7 *start-up costs and losses during the earlier years of the National-Local Strategy. This*
8 *dilution cannot be borne by SBC alone. By spreading that dilution and risk across a*
9 *broader base of shareholders, the combined SBC/Ameritech can continue to provide*
10 *investors with appropriate returns notwithstanding the costly National-Local Strategy.*
11 *SBC would not, on its own, expose its smaller base of shareholders to the dilution and*
12 *extensive risk of the National-Local Strategy.*

13
14 Indeed, the business plan contemplates having a cumulative negative cash flow for
15 nearly ten years. *The remaining business operations of the new SBC must carry these*
16 *negative cash flows while we continue to grow our existing business, grow our customer*
17 *base, compete in the market where we are the incumbent, maintain and enhance our*
18 *existing networks and fund dividends. In fact, a significant percentage of the projected*
19 *positive net present value in the business plan is a result of favorable results in the later*
20 *years of the plan. Again, SBC on a stand-alone basis could not reasonably accept those*
21 *short-term and medium-term losses, particularly given the rapidly changing nature of*
22 *the industry that makes more distant gains less certain.*⁸⁶

23
24 Drs. Schmalensee and Taylor echo this linkage between the National-Local Strategy and the
25 merged company's ability to use its "substantial base of current customers and revenues" to
26 financially support the National-Local Strategy:

27
28 Managing a strategy of entering geographically-dispersed markets initially to serve a
29 relatively narrow base of customers requires a large, flexible pool of management and
30 employee skills if such entry is to be cost-effective. *A substantial base of current*

86. Kahan (SBC), FCC Affidavit at ¶¶ 79-80, emphasis supplied.

1 *customers and revenues is necessary to maintain earnings growth and spread risk while*
2 *following customers into out-of-region local markets. ...*⁸⁷
3

4 Thus, by SBC's own admission, it needs the Ameritech acquisition to provide a core revenue
5 base for the National-Local Strategy, and in the case of Illinois, that core revenue base will
6 come from the extensive noncompetitive services that Illinois Bell will continue to provide
7 and dominate within its operating areas.

8
9 Q. What forms might the increases in Illinois Bell rates take?

10
11 A. There are several possibilities. Illinois Bell is currently subject to a price cap regime in
12 which the annual price change is determined by offsetting the annual change in the fixed-
13 weight Gross Domestic Product Price Index (GDPPPI) by 4.3%, the so-called "X-factor" that
14 is intended to reflect productivity growth and a persistently slower-than-inflation growth in
15 the Company's input prices. *No other state in which SBC currently operates applies an*
16 *offset factor as high as 4.3% in its incentive regulation system.* If the merger is approved,
17 SBC is likely to seek a significant decrease in, or perhaps outright elimination of, the offset
18 factor; indeed, by stating his and Mr. Gebhardt's expectation that all services will be
19 unregulated or competitive in the next three years, Mr. Kahan is all but telegraphing SBC's
20 intention to ask the Illinois Commerce Commission to scrap its present price cap system
21 altogether.⁸⁸ (As I will discuss later on in my testimony, SBC has pursued precisely such a
22 tactic in California.) Since the Illinois Price Cap system went into effect, Illinois Bell rates
23 for noncompetitive services have *decreased* by between 1.38% and 2.44% in each year since

87. Schmalensee/Taylor (SBC/Ameritech), FCC Affidavit, at ¶ 16, emphasis supplied.

88. Kahan (SBC), at 74.

1 1994, resulting in a cumulative net decrease in Illinois Bell rates of more than a quarter of a
2 billion dollars. Elimination of the 4.3% X-factor from the price cap formula would produce
3 rate *increases* over the coming five years of roughly \$300-million; retaining the offset at its
4 present level would result in more than \$200-million in additional rate reductions relative to
5 present levels. Hence, this single regulatory change could channel upwards of one-half
6 billion dollars out of the Illinois economy and into SBC's out-of-region National-Local
7 Strategy.

8
9 Separate and apart from any fundamental changes in the price cap system or rate adjustment
10 mechanism, SBC can effect a variety of rate increases through miscellaneous tariff filings in
11 its noncompetitive services as well as through higher rates for services that are classified as
12 "competitive" but for which the Company would retain substantial market power. An
13 example of such "competitive" services that continue to face only limited actual competition
14 is intraLATA toll, which, following reclassification in 1996 resulted in significant rate
15 increases.

16
17 Q. Dr. Selwyn, in defending his Company's record in California since taking over control of
18 Pacific Bell, Mr. Kahan claims that "prices for [Pacific Bell] local service have remained
19 unchanged."⁸⁹ Is this an accurate description of the situation in California since the SBC
20 takeover?

21
22 A. Mr. Kahan's statement may well be one of those that "while legally accurate, does not
23 volunteer information." In fact, Pacific has submitted a number of applications and

89. Kahan (SBC), FCC Affidavit, at ¶ 93.

1 miscellaneous tariff filings to the California PUC seeking increases in rates since it took
2 over control of Pacific Bell; however, as of the date of his FCC Affidavit, none of these had
3 been acted upon. Moreover, in its also pending price cap filing, Pacific/SBC proposes
4 significant changes to its current regulatory framework, the effect of which would be to
5 allow Pacific/SBC upward pricing flexibility for services not currently subject to competitive
6 pressure. In 1998 alone, Pacific has filed numerous applications before the CPUC, all of
7 which request either a rate increase or recategorization of service to a more price-flexible
8 category (see Table below).⁹⁰

9

90. Established in D.89-10-031, updated in D.95-12-052, and currently undergoing its third triennial review, California's New Regulatory Framework is based on three service categories, each of which has different levels of pricing flexibility depending on the type of service and how much, if any, competition it faces. The service categories are: Category I, basic monopoly services whose rates can be changed only with Commission approval; Category II, discretionary or partially competitive services with downward pricing flexibility; and Category III, competitive services which have the maximum pricing flexibility allowed by law. D.89-10-031 33 CPUC 2d 43, 59.

Table 2

Applications of Pacific Bell for Rate Increases or Recategorization of Service in 1998

- Application of Pacific Bell (A.98-04-048) for authority to categorize residence inside wire repair as a Category III service
- Application of Pacific Bell (A.98-02-017) for authority to categorize business inside wire repair, interexchange carrier directory assistance, and limited call control service as Category III services
- Application of Pacific Bell (A.98-05-038) for authority for pricing flexibility and to increase prices of certain operator services, including directory assistance, emergency interrupt, and busyline verification, to reduce the number of monthly directory assistance call allowances, and adjust prices for four Centrex optional features
- Application of Pacific Bell (A.98-06-050) to modify certain affiliate transaction rules as contained in D.92-07-072 and D.86-01-026 to facilitate the post-merger consolidation of support services
- Application of Pacific Bell (A.98-07-020) for authority to categorize Centrex as a Category III service
- Application of Pacific Bell (A.98-07-029) for authority to categorize Toll-Free (8XX) and Business MTS IntraLATA Toll services as Category III services
- Advice Letter 19273 of Pacific Bell to increase current rates for certain applications of the Call Management Product
- Advice Letter 19278 of Pacific Bell to increase maximum rates for certain applications of the Call Management Product

1 Taken alone, these applications demonstrate Pacific/SBC's desire to increase rates in
2 California as much as is feasibly possible. However, these applications do not represent
3 Pacific/SBC's most significant threat to rate stability in California.
4

5 In its pending price cap filing, Pacific/SBC proposes to overhaul its existing price cap-based
6 regulatory framework. In this application, Pacific/SBC requests the elimination of "the
7 remaining vestiges of earning/rate of return regulation ... including the earnings sharing
8 mechanism, the rate of return earnings cap and floor, the 'benchmark' and 'market-based'
9 rates of return, and the 'trigger' mechanism."⁹¹ These requests, if approved, will eradicate
10 most, if not all, ratepayer protection included in the current regulatory framework that are
11 designed to ensure rate stability. As if this alone was not a significant enough threat to rate
12 stability, Pacific/SBC additionally requests in this application upward pricing flexibility for
13 services not subject to meaningful competition. If this application is accepted as proposed,
14 Pacific/SBC's ability to increase rates, as well as total revenues, will be unrestrained.
15

16 In considering whether the proposed merger satisfies the requirements of Section
17 7-204(b)(7), the Commission should take explicit notice of SBC's pricing actions in
18 California and of Mr. Kahan's effort to conceal them in his statements in the instant matter.
19

91. *Application of Pacific Bell for a Third Triennial Review of the Regulatory Framework Adopted in Decision 89-10-031*, February 2, 1998, at 4.

1 **SBC will cross-subsidize its National-Local Strategy and other competitive ventures with**
2 **monopoly revenues derived from noncompetitive Illinois Bell services and its other ILEC**
3 **entities.**

4
5 Q. Dr. Selwyn, Section 7-204(b)(2) of the PUA requires the Commission to determine that
6 “[t]he reorganization will not result in the unjustified subsidization of non-utility activities.”
7 Moreover, Section 254(k) of the federal *Telecommunications Act of 1996* expressly requires
8 that “[a] telecommunications carrier may not use services that are not competitive to
9 subsidize services that are subject to competition. The [Federal Communications]
10 Commission, with respect to interstate services, and the States, with respect to intrastate
11 services, shall establish any necessary cost allocation rules, accounting safeguards, and
12 guidelines to ensure that services included in the definition of universal service bear no more
13 than a reasonable share of the joint and common costs of facilities used to provide those
14 services.” As an economist, do you believe that the relationship that Mr. Kahan has
15 described as between Illinois Bell and SBC’s National-Local Strategy following the merger
16 would appear to violate one or both of these statutes?

17
18 A. Yes, in my opinion, the proposed reliance upon the post-merger SBC ILEC core revenues to
19 financially buttress the National-Local Strategy would constitute precisely the type of
20 subsidization of competitive services by monopoly revenues that is expressly prohibited by
21 Section 254(k) and that is to be considered by the Commission in evaluating the proposed
22 merger under Section 7-204(b)(2). Indeed, not only would SBC flow revenues from its core
23 services to make up the ten years’ worth of losses it expects to sustain as it rolls out its
24 National-Local Strategy, the Company has made no secret of its intention to exploit and in
25 some cases to raid assets and other resources of its ILECs that had been acquired and funded
26 through revenues from its noncompetitive services, which would necessarily include

1 “services included in the definition of universal service,” which is expressly prohibited by
2 Section 254(k).

3
4 For example, Mr. Kahan indicates that SBC will staff its National-Local Strategy by taking
5 personnel from the SBC and Ameritech operating companies, which would necessarily
6 include Illinois Bell:

7
8 *The merger creates a far larger pool of employees on which to draw in implementing*
9 *the [National-Local] strategy. Even with Ameritech, we will be challenged to meet the*
10 *personnel requirements of the strategy. It will still be necessary to hire significant*
11 *numbers of new employees. However, the merger creates a larger cadre of managerial*
12 *and technical talent on which we can draw. It has generally been our experience that*
13 *staffing new ventures with a significant number of existing managers is preferable to*
14 *relying extensively on newly hired managers.*⁹²
15

16 Dr. Carlton’s description of the management demands of the National-Local Strategy is
17 more specific: Citing articles by A. Campbell, Michael Goold, and Marcus Alexander,
18 “Corporate Strategy, The Quest for Parenting Advantage,” (*Harvard Business Review*,
19 March-April, 1995) and A. Chandler, Jr., “The Functions of the HQ Unit in the
20 Multibusiness Firm,” (*12 Strategic Management, Journal 31*, 1991), Dr. Carlton observes
21 that:

22
23 *While not all managers for the out-of-region venture would be drawn from SBC or*
24 *Ameritech, firms often prefer to staff new ventures using existing employees whose skills*
25 *are known and who understand the corporate parent’s goals. This does not imply that*
26 *a firm would pursue such a strategy without regard to its current businesses. I*
27 *understand that much of the senior staff of SBC’s past new ventures have been drawn*

92. Kahan (SBC), FCC Affidavit, at ¶ 78, emphasis supplied.

1 *from SBC and that SBC intends to rely to a significant extent on managers from SBC*
2 *and Ameritech to staff the 30-city venture.*⁹³
3

4 Dr. Carlton estimates that staffing the National-Local Strategy will require 2,850 managers,
5 which represents about 8.4% of the 33,968 management personnel currently employed by
6 SBC and Ameritech. He makes no secret of SBC's plan, following the merger, to raid the
7 SBC operating companies for managers to staff the National-Local Strategy CLECs:

8 *The transaction also increases the combined firm's ability to deploy facilities in a large*
9 *number of out-of-region areas by allowing more effective utilization of scarce*
10 *managerial resources. Deployment of facilities and services in 30 regions in three years*
11 *reflects an enormous managerial and logistical undertaking. By combining the*
12 *managerial and engineering resources of SBC and Ameritech, the merger substantially*
13 *increases the pool of human resources that can be drawn upon.*⁹⁴
14
15

16 Recruitment and training of ILEC management personnel is a costly and time-consuming
17 effort the costs of which have been largely if not entirely funded by revenues from core
18 monopoly services. Permitting the nonregulated CLEC affiliates that will comprise the
19 National-Local Strategy to raid these managerial resources constitutes a substantial cross-
20 subsidy that is simply not permitted by federal law.

21
22 Q. Are there other forms of cross-subsidization that are inherent in the SBC National-Local
23 Strategy and that could impact Illinois ratepayers or implicate portions of the Illinois statute?
24

93. Carlton (SBC), FCC Affidavit, at ¶ 32, emphasis supplied, footnotes omitted.

94. *Id.*, at ¶ 31, emphasis supplied.

1 A. Yes. SBC considers the National-Local Strategy as requiring a large commitment of capital
2 and other resources, as well as presenting substantial risk to the Company. The Company
3 has stated:

4
5 As one would expect when constructing 2,900 miles of fiber and placing into operation
6 140 switches, SBC's National-Local Strategy will require extensive capital investment
7 and the commitment of extensive financial and managerial resources. *The National-*
8 *Local Strategy calls for the investment of more than \$2-billion in capital expenditures.*
9 This capital requirement is in addition to the capital requirements the new SBC must
10 bear as it continues to enhance and maintain its local exchange networks in those
11 markets where it is an in-region provider.

12
13 Over the next ten years, the operating expenses involved in these out-of-region
14 operations will be in excess of \$23.5-billion. In addition, these capital requirements and
15 operating expenses are heavily weighted towards the early years of the business plan -- a
16 return on this investment does not occur until the later years. *Indeed, the magnitude of*
17 *the investment required to sustain this venture is demonstrated by the fact that these*
18 *operations are expected to generate negative cumulative cash flow until the ninth year*
19 *of the National-Local Strategy.*⁹⁵
20

21 Trading on the core earnings of the merged company's ILEC operations to finance the high-
22 risk National-Local Strategy will increase the overall portfolio risk of the new SBC, thereby
23 placing upward pressure on its overall cost of capital. Put another way, all else being equal,
24 SBC's capital costs would be lower without the National-Local Strategy than with it. That
25 condition is not, *per se*, a problem except to the extent that capital costs are allocated among
26 the various SBC ILEC and other entities on an average basis rather than in relation to the
27 specific risks peculiar to each line of business. Since the Illinois price cap plan does not
28 include any earnings sharing or cap, an increase in Illinois Bell's cost of capital due to the
29 inclusion of the highly risky National-Local Strategy would not necessarily have a direct
30 impact upon rates for noncompetitive services, but could nevertheless cause Illinois Bell to

95. Kahan (SBC), FCC Affidavit, at ¶¶ 57-58, emphasis supplied.

1 report poorer financial performance overall as part of an attempt to revise the price cap plan
2 along the lines I discussed earlier. Moreover, in adopting price cap regulation in its 1994
3 ruling, the Commission expressly linked its review of the price cap plan to IBT's
4 performance and earnings over the initial five-year period. Hence, inclusion of the high-risk
5 National-Local Strategy in the IBT cost of capital could eventually, if not immediately,
6 translate directly into higher rates for IBT services.

7
8 It is also worth mentioning, in this context, that Section 7-204(b)(3) of the PUA requires the
9 Commission to determine that "costs and facilities are fairly and reasonably allocated
10 between utility and non-utility activities in such a manner that the Commission may identify
11 those costs and facilities which are properly included by the utility for ratemaking purposes."
12 Any use of SBC ILEC book and non-book assets and other resources by SBC's National-
13 Local Strategy CLECs (or other competitive ventures) would require such an allocation.
14 With respect to Illinois Bell's cost of capital, if SBC were to finance relatively risky ventures
15 based upon the financial strength and stability of its ILEC entities, Section 7-204(b)(3)
16 would require precisely the type of capital cost deaveraging that I described above.

17
18 Q. Does SBC's plan to staff its National-Local Strategy CLEC operations by transferring
19 managers and perhaps other employees as well from Illinois Bell and its other ILECs raise
20 any other concerns that are specifically addressed in Section 7-204(b)?

21
22 A. Yes. Section 7-204(b)(1) requires that the Commission find that "the proposed reorganiz-
23 ation will not diminish the utility's ability to provide adequate, reliable, efficient, safe and
24 least-cost public utility service." Although continued mechanization of ILEC operations

1 could generally reduce the ILEC's personnel requirements over time, in selecting ILEC
2 personnel to staff its high-risk, high-stakes competitive initiatives (such as the National-
3 Local Strategy), SBC will have a strong incentive to choose the most experienced, highly
4 qualified people for assignment to the new out-of-region CLEC operations. This, in turn,
5 would work to diminish the overall quality of Illinois Bell and other SBC ILEC managerial
6 and labor forces, which could result in a diminution of service quality overall.

7
8 Q. But in view of the potential for increased competition within the home-region ILEC
9 territories, won't SBC also have an incentive to maintain high-quality and efficient
10 operations within its core ILEC businesses?

11
12 A. Only to the extent that actual competition becomes a significant factor in the home ILEC
13 market areas. As I have previously discussed, even by SBC's own assessment of its ability
14 to capture market share in its out-of-region operations, the limited possibility for any other
15 firm to launch its own National-Local Strategy into SBC/Pacific/SNET/Ameritech territory,
16 and the persistence of competition limited largely to niche market players, SBC will face far
17 less of a challenge defending its ILEC monopolies than in developing market share against
18 incumbent LEC monopolies in the out-of-region markets it plans to enter. In fact, although
19 Mr. Kahan speculates about retaliatory actions by other ILECs to move into SBC-controlled
20 markets when SBC moves into theirs, he offers no evidence that SBC expects any significant
21 market share or revenue erosion in its home regions specifically as a consequence of its

1 National-Local Strategy.

2

3

4 **There is no assurance that any post-merger synergies and efficiencies will result in lower**
5 **prices for Illinois ratepayers.**

6

7 Q. In his testimony, Mr. Kahan has outlined a series of “benefits” that, he contends, ratepayers
8 will realize as a result of the proposed merger. In considering the relative merits and risks of
9 the proposed transfer of control of Ameritech to SBC, how should the Commission evaluate
10 the significance of these claimed benefits?

11

12 A. In addition to contending that the merger will provide SBC with the opportunity to enter and
13 compete in out-of-region local markets under the National-Local Strategy, Mr. Kahan also
14 claims that the merger will produce specific benefits for consumers of Illinois Bell’s
15 services:

16

17 In addition, the merger of our companies creates the opportunity for the realization of
18 significant synergistic benefits or cost savings in SBC’s in-region states and significant
19 opportunities for revenue enhancements in Ameritech states. These opportunities
20 translate to new, innovative services and features and packages of services made
21 available in Illinois faster and more cost effectively than would have been possible
22 absent the merger.⁹⁷

23

96.

97. Kahan (SBC), at 6-7.

HIGHLY CONFIDENTIAL DATA
HAS BEEN DELETED

1 Mr. Kahan does not, however, explain how, when or even *if* any of the specific “synergistic
2 benefits or cost savings in SBC’s in-region states” or its “opportunities for revenue
3 enhancements in Ameritech states” will flow to customers of Illinois Bell’s noncompetitive
4 services, other than through vague and unspecific references to the development of
5 competition in the future. Indeed, there is an obvious inconsistency between the Applicants’
6 contentions that effective competition is on the horizon for all of Illinois Bell’s services, on
7 the one hand, and the specific linkage that Mr. Kahan draws between the merger and the
8 Company’s ability to introduce “new, innovative services and features and packages of
9 services in Illinois faster and more cost effectively than would have been possible absent the
10 merger.”⁹⁸ If the prospect of broad-based competition in all market segments is as real and
11 imminent as Mr. Kahan suggests, then the *market*, rather than any individual firm, will bring
12 about the rapid introduction of those “new, innovative services and features and packages of
13 services.”

14
15 Indeed, it is not entirely clear exactly what types of “new, innovative services and features
16 and packages of services” Mr. Kahan believes that SBC will be introducing that Ameritech
17 would not otherwise do on its own. Ameritech has by no means lagged behind other ILECs
18 in bringing new services and features to market. For example, Ameritech was one of the
19 first RBOCs to offer ISDN in the residential market at affordable prices; by contrast, when
20 SBC introduced ISDN in Texas, it set the installation and monthly charges so high as to
21 effectively block its availability in the residential market. Illinois Bell has just introduced a
22 new package of Caller ID and call blocking services that afford customers the ability to

98. *Id.*, at 6.

1 screen and block identified calls from telemarketers;⁹⁹ I am not aware of any comparable
2 package being offered in SWBT territory, despite its apparent success in promoting
3 widespread penetration of Caller ID.¹⁰⁰ Also, as I have previously noted, while still minimal
4 by any reasonable standard, there has been far more competitive activity in Illinois than in
5 any of the SWBT states, and it is difficult to understand how the replacement of Ameritech
6 with SBC will lead to more, rather than to less, actual competition in the Illinois local
7 services market.

8
9 In any event, these kinds of “soft” and unspecific benefits can hardly be sufficient to
10 overcome the substantial risks that I have identified as arising from the proposed transaction,
11 and certainly cannot be held out as satisfying the specific requirements of Section 7-204(c)
12 of the PUA with respect to the allocation of merger savings to Illinois ratepayers.

13
14 Q. Dr. Selwyn, in his FCC Affidavit (in support of the National-Local Strategy), Mr. Kahan
15 states that “[b]y competing successfully for the traffic of large businesses, SBC will also
16 retain the ability in-region to offer affordable, high quality and innovative products and
17 services to our residential and smaller business customers.”¹⁰¹ Shouldn’t this Commission
18 recognize this as an important merger-driven benefit?

99. “Tired of Telemarketing Calls? Ameritech Launches Breakthrough Service, Privacy Manager,” September 22, 1998. <http://www.ameritech.com/media/releases/release-1628.html>

100. See Testimony of GCI Witness Ms. Charlotte TerKeurst.

101. Kahan (SBC), FCC Affidavit, at ¶ 14.

1 A. No, for several reasons. Under the existing Illinois Bell price cap plan, “competitive”
2 services are excluded entirely from price cap or any other form of rate regulation, while rates
3 for noncompetitive services are subject only to the price cap mechanism. “Traffic of large
4 businesses” would undoubtedly be classified as “competitive” and would thus have no effect
5 upon the pricing of basic noncompetitive services furnished to residential and small business
6 customers. Moreover, interLATA long distance traffic, once the Company is permitted to
7 enter this segment, would almost certainly be furnished out of an entirely separate SBC
8 affiliate, and would in any event make no “contribution to the coverage of the common costs
9 associated with the network that serves all market segments”¹⁰² (other than through the
10 “payment” of access charges to Illinois Bell), notwithstanding Mr. Kahan’s claim to the
11 contrary.¹⁰³

12

13 **The merger as proposed will diminish competition in Illinois, pose substantial risks for**
14 **Illinois consumers, produce few if any tangible benefits, and for these reasons should not be**
15 **approved.**

16

17 Q. Dr. Selwyn, please summarize your overall recommendation to this Commission with
18 respect to the proposed takeover of Ameritech by SBC.

19

20 A. For the various reasons that I and Ms. TerKeurst have discussed, the substantial risks
21 associated with the proposed transfer of control far outweigh the vague and, in general,
22 “soft” consumer benefits that the Applicants ascribe to the transaction. These risks include

102. *Id.*, at ¶ 13.

103. Of course, if the toll service affiliate utilizes any utility resources of Illinois Bell Telephone, then section 7-204(b)(3) and 254(k) of the Telecom Act of 1996 would require that a portion of the costs for those resources be allocated to interLATA toll.

1 diminution of present and future competition in Illinois, increased prices for noncompetitive
2 services as the new owner undertakes to recover the substantial premium it will be paying to
3 acquire Ameritech, and the prospect of a sustained drain on the human resources and other
4 assets of Illinois Bell to staff and support the SBC National-Local Strategy and other
5 competitive ventures. For all of these reasons, the Commission should not approve the
6 merger transaction as proposed.

7
8 Q. Notwithstanding your principal recommendation that the merger not be approved as
9 currently structured, in the event that the Commission does determine that the takeover of
10 Ameritech by SBC should go forward, are there any specific provisions that the Commission
11 should impose that might mitigate the potentially adverse consequences of the takeover?
12

13 A. The imposition of certain requirements and safeguards would certainly be an essential
14 element of any decision approving the transaction in order to assure that consumers are
15 protected to the greatest extent possible and that competition now and in the future is not
16 impaired or diminished. I would observe, however, that any such provisions and safeguards,
17 while potentially mitigating certain of the risks that I have been discussing, are nevertheless
18 “second best” solutions.

19
20 The types of mitigation measures that should be adopted in the event that the merger is
21 otherwise allowed to go forward fall into two categories: (1) operational practices and
22 safeguards, and (2) allocation of economic benefits arising from the merger to customers of
23 Illinois Bell’s noncompetitive services. Ms. TerKeurst addresses the first category, and I
24 will address the second.

1 PREREQUISITES FOR THE SBC/AMERITECH MERGER

2

3 **If the proposed merger is to be approved, it is essential that certain specific measures be**
4 **adopted by the Commission as a condition for approval.**

5

6 Q. Dr. Selwyn, in previous sections of your testimony and based upon the analysis that you
7 have offered, you have recommended that the Commission reject the merger of SBC and
8 Ameritech as proposed. You also stated that, if the Commission nevertheless determines
9 that the transaction should be permitted to go forward, it should impose specific conditions.
10 What is the purpose of requiring such conditions?

11

12 A. As I have shown, in the form in which the Applicants have proposed this change of control,
13 the proposed SBC/Ameritech merger is adverse to the public interest and poses the potential
14 for higher prices, less competition, and worse service quality. While the imposition of
15 regulatory conditions will do nothing to alter the fact that if the merger is consummated the
16 potential entry of SBC as an actual competitor to Ameritech in the Illinois local
17 telecommunications market will be eliminated, the Commission can adopt measures that will
18 specifically target certain other shortcomings of the transaction, and reduce the substantial
19 imbalance between shareholder and ratepayer interests that the merger application, as
20 presently framed, creates. If the transaction is nonetheless approved under these
21 circumstances, it is essential that the various adverse impacts are either eliminated through
22 regulation or adequately compensated through full compliance with Sections 7-204(b)(3), 7-
23 204(b)(2) and 7-204(c), such that consumers receive specific, tangible benefits from the
24 merger and competitors are adequately protected against the potential for even more
25 formidable entry barriers than presently prevail in Illinois. Such conditions will help to

1 mitigate, though not eliminate, the potential harm that could prevail following Commission
2 approval of the proposed merger.

3
4 Q. Do you have any recommendations as to the particular conditions that the Commission
5 should impose upon the Applicants?

6
7 A. Yes. These fall into two separate categories. Ms. TerKeurst addresses and recommends
8 specific regulatory measures and procedures that the Commission should adopt and enforce
9 so as to minimize the takeover's potential to limit competition and impair service quality. I
10 will focus upon measures intended to assure that (1) there are no adverse rate effects (as
11 required by Section 7-204(b)(7) of the PUA); (2) costs incurred to support the provision of
12 competitive services are properly allocated to affiliates (Section 7-204(b)(2) and Section 7-
13 204(b)(3)); and (3) merger-driven cost savings are properly allocated to captive customers of
14 Illinois Bell's noncompetitive services (Section 7-204(c)).

15
16 **Section 7-204(c) applies to this merger.**
17

18 Q. Are you familiar with the Applicants' position regarding the applicability of Section
19 7-204(c) of the PUA to SBC's proposed takeover of Ameritech?

20
21 A. Yes. Section 7-204(c) requires that

22 the Commission shall not approve a reorganization without ruling on: (i) the allocation
23 of any savings resulting from the proposed reorganization; and (ii) whether the company
24 should be allowed to recover any cost incurred in accomplishing the proposed
25 reorganization and, if so, the amount of cost eligible for recovery and how the cost will
26 be allocated.
27

1 SBC and Ameritech take the position that Section 7-204(c) does not apply to this merger
2 because the requirement “relate[s] only in the context of a merger between two companies
3 subject to rate of return regulation.”¹⁰⁴ The Applicants argue that since Illinois Bell is
4 subject to price cap regulation (rather than rate of return regulation), there is no requirement
5 that savings arising from the merger be shared with or allocated to ratepayers.

6
7 Q. Does the Applicants’ position have merit?

8
9 A. Counsel advises me that there is nothing in the statute or in its prior application that would
10 support the Applicants’ argument that price cap utilities are exempt from the provisions of
11 this section. SBC’s contention is fundamentally illogical on its face, and is inconsistent with
12 other requirements of Section 7-204.

13
14 Q. Why is SBC’s contention that Section 7-204 does not apply to a price cap regulated
15 company illogical and inconsistent with other provisions of Section 7-204?

16
17 A. If Illinois Bell were still subject to rate of return regulation, any net cost savings arising from
18 the merger would be flowed through to ratepayers in the routine course of periodically
19 setting the utility’s revenue requirement and rate level. Section 7-204(c) thus becomes
20 operative where merger-driven cost savings would *not* otherwise be flowed through to
21 ratepayers, i.e., where price cap regulation, *rather than rate of return regulation*, has been
22 adopted.

23

104. Kahan.(SBC), at 61.

1 Even if there were any merit to SBC's theory that Section 7-204(c) applies only to utilities
2 subject to rate of return regulation, it is important to recognize that price cap regulation does
3 not constitute a total departure from rate of return regulation; rather, it is essentially rate of
4 return regulation with a relatively lengthy "regulatory lag." I say this because, when the
5 Commission adopted price cap regulation in 1994, it set a finite life (5 years) for the current
6 plan, and specifically contemplated a full review of the plan at the completion of the fourth
7 year.¹⁰⁵ It is reasonable to assume that one of the issues to be addressed in such a review is
8 the overall level of earnings that the Company had been able to achieve under the plan so
9 that, for example, the annual price adjustment mechanism could be modified. In the FCC's
10 price cap plan, the price adjustment mechanism has been modified twice since the system
11 was put in place in 1989, and on October 5 of this year the FCC announced that it would
12 consider further modifications.¹⁰⁶

13
14 Moreover, the applicability of Section 7-204(c) must be considered in the context of Section
15 7-204(b)(3), which requires the Commission to determine that "costs and facilities are fairly
16 and reasonably allocated between utility and non-utility activities." Inasmuch as SBC
17 readily concedes its intention to draw on the assets and resources of its ILEC entities in
18 pursuing its National-Local Strategy, the statute would require that the Company allocate an
19 appropriate portion of Illinois Bell costs to the nonregulated affiliates that will be benefitting

105. ICC Docket No. 92-0448; 93-0239 Consol., *Illinois Bell Telephone Company: Petition to Regulate Rates and Charges of Noncompetitive Services Under An Alternative Form of Regulation. Citizens Utility Board -vs- Illinois Bell Telephone Company: Complaint for an investigation and reduction of Illinois Bell Telephone Company's rates under Article IX of the Public Utilities Act*, Appendix A, Plan for Alternative Form of Regulation, Application for Review of the Alternative Regulatory Plan, mimeo at 117.

106. FCC Public Notice, FCC 98-256, October 5, 1998.

1 from access to the Illinois Bell assets, resources and customer base. Such an allocation
2 would have no purpose if, in the end, Illinois Bell were permitted simply to retain as
3 additional profit the portion of its costs that are allocated over to its competitive affiliates.
4 Sections 7-204(b)(3) and 7-204(c) must be construed as requiring a flow-through to
5 customers of Illinois Bell's noncompetitive services of both the merger-driven cost savings
6 as well as the cost savings arising from the allocation of costs from the ILEC to the affiliate.

7
8 Section 254(k) of the federal *Act* must also be considered. If, by failing to allocate to Illinois
9 Bell ratepayers the merger savings and an offset that corresponds with the reduction in
10 Illinois Bell's regulated costs that support competitive SBC activities, Illinois Bell is
11 permitted to earn excessive profits which can then be used to finance the money-losing
12 National-Local Strategy for up to ten years, the result is precisely the type of cross-subsidy
13 that is expressly prohibited by Section 254(k). Moreover, the federal statute both authorizes
14 and mandates the state commissions to assure that no such cross-subsidy is permitted to
15 arise. There can thus be no question but that Section 7-204(c) applies here, as does Section
16 7-204(b)(3) and Section 254(k) of the federal *Act*.

17
18 Q. Section 7-204(c) also requires that the Commission consider "whether the companies should
19 be allowed to recover any costs incurred in accomplishing the proposed reorganization and,
20 if so, the amount of costs eligible for recovery and how the costs will be allocated." How
21 should these merger implementation costs be treated?

22
23 A. If the Commission chooses to allow for the recovery of implementation costs, it must ensure
24 that Illinois ratepayers are only responsible for their fair share of those costs. Thus, the

1 Commission should require that implementation costs be fairly apportioned (a) between
2 SBC and Ameritech; (b) between existing and future (e.g., National-Local Strategy)
3 activities that will benefit directly from the merger; (c) between telco and non-telco
4 Ameritech operations; (d) between Illinois and other AOCs; (e) between regulated and non-
5 regulated Illinois operations; (f) between intrastate and interstate operations; and (g) over a
6 time frame that is comparable to that used in valuing the merger transaction itself. As I will
7 discuss later in my testimony, the Applicants have provided no concrete evidence that such
8 an apportionment has been undertaken.

9
10 Q. How does the proposed merger result in benefits that should be allocated to Illinois Bell
11 customers in accordance with Section 7-204(c)?

12
13 A. Presumably, a merger of two companies takes place when their respective managements,
14 directors and shareholders conclude that the whole will be worth more than the sum of its
15 individual parts, i.e., that the two firms together will create greater shareholder value than
16 they could individually. This increase in combined shareholder value vis-a-vis the sum of
17 the shareholder values of the separate firms constitutes the *merger synergies*. In theory, the
18 present value of those merger synergies should flow directly to the share price of the merged
19 company, appropriately discounted for risk, uncertainty and illiquidity.

20
21 The precise manner in which the aggregate merger synergies will be apportioned as between
22 the two participating firms (and their respective shareholders) is necessarily arbitrary.
23 Obviously, each will have to get something out of the deal, or no transaction will take place
24 at all. Thus, the minimum portion of the combined merger synergies that either firm will

1 accept will necessarily be greater than zero, and the maximum amount that either firm will
2 be willing to give up will necessarily be less than all. The precise point between these two
3 extremes where the parties reach a meeting of the minds is necessarily arbitrary, and will be
4 decided based upon the respective negotiating skills and positions of each participant.

5
6 Q. The Applicants do claim, among other things, that these merger synergies are “speculative”
7 and on that basis argue that such speculative gains cannot be shared with ratepayers.¹⁰⁷ Are
8 these estimates of merger synergies speculative?

9
10 A While the total synergy estimate of \$19-billion (in present value terms, provided by SBC’s
11 financial advisor, Salomon Smith Barney¹⁰⁸), contains certain speculative components, from
12 the perspective of Ameritech and its shareholders, most of their allocated portion of synergy
13 gains is not driven by the actual, long-term results. If the merger closes, Ameritech
14 shareholders receive \$13.2-billion in additional value *whether or not SBC is successful in*
15 *capturing all of the synergies upon which it determined to pursue the transaction.*
16 Additionally, if SBC does achieve the additional gains that are reflected in the Salomon \$19-
17 billion value, then Ameritech shareholders will realize an *additional* benefit on top of the
18 \$13.2-billion premium.¹⁰⁹ If there is anything that is “speculative” about the synergy
19 estimates, it is that in actuality they will *exceed* the SBC/Salomon forecasts, since *it would*
20 *make no sense for SBC to pursue this acquisition on the terms to which it has agreed if the*

107. Kahan (SBC), at 63-65.

108. Amended Proxy Statement/Prospectus, September 21, 1998, at 35.

109. I derive the additional benefit in detail later in my testimony.