

1 Ameritech's region are still disturbingly small, they are even more miniscule in SBC  
2 states.

3  
4 The harm to competition that would result from the merger, as proposed, would be  
5 systemic and far-reaching. The consolidation of large incumbent carriers and their entry  
6 into other geographic areas may be in the public interest only if the carriers' home  
7 markets are truly open to competition. Neither SBC nor Ameritech has met such a  
8 standard at this time. Further, SBC's history of challenging statutory and regulatory  
9 mandates and of obstructing the legitimate efforts of competitive local exchange carriers  
10 (CLECs) to enter local markets is well documented and on-going. Approval of the  
11 merger, as proposed, would solidify SBC's and Ameritech's current monopolies and  
12 import to Illinois a management philosophy particularly hostile to competition. In  
13 assessing the likely outcomes of the proposed merger, these realities should be given far  
14 greater weight than the textbook theories of SBC's expert economists.

15  
16 On a national basis, SBC's claim that its National-Local strategy will lead to widespread  
17 local competition is overblown. Another outcome that is at least equally likely is that  
18 SBC will engage out-of-region in the type of "cream skimming" of large business  
19 customers that incumbent local exchange carriers find so objectionable when undertaken  
20 by their competitors. There is no reason to believe the spurious claims that out-of-region  
21 efforts by the Applicants will force other carriers to begin serving residential customers in  
22 Illinois. Further, to the extent merger-related synergies materialize, they could be used to

1 make it even harder for existing CLECs to compete in Illinois and could discourage other  
2 CLECs contemplating entry. The merger would also tend to harm long distance  
3 competition, particularly if SBC prevails in its efforts to have Section 271 of the 1996  
4 Act overturned and Bell Operating Companies (BOCs) are allowed to enter in-region  
5 long distance markets without first opening their local markets.

6  
7 Consistent with the Applicants' own justifications regarding the necessity of this merger  
8 for them, it is almost inevitable that this merger would lead to yet additional  
9 consolidation in the telecommunications industry. A central issue before this  
10 Commission, the FCC, and others reviewing the proposed merger is when to say,  
11 "enough is enough." A myopic view of a single merger can be very dangerous, since this  
12 is an instance where the combined effect of multiple mergers may be greater than the sum  
13 of the effect of the individual mergers, if considered in isolation. The cumulative effect  
14 of all the mergers must be recognized.

15  
16  
17 While Ameritech Illinois would continue to be regulated by the Commission, an  
18 Ameritech Illinois whose marching orders come from SBC would be a quite different  
19 entity than the current one. GCI witness Lee L. Selwyn and I, and undoubtedly other  
20 witnesses as well, chronicle SBC's pattern of resisting regulation and competition.  
21 Illinois would be at serious risk of losing all the hard-won gains in opening up the local  
22 telecommunications markets; at a minimum the Commission could expect persistent

1 attempts by SBC to undermine regulatory authority, on-going court challenges, and  
2 belated “compliance” with market-opening mandates in ways that are still obstructionist.  
3 The current cycle of mergers, if allowed to continue, would continue to reduce the  
4 number of incumbent local exchange carriers whose operations may be used to develop  
5 industry benchmarks for assessing individual company behavior.

6  
7 The Commission should make clear that certain conditions must be met before it would  
8 consider approval of a merger between SBC and Ameritech. I propose a number of  
9 conditions that could mitigate some of the harms and risks of the proposed merger, as set  
10 forth in the Joint Application. In an effort to identify problem areas in a timely fashion,  
11 the Commission would monitor Ameritech Illinois’ activities closely as it implements the  
12 merger. Ameritech Illinois should file annual merger-related reports, also posted on the  
13 Internet, that track network investments, employment changes, the implementation of  
14 “best practices” from other SBC areas, and the quality of service provided to end user  
15 customers and to CLECs. The conditions I recommend include the following:

- 16 • Extension of Ameritech Illinois’ current network investment commitments,  
17 with more detailed annual reporting to include a description of the services,  
18 customers, and geographic areas of the State that benefit from each  
19 investment.
- 20  
21 • Requirements that Ameritech Illinois employment be maintained at adequate  
22 levels to provide high quality of service; that state regulatory personnel remain  
23 in Illinois; and that customer service representatives remain in the Ameritech  
24 region. Ameritech Illinois should report any transfers of current employees  
25 out of Illinois (by job title and years of experience), any changes in employee  
26 counts by job title, and the effects of such changes on telecommunications  
27 service in Illinois.

- 1           • In the annual merger report, Ameritech Illinois would identify any proposed  
2           “best practices” whose adoption by SBC or its affiliates would affect the  
3           provisioning of intrastate telecommunications in Illinois. Ameritech Illinois  
4           should report how each identified “best practice” would affect costs, revenues,  
5           employment, service quality, marketing, competition and CLECs, and the  
6           ability of the Commission to monitor and regulate intrastate  
7           telecommunications services. Ameritech Illinois should also explain how  
8           SBC is identifying “best practices,” the results of any “best practices”  
9           implementation that has occurred, and how such “best practices” will be  
10          maintained over time.
- 11
- 12          • More detailed reporting regarding quality of service, including the metrics and  
13          standards recommended by CUB in Docket 96-0178.
- 14
- 15          • Modification to the Service Quality Index (SQI) in Ameritech Illinois’ price  
16          cap mechanism, to include a broader range of more customer-oriented indices  
17          and to increase the financial consequences when a standard in the SQI is  
18          missed.
- 19
- 20          • The development of specific conditions to ensure that Ameritech Illinois’  
21          local markets have been opened to competition. Unless such conditions are  
22          developed during the initial hearings in this proceeding, I recommend that a  
23          collaborative process be undertaken, similar to those that have been  
24          established in California, Texas, and New York, with parties reporting the  
25          results to the Commission within a set time limit.
- 26
- 27          • A requirement that Ameritech account managers overseeing Ameritech’s  
28          interactions with specific Illinois CLECs remain in Illinois and that they retain  
29          decision-making authority.
- 30
- 31          • A requirement that Ameritech Illinois not make changes to its local  
32          competition policies and practices, including its operations support systems,  
33          without first obtaining the agreement of the affected CLECs or, if agreement  
34          is not reached, approval by the Commission.
- 35
- 36          • Reporting requirements to allow monitoring of service provided to CLECs  
37          and whether such service is at parity with the treatment of Ameritech Illinois’  
38          retail operations and any affiliates. These would be guided by the reporting  
39          requirements developed by the Department of Justice (DoJ), the additional  
40          reporting requirements being developed in Texas, and any improvements  
41          developed by the FCC, modified as appropriate for Illinois.
- 42

- 1           • The inclusion of self-enforcing mechanisms in new interconnection  
2           agreements that would provide financial compensation to the CLECs if  
3           Ameritech Illinois does not comply with the interconnection agreements and  
4           does not meet standards for the provision of services and products needed by  
5           the CLECs. The Commission should make clear that it will include such  
6           provisions through arbitration if Ameritech Illinois and CLECs are not  
7           successful in developing such provisions through negotiation.

8  
9  
10       As a final matter, I address the way in which merger benefits should be reflected in rates  
11       if the merger is approved. Dr. Selwyn addresses how a portion of the projected benefits  
12       should be allocated to intrastate noncompetitive telecommunications services. I  
13       recommend that these merger benefits be allocated on an equal percentage basis among  
14       noncompetitive retail rates, wholesale rates, and intrastate switched access rates. A  
15       portion of the merger-related rate reduction would also be flowed through to rates for  
16       unbundled network elements, interconnection, and transport and termination rates based  
17       on updated cost studies reflecting merger-related cost savings. Ameritech should not be  
18       allowed to use the rate reductions for its strategic advantage.

19  
20    II.    EFFECTS ON PUBLIC UTILITY SERVICE—SECTION 7-204(b)(1)

21    Q.    What are the Applicants' views regarding how the merger could affect the quality of  
22       telecommunications service?

23    A.    SBC and Ameritech assert that the merger would not diminish Ameritech Illinois' ability  
24       to provide adequate, reasonable, efficient, safe and least-cost public utility service, as  
25       required by Section 7-204(b)(1). They argue, to the contrary, that the success of their  
26       proposed "National-Local Strategy" is "essential to the long term viability of Ameritech

1 Illinois, and to Ameritech and SBC” and, thus, “essential to providing high quality  
2 telecommunications services to [Ameritech Illinois’] retail and wholesale customers.”<sup>2</sup>

3  
4 SBC states that it has no substantive information about how Ameritech would maintain  
5 quality of service for its customers post-merger.<sup>3</sup> However, Ameritech witness David H.  
6 Gebhardt assures us that he expects Ameritech Illinois’ service quality to continue at its  
7 present level or improve after the merger.<sup>4</sup>

8  
9 Q. What concerns regarding quality of service are raised by the proposed merger?

10 A. There is concern that SBC may allow Ameritech’s quality of service to deteriorate so that  
11 it can “bleed” earnings from the region for its investments elsewhere. Service quality can  
12 deteriorate due to a variety of causes, including reduced network investment, maintenance  
13 budgets, and personnel levels. In addition, a carrier can lag behind in implementation of  
14 new technologies and the offering of new services and products, thus depriving its  
15 customers of telecommunications options available in other areas. While perhaps not as  
16 obvious, customer service and education are important aspects of service quality.  
17 Misleading and overly aggressive marketing tactics would make a mockery of the job  
18 title and degrade quality of service. I address each of these aspects of service quality in  
19 turn.

20  

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<sup>2</sup> SBC-Ameritech Ex. 1.0 at 8.

<sup>3</sup> SBC response to ICC Staff data request CJ 2.01.

<sup>4</sup> SBC-Ameritech Ex. 3.0 at 7.

1           A.     Network Investment and Modernization

2    Q.     What do the Applicants state regarding the effect of the proposed merger on network  
3           investment and modernization?

4    A.     SBC has stated that it is committed to continue to invest the capital necessary to support  
5           the network “consistent with Ameritech’s past practices.”<sup>5</sup> The Applicants assert that the  
6           merger would result in more advanced network infrastructure.<sup>6</sup> However, SBC states that  
7           it does not have any specific plans for new investments in Illinois.<sup>7</sup>

8  
9    Q.     What concerns regarding network investment and modernization are raised as a result of  
10          the proposed merger?

11   A.     It is essential that Ameritech Illinois make those investments needed to maintain the  
12          quality of basic exchange services and to upgrade the basic network infrastructure  
13          throughout its service territory so that all customers have access to a reasonable array of  
14          new products and services.

15  
16          As part of the alternative regulation plan currently in effect, Ameritech Illinois made a  
17          commitment to invest \$3 billion in its intrastate network over five years. Ameritech  
18          Illinois files annual infrastructure investment reports with the Commission detailing  
19          projects and amounts invested on new technology in the prior year and providing the  
20          current year’s budget. With the expiration of this commitment next year, there is concern

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<sup>5</sup> Letter from Edward E. Whitacre, Jr. to Richard C. Notebaert, May 10, 1998.

<sup>6</sup> SBC-Ameritech Ex. 3.0 at 39.

<sup>7</sup> SBC response to ICC Staff data request DHP 1.11.

1 that Ameritech Illinois could cut back on network upgrades and modernization. While  
2 maintenance of the network is important in any event, SBC's expansion plans raise even  
3 greater concerns that in-region networks, particularly in areas not facing competitive  
4 pressures, could be neglected in order to maintain overall cash flow in the face of large  
5 capital investments elsewhere.

6  
7 Q. If the merger is approved, what steps should be taken to help ensure that the merger does  
8 not harm network investment and modernization in Illinois?

9 A. If the merger is approved, the Commission should renew and extend the network  
10 modernization requirements adopted as part of Ameritech Illinois' price cap plan.  
11 Ameritech Illinois should be required to invest at least \$600 million each year in its  
12 network, which is the amount that Ameritech Illinois must spend each year, on average,  
13 to meet its 5-year \$3 billion commitment. The investment reporting requirements  
14 instituted as part of the alternative regulation plan should also be continued.

15  
16 In reviewing Ameritech's investment reports following the Company's original \$3 billion  
17 investment commitment, it became clear that Ameritech planned to meet its commitment  
18 by including investments made by affiliates of Ameritech Illinois.<sup>8</sup> Ameritech's eventual  
19 agreement to meet the commitment using only investments by Ameritech Illinois has  
20 helped to ensure that basic network investments continue. This limitation may not go far

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<sup>8</sup> Illinois Bell Telephone Company Petition for Clarification of Investment Obligation under the Alternative Regulation Plan, Docket 96-0469.

1 enough, however, to ensure that investments needed to maintain the infrastructure used to  
2 provide basic local service are realized.

3  
4 Ameritech Illinois has reported that investments are not tracked on the basis of which  
5 services benefit from the investment.<sup>9</sup> Because it is essential that investments be made to  
6 maintain the basic infrastructure, as well as to introduce advanced services in the market,  
7 I recommend that the Commission require Ameritech Illinois to identify, for each  
8 reported investment, which of its services and products benefit from the investment. In  
9 addition, Ameritech Illinois should identify the area (e.g., MSA 1 or elsewhere in the  
10 state) in which the investment is made. This would allow the Commission to monitor to  
11 ensure that Ameritech Illinois is not skimping on network investments, particularly those  
12 needed for basic services in areas of the state with less competitive pressures.

13  
14 B. Job Creation and Retention

15 Q. What do the Applicants state regarding effects of the merger on employment in Illinois?

16 A. SBC has committed that employment levels in Ameritech's region will not be reduced  
17 due to the merger and, in fact, states that it expects the number of employees in  
18 Ameritech's region to increase.<sup>10</sup> SBC witness James S. Kahan assures us that Ameritech  
19 will continue to be operated to the fullest extent possible by the current management

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<sup>9</sup> Ameritech Illinois response to Attorney General data request AG-4.

<sup>10</sup> Letter from Edward E. Whitacre, Jr. to Richard C. Notebaert, May 10, 1998.

1 team.<sup>11</sup> However, SBC states that it has not formulated post-merger plans that would  
2 provide information regarding employee levels in Illinois.<sup>12</sup>

3  
4 Q. What concerns regarding employment are raised by the proposed merger? .

5 A. Like the overall issue of service quality, there is concern that SBC may, in its efforts to  
6 cut costs in Illinois, reduce employee levels below those needed to maintain adequate  
7 service quality. In addition, SBC may relocate management out-of-state and may  
8 redeploy the most experienced and valuable employees to its out-of-region expansion  
9 efforts, to the detriment of Illinois customers. An equally important concern is that, even  
10 if overall employee levels are maintained, SBC may redirect the employee count away  
11 from the maintenance of high quality telecommunications services to activities whose  
12 sole aim is enhancing profitability.

13  
14 SBC admits explicitly to the FCC that it is relying on the merger in order to staff its  
15 expansion plans:

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

21 ...

22  
23 ...Even with Ameritech, we will be challenged to meet the personnel  
24 requirements of the strategy. ... It has generally been our experience that staffing

---

<sup>11</sup> SBC-Ameritech Ex. 1.0 at 17.

<sup>12</sup> SBC response to ICC Staff data request DHP 1.09.

1 new ventures with a significant number of existing managers is preferable to  
2 relying extensively on newly hired managers.<sup>13</sup>  
3

4 SBC's commitment that the number of Ameritech employees will not be reduced does  
5 not guarantee that employment in the local exchange companies will increase. Indeed, in  
6 response to a data request, SBC provided a proprietary forecast of post-merger  
7 employees-per-access-line that implies to the contrary.<sup>14</sup>  
8

9 The experience in California shows that job growth there has not been concentrated in the  
10 subsidiaries providing local exchange service. Mr. Kahan reports that the company's  
11 overall employment in California and Nevada is up more than 2,200 from April 1, 1997  
12 to August 14, 1998.<sup>15</sup> While that represents an overall increase of 4.3%,<sup>16</sup> the growth is  
13 spread unevenly among subsidiaries, with the basic service operations getting the short  
14 end of the stick. Employment by Pacific Bell (the local exchange company in California)  
15 has increased by only 205 jobs since the merger, which is less than 0.5 percent of its  
16 employee level.<sup>17</sup> Almost 60 percent of the reported employment increases are in Pacific  
17 Bell Mobile (1300), with other significant increases in the headquarters Pacific Telesis  
18 (509) and in information services (227).<sup>18</sup> Over 70 percent of the increases are in  
19 competitive affiliates, with most of the remaining increases in entities such as Pacific

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<sup>13</sup> FCC Merger Filing, affidavit of James S. Kahan at 28-29.

<sup>14</sup> SBC response to ICC Staff data request RTY 1.01.

<sup>15</sup> SBC-Ameritech Ex. 1.0 at 20 (revised).

<sup>16</sup> 2,20/50,839 total employment on April 1, 1997, from SBC response to ICC Staff data request JMV 1.02.

<sup>17</sup> Calculated from data in SBC response to ICC Staff data request JMV 1.02.

<sup>18</sup> SBC response to ICC Staff data request JMV 1.02.

1 Telesis and Pacific Telesis Shared Services that support competitive undertakings as well  
2 as the local exchange companies.

3  
4 While Pacific Bell has added a small number of positions, the reality is that more than  
5 825 Pacific Bell positions have been shifted to sales positions, resulting in a reduction in  
6 the network operations work force.<sup>19</sup> As Edwin A. Mueller, President and Chief  
7 Executive Officer of Pacific Bell, explained to a New York analyst conference,

8 Let me clarify this point...our guidance with regard to force levels at Pacific  
9 remains consistent with what we've told you in the past. What we're doing is  
10 redirecting our force increases to bring on more people who can help us  
11 generate...sales while we're reducing back-room operations.<sup>20</sup>  
12

13 SBC reports that 2,363 management positions were eliminated or consolidated as a result  
14 of the SBC/Pacific Telesis merger, with the job losses evenly distributed between the  
15 Pacific Telesis and Southwestern Bell regions.<sup>21</sup> In addition, a net of 80 management  
16 jobs were shifted from California to another state as a result of the merger.<sup>22</sup>

17  
18 While there may well be reasonable efficiency savings that could lead to lower  
19 employment levels within Ameritech Illinois, it is important that such cuts not  
20 compromise the quality of service anywhere in Ameritech Illinois' service area. Further,  
21 the offering of new products and services throughout the region should not be jeopardized

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<sup>19</sup> "The Opportunity at Pacific Bell," Presentation by Edward A. Mueller, New York Analyst Conference, June 23, 1998, at 4, 8, and 10.

<sup>20</sup> Id. at 4.

<sup>21</sup> SBC-Ameritech Ex. 1.0 at 20 (revised).

<sup>22</sup> SBC response to Attorney General data request AG-10.

1 or delayed because of employee cuts. Since Ameritech Illinois has already trimmed its  
2 workforce considerably,<sup>23</sup> the Commission should view any significant reductions below  
3 current levels with suspicion as long as the number of Ameritech Illinois access lines  
4 continue to grow.

5

6 Q. What steps should be taken, if the merger is approved, to help ensure that SBC does not  
7 reduce employee levels to the detriment of telecommunications customers?

8 A. The Commission should require, as a condition of the merger, that Ameritech Illinois  
9 employment levels be maintained at adequate levels to provide high quality of service.  
10 Customer service representatives should also remain in the Ameritech region. Customer  
11 service is enhanced if the representatives are familiar with the local exchange company's  
12 services and service territory, state regulatory policies, numbering practices, and other  
13 state or regional factors. Such knowledge would be very difficult to duplicate with  
14 customer service representatives located elsewhere.

15

16 It is important that the Commission monitor any changes in Ameritech Illinois' employee  
17 levels. As part of the annual report on implementation of the merger, Ameritech Illinois  
18 should report any transfers of current employees out of Ameritech Illinois (by job title  
19 and years of experience), any changes in the number of Ameritech Illinois employees in  
20 any job classification, and the effects of such changes on telecommunications service in  
21 Illinois.

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<sup>23</sup> SBC-Ameritech Ex. 3.0 at 25.

1

2 C. New and Improved Services and Products

3 Q. What have the Applicants stated regarding the merger's effect on the development of new  
4 and improved services and products?

5 A. SBC points to synergies arising from the introduction of one company's products in both  
6 territories and testing a product in only one area for use throughout a larger roll out area.<sup>24</sup>  
7 SBC promises that its commitment to providing new products and services that have been  
8 made available in SBC states will be a tremendous asset to Illinois.<sup>25</sup> SBC asserts that  
9 the range of available consumer services and products will increase because of the  
10 economies of scale attainable by the new SBC, that new services will be developed more  
11 quickly, and that customers will enjoy increased convenience of one-stop shopping and  
12 integrated billing.<sup>26</sup> Ameritech contends that the merger is needed in order to improve its  
13 ability to fund product and service development efforts.<sup>27</sup>

14

15 Q. Do you agree with SBC and Ameritech Illinois that the merger would bring more services  
16 to Illinois faster than would occur otherwise?

17 A. No. I agree that some efficiencies may be achieved in the joint development and testing  
18 of new products and services. However, there are other potential consequences that could  
19 more than offset any such advantages.

20

---

<sup>24</sup> SBC-Ameritech Ex 4.0 at 14.

<sup>25</sup> SBC-Ameritech Ex. 1.0 at 21-22.

<sup>26</sup> FCC Merger Filing at 44.

1 First, there are benefits to having multiple companies explore and develop new products.  
2 In the not-too-distant past, there were eight major incumbent LECs that all developed  
3 local telecommunications services. One company's innovations could be adopted by all  
4 the other companies.

5  
6 For example, Ameritech Illinois was the first local exchange carrier to offer national  
7 directory assistance. It recently introduced Privacy Manager, a new service that  
8 intercepts unidentified calls before a Caller ID customer's phone even rings. As another  
9 example, Illinois has led the nation in developing permanent number portability and  
10 number pooling solutions, under Commission direction and with ongoing involvement by  
11 consumer groups and all affected segments of the telecommunications industry. Illinois  
12 has made breakthroughs that national efforts, with the supposed cooperation and pooling  
13 of all companies' expertise, would have taken years longer to achieve, if at all.

14 Undoubtedly, the road to number portability would have been much more difficult if  
15 SBC, with its staunch opposition to opening local markets to competition, had been at the  
16 helm of Ameritech Illinois.

17  
18 Other carriers have excelled in other areas. SBC reports that Ameritech has adopted  
19 SBC's methods for provisioning high-capacity telecommunications circuits used for data,  
20 video, and voice services, at the request of AT&T.<sup>28</sup>

---

<sup>27</sup> SBC-Ameritech Ex. 2.0 at 7.

1       Number portability and high-capacity circuit provisioning methods are but two examples  
2       of instances where one company's advancements have diffused into other regions of the  
3       country. Such diversity is being whittled away, with the two currently proposed mega-  
4       mergers between large incumbent LECs (SBC/Ameritech Illinois and Bell Atlantic/GTE)  
5       bringing the number of large incumbents down to four.

6  
7       SBC and Ameritech's claim that their merger and the resulting pooling of resources is  
8       necessary to support innovation is counter to experience. Many valuable innovations in  
9       the telecommunications and digital revolutions have come from young start-up  
10      companies. For example, WinStar and Teligent are developing fixed wireless  
11      applications, an area not focused on by incumbent carriers. Fiber rings were pioneered by  
12      small providers such as LDDS. Other small CLECs have developed services aimed at  
13      niche market segments, such as non-English-speaking populations or high-risk customers.

14  
15      There is also concern, because of SBC's track record elsewhere, that having SBC take  
16      over in Illinois could make it more difficult for competitors to offer new services and  
17      products that rely on the incumbent carrier.

18  
19      Q.     Please comment on SBC's assertion that the merger would stimulate competitors to  
20      accelerate their own investment and innovations in Illinois in anticipation of the increased  
21      competition, investment, and innovation of Ameritech Illinois in the state.

---

<sup>28</sup> FCC Merger Filing at 48.

1 A. SBC witness Robert G. Harris contends that, by making Ameritech Illinois a more  
2 effective competitor, the merger would cause all of Ameritech Illinois' competitors to  
3 improve their responsiveness to customers, add investments to their networks, and roll  
4 out new services sooner.<sup>29</sup>

5  
6 Dr. Harris' theory that a merger would cause would-be competitors to "try harder" may  
7 make sense in a fairly stable market where several competitors are competing profitably  
8 and may become complacent about their market share. In such a situation, a merger of  
9 two large competitors could act as a wake-up call that other companies must shape up if  
10 they are to maintain market share.

11  
12 However, the current situation in Illinois is far different. The new entrants have been  
13 scrambling to try to establish themselves, build their networks and marketing capabilities,  
14 and grab a toehold in the local markets. Companies such as AT&T have sustained  
15 considerable losses in their efforts to enter local markets. The idea that CLECs are not  
16 already working full speed ahead to try to offer services attractive to customers as quickly  
17 as possible and, ideally, in a profitable manner is absurd. Dr. Harris' theory is simply not  
18 applicable in the current environment.

19

---

<sup>29</sup> SBC-Ameritech Ex. 4.0 at 14.

1 Q. Are there other market developments that would be more effective than mergers of  
2 incumbent carriers, in terms of spurring innovation and the development of new products  
3 and services?

4 A. Yes. Robust local competition would be much more effective than mergers of entrenched  
5 incumbents as a spur to innovation.

6  
7 Q. Are there other ways in which SBC and Ameritech could obtain efficiencies in their  
8 development of new products and services, without a merger?

9 A. Yes. Two carriers such as Ameritech and SBC are free to share information on new  
10 products and services, as long as such activities do not impede competition. A merger is  
11 not necessary.

12  
13 Q. Please comment on the Applicants' assertions that Ameritech Illinois would benefit from  
14 SBC's research and development capabilities through its access to SBC's subsidiary  
15 Technology Resources, Inc. (TRI).

16 A. Mr. Gebhardt states that Ameritech Illinois "has never attempted to establish the type of  
17 stand-alone, extensive research and development capability that SBC has," and concludes  
18 that Ameritech would benefit from SBC's research capabilities.<sup>30</sup> Ameritech and SBC  
19 assert that the combined companies are likely to have more cash available for research  
20 and development than without a merger.<sup>31</sup>

21

1 The Applicants overstate the importance of a stand-alone research organization. Indeed,  
2 the fact that Ameritech has met its research needs through other avenues indicates that  
3 alternatives can yield fruitful results. Ameritech has explained that it determined  
4 previously that outsourcing of research and development has more net benefits than  
5 would an in-house organization.<sup>32</sup>

6  
7 Ameritech performs marketing research and has a Systems Integration Laboratory, which  
8 tests the operational ability of potential services and features. It provides vendors with  
9 “technical, operational, and market requirements which provide direction for vendors  
10 research and development efforts.” Ameritech describes that it “participates in or  
11 provides funding to various joint boards, trade associations, consortiums and university  
12 research centers. For example, the Ameritech and Nortel chairmen sit on one joint board  
13 dedicated to research and technology. Ameritech also has an internal Technical Resource  
14 Advisory Council (TRAC). TRAC’s mission is to identify new technologies that are of  
15 interest to the Company and to match research on these technologies with universities,  
16 Bellcore, or other research organizations to evaluate and provide informed opinions on  
17 the opportunity. University alliances exist with Northwestern University and Penn State  
18 University.”<sup>33</sup>

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<sup>30</sup> SBC-Ameritech Ex. 3.0 at 26.

<sup>31</sup> SBC response to Sprint data request Sprint 1-26.

<sup>32</sup> Ameritech Illinois response to City of Chicago data request 1-4.

<sup>33</sup> Ameritech Illinois response to Attorney General data request AG-6 and City of Chicago data request 1-4.

1 SBC claims that TRI is similar to research organizations such as Bellcore and Bell Labs.<sup>34</sup>  
2 It explains that TRI focuses on applications research rather than basic research and that  
3 TRI “assists its client companies in bringing technology applications to market by  
4 providing actionable information that allows them to make faster, better-informed  
5 technology decisions.” TRI’s laboratories in Texas and California allow the testing of  
6 new technology and equipment in real-world conditions. TRI has about 200 employees,<sup>35</sup>  
7 including “engineers, computer scientists, applied psychologists and communications  
8 experts” who “work to incorporate leading edge technology into communications  
9 products and services offered by SBC companies.” TRI identifies competitive  
10 opportunities enabled by technology, specifies the needed technology capabilities,  
11 determines the viability and cost effectiveness of technology, produces new products and  
12 services “either internally or through third parties,” combines existing and/or new  
13 products and technologies into unique products or services, integrates technologies,  
14 products and systems into the business operations of SBC, shares its knowledge with  
15 other SBC affiliates, and participates in standards forums.<sup>36</sup>

16  
17 It appears that SBC may be stretching in its comparison of TRI to Bellcore and Bell Labs.  
18 At the time of its sale, Bellcore has 5,600 employees and annual revenue exceeding \$1  
19 billion.<sup>37</sup> Bellcore is deeply involved in technology development, with its Web site  
20 pointing to its role in creating and developing ADSL, AIN, ATM, ISDN, Frame Relay,

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<sup>34</sup> SBC response to City of Chicago data requests 1-4.

<sup>35</sup> SBC-Ameritech Ex. 1.0 at 12.

<sup>36</sup> SBC response to City of Chicago data request 1-4.

1 PCS, SMDS, SONET, and video-on-demand and reporting that Bellcore holds nearly 800  
2 patents for technical innovation.<sup>38</sup> Bell Labs, which is the research and development arm  
3 of Lucent Technologies, has about 25,000 employees. Among its long list of  
4 accomplishments, Bell Labs invented the transistor, laser, digital computer, and digital  
5 switching, and its software runs much of the world's telephone switching systems. It has  
6 received more than 26,000 patents.<sup>39</sup> In actuality, the operations of TRI do not sound that  
7 different than what Ameritech Illinois performs in-house on a more focused basis.

8  
9 Working with vendors, Ameritech Illinois has introduced many of the same advanced  
10 services that are available in SBC's territories and has been the first to offer services such  
11 as national directory assistance and Privacy Manager. Ameritech Illinois and SBC have  
12 not identified a single service that Ameritech Illinois has been unable to offer because it  
13 does not have an independent affiliate like TRI.

14  
15 A consolidated research organization like TRI may actually be less helpful than in-house  
16 capabilities. Mr. Kahan explains that the various subsidiaries of SBC, which are TRI's  
17 clients, drive TRI's activities.<sup>40</sup> As an entity with many masters, TRI's resources would  
18 be channeled to whatever undertakings the holding company deems most pressing and  
19 most profitable, whether that be mobile, long distance, international, or whatever. As a

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<sup>37</sup> "SAIC to Acquire Bellcore," November 21, 1996 News Release.

<sup>38</sup> "Fast Facts About Bellcore," available at <http://www.bellcore.com>.

<sup>39</sup> "Bell Laboratories Backgrounder," available at <http://www.bell-labs.com>.

<sup>40</sup> SBC-Ameritech Ex. 1.0 at 13.

1 result, TRI may not be able to focus on local exchange services to the same extent that in-  
2 house research capabilities can.

3  
4 Another concern is that the ILEC affiliates may subsidize activities of a consolidated  
5 research organization whose benefits accrue largely to other parts of the business. Each  
6 SBC affiliate pays TRI for the costs of the projects in which it participates and for certain  
7 core projects common to all companies. Fully loaded costs are charged to each  
8 company.<sup>41</sup> While Ameritech Illinois is under price cap regulation, such an arrangement  
9 could provide one more way in which Ameritech Illinois' coffers are raided to the benefit  
10 of SBC's operations elsewhere.

11  
12 Finally, Ameritech and SBC may be able to share research and development and other  
13 efforts without a merger. The manner in which Bellcore was funded and operated prior to  
14 its sale by the BOCs<sup>42</sup> is one example of such cooperation. The numerous alliances that  
15 exist throughout the telecommunications industry indicate the broad levels of cooperation  
16 that are possible without giving rise to antitrust concerns. SBC cites WorldPartners,  
17 GlobalOne, and Unisource as noteworthy international alliances.<sup>43</sup> Alliances have been  
18 used broadly in the acquisition and development of cellular and PCS licenses. Examples  
19 include PrimeCo Personal Communications, which is a limited partnership owned by

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<sup>41</sup> Ameritech Illinois response to Government and Consumer Intervenors data request GCI-AM-1-21.

<sup>42</sup> BellCore is now a wholly owned subsidiary of Science Applications International Corporation.

<sup>43</sup> FCC Merger Filing at 54.

1 AirTouch Communications and Bell Atlantic. TCG is a notable example of a major  
2 CLEC begun as a partnership.<sup>44</sup>

3  
4 Mr. Kahan reports that SBC rejected joint ventures as “inherently unstable”<sup>45</sup>. However,  
5 their widespread use throughout the telecommunications industry indicates that other  
6 companies have found them to be a useful avenue to pool resources and spread risk, when  
7 done in a way that is not harmful to competition. SBC’s apparent preference for  
8 ownership rather than joint ventures is inadequate justification for approval of a merger  
9 undertaken in a manner that would harm Illinois customers and hinder the development  
10 of competition.

11  
12 D. Marketing Practices

13 Q. Please describe how the Applicants view differences in the two companies’ marketing  
14 practices as creating an opportunity for merger benefits.

15 A. SBC plans to incorporate the most successful of SBC’s and Ameritech Illinois’ marketing  
16 practices throughout the regions. It projects \$778 million in merger benefits arising from  
17 improved marketing efforts, based on narrowing the gap in subscribership rates between  
18 the two companies’ customers.<sup>46</sup> SBC informed the FCC of the following penetration  
19 rates for various discretionary services.<sup>47</sup>

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<sup>44</sup> TCG was begun as a joint venture among TCI, Cox, Comcast, and Continental Cablevision (now Media One.)

<sup>45</sup> FCC Merger Filing, Affidavit of James S. Kahan, at 5.

<sup>46</sup> FCC Merger Filing, Affidavit of Martin A. Kaplan, at 4.

<sup>47</sup> FCC Merger Filing at 47. SBC data for Caller ID excludes Pacific Bell. SBC provided more detailed data on penetration rates, which SBC claims is highly confidential, in response to ICC Staff data request RTY 1.01.

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**TABLE 1**

**Subscribership Rates for SBC Discretionary Services**

	<b>SBC</b>	<b>Ameritech</b>
<b>Vertical services per access line</b>	<b>2.45</b>	<b>about half of SBC's rate</b>
<b>Caller ID</b>	<b>47%</b>	<b>25%</b>
<b>Voice mail</b>	<b>14%</b>	<b>9%</b>
<b>Call waiting</b>	<b>49%</b>	<b>43%</b>
<b>Second residential lines</b>	<b>23%</b>	<b>17%</b>

SBC has provided the following breakdowns of forecasted marketing-related revenue enhancements.<sup>48</sup>

**TABLE 2**

**Forecasted Revenue Enhancements**

(\$million)

<b>Vertical services (except Caller ID)</b>	<b>230</b>
<b>Caller ID (residential)</b>	<b>81</b>
<b>Additional lines</b>	<b>134</b>
<b>Data Products</b>	<b>65</b>
<b>Directory</b>	<b>98</b>
<b>Wireless</b>	<b>50</b>
<b>Centrex/other</b>	<b>120</b>
<b>TOTAL</b>	<b>778</b>

<sup>48</sup> FCC Merger Filing, affidavit of Martin A. Kaplan, at 4-8.

1 Financial analysts have commented that SBC's marketing-related revenue forecasts are  
2 conservative, since they assume only a partial closing of the gap in penetration rates.<sup>49</sup>  
3

4 Q. Please comment on SBC's plans regarding marketing practices.

5 A. I am concerned that what SBC views as marketing "best practices" could lead to overly  
6 aggressive marketing tactics that may entice customers, in potentially misleading ways, to  
7 buy discretionary services that they may not need or want. Customers still rely on their  
8 local service provider for basic, reliable information regarding telecommunications  
9 services and options. Particularly in the absence of widespread competitive alternatives,  
10 local exchange companies must be mindful of their continuing public utility role in  
11 educating customers. Revenue enhancements should not be viewed as merger benefits if  
12 they come as a result of misleading customers.  
13

14 Q. What issues have been raised regarding Pacific Bell's marketing practices since the  
15 SBC/Pacific Telesis merger?

16 A. Several complaints and other filings have been made with the California Public Utilities  
17 Commission (CPUC) since the SBC/Pacific Telesis merger regarding Pacific Bell's  
18 marketing practices.<sup>50</sup> While these filings have been made variously by the CPUC's

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<sup>49</sup> See, for example, "SBC/Ameritech Merger Creates Value and Growth Opportunities," Montgomery Securities, May 14, 1998, at 2.

<sup>50</sup> The Utility Consumers' Action Network v. Pacific Bell, C. 98-04-004; Greenlining Institute and Latino Issues Forum v. Pacific Bell, C.98-06-003; The Utility Consumers' Action Network v. Pacific Bell, C.98-06-027; Motion of the Office of Ratepayers Advocates for Authorization to Publicly Release Its Report on Pacific Bell's Handling of Residential Service Ordering (filed on June 4, 1998 in I.90-02-047); Telecommunications International Union, California Local 103, International Federation of Professional and Technical Engineers, AFL-CIO (TIU), on Behalf

1 Office of Ratepayer Advocates (ORA), consumer groups, and telecommunications  
2 workers unions, they all make similar allegations, including the following:

- 3 • Pacific Bell's practices of having optional feature packages with "basic" in the  
4 brand name is confusing to customers and likely results in the purchase of  
5 more or higher-priced products than a customer wants or needs.  
6
- 7 • Pacific Bell offers only the highest priced inside wiring plans to customers,  
8 without informing customers that inside wire services can be obtained  
9 elsewhere.  
10
- 11 • The scripts used to explain Complete versus Selective Blocking for Caller ID  
12 are misleading, with representatives instructed not to offer Complete Blocking  
13 for new service and to attempt to remove Complete Blocking on existing  
14 service.  
15
- 16 • Representatives sell services without verification that the account changes are  
17 authorized by the customer of record.  
18
- 19 • Representatives are specifically instructed not to provide line-by-line  
20 verification of orders for new connections or changes to existing orders.  
21
- 22 • The new Pacific Bell sales program employs sales quotas, Complete Blocking  
23 removal goals, mandatory training on high-pressure sales tactics, sales  
24 performance-based evaluations, monetary incentives, threats of disciplinary  
25 action if products are not offered on every call, and unlawful surveillance of  
26 representatives. Representatives are required to offer every Pacific Bell  
27 product on every call received, despite the nature of the call and including  
28 calls from customers whose accounts have been disconnected for delinquency  
29 and non-payment.  
30
- 31 • Pacific Bell's service to its residential customers had deteriorated due to the  
32 time-consuming emphasis on sales of optional features, particularly Caller ID.  
33

1 I was recently involved in a case involving the competitive classification of Pacific Bell's  
2 inside wiring services<sup>51</sup> and can confirm that Pacific Bell's inside wiring marketing  
3 practices are misleading. For marketing purposes, Pacific Bell combines the residential  
4 inside wire maintenance plan, with a regulated price of \$0.60 per month, with an  
5 unregulated service that offers a loaner phone for 60 days if a customer's phone fails.  
6 The combined package is offered for \$2.25 per month, with no mention that the inside  
7 wire portion, which is by far the most valuable portion of the package, is available for  
8 about one-fourth of the combined price. Further, representatives do not inquire whether  
9 the customer rents and do not inform customers that, under California law, landlords are  
10 responsible for inside wiring in rental situations. As a result, a larger percentage of  
11 renters subscribe to the inside wire maintenance program than do homeowners, even  
12 though they do not need the service at all.

13  
14 The importation of inappropriate marketing practices would lead to the Commission  
15 assuming the time-consuming role of micromanaging SBC's marketing practices. The  
16 Commission has generally tried to avoid such involvement in a company's business  
17 practices. The cases pending in California are but one indication of the additional  
18 workload the Commission may expect as a result of the merger, if approved.

19  

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<sup>51</sup> In the Matter of the Application of Pacific Bell, a Corporation, for Authority to Categorize Business Inside Wire Repair, Interexchange Carrier Directory Assistance, Operator Assistance Service and Inmate Call Control Service as Category III Services, et al., A.98-02-017, California Public Utilities Commission.

1           **Misleading or overly aggressive marketing practices should not be viewed as “best**  
2           **practices” worthy of emulation in Illinois. Such time-consuming sales techniques could**  
3           **negatively affect Ameritech Illinois’ ability to provide essential customer service**  
4           **functions, such as prompt answering of business office calls and taking the time to inform**  
5           **customers about important aspects of basic and emergency telephone services. As I**  
6           **discuss in the next section, Ameritech Illinois should be required to report on its planned**  
7           **adoption of SBC’s “best practices” in Illinois, including any changes to Ameritech**  
8           **Illinois’ marketing practices, if the merger is approved.**

9  
10           **E.     Need for Service Quality Safeguards**

11   **Q.     If the merger is approved, do you recommend that conditions be adopted to help mitigate**  
12           **the possible harm to service quality?**

13   **A.     Yes, I do. I have already discussed the need for safeguards regarding network investment**  
14           **and employee levels. Additional safeguards are needed regarding the importation of**  
15           **“best practices” whose results may benefit shareholders but not customers. I also**  
16           **recommend that improved reporting of service quality achievements be required and that**  
17           **the service quality index in the price cap mechanism be modified to include more**  
18           **customer-oriented measurements and to provide more effective incentives for Ameritech**  
19           **Illinois to provide high quality service in Illinois.**

20  
21   **Q.     What safeguards do you recommend regarding the importation of SBC’s “best practices”**  
22           **into Illinois?**

1 A. If the merger is approved, it is important that SBC and Ameritech adopt a “best practices”  
2 approach in which Ameritech maintains (or improves) its service quality in areas where it  
3 may exceed SBC’s quality of service and adopts SBC’s practices and standards where  
4 they lead to service whose quality is superior to Ameritech’s. The Commission should  
5 make clear to SBC and Ameritech Illinois that practices that lead to inadequate quality of  
6 service do not constitute “best practices.”

7  
8 To this end, I recommend that the Commission require that Ameritech Illinois include in  
9 an annual merger-related report details regarding any proposed “best practices” whose  
10 adoption by SBC or any of its affiliates would affect the provisioning of intrastate  
11 telecommunications in Illinois. Among other things, Ameritech Illinois should report  
12 how each such “best practice” would affect costs, revenue, employment, service quality,  
13 marketing, competition, and the ability of the Commission to monitor and regulate  
14 intrastate telecommunications services.

15  
16 Q. What are your recommendations regarding the monitoring of service quality in Illinois?

17 A. If the merger is approved, the Commission will need to monitor Ameritech Illinois’  
18 service quality carefully, to help ensure that service quality is not deteriorating and to  
19 identify any problem areas as quickly as possible. To that end, I recommend that the  
20 Commission require more detailed reporting regarding the quality of service, in particular  
21 the provisioning of basic exchange service (“POTS”) to end user customers. I discuss the

1 need for monitoring the quality of service being provided to CLECs later in my direct  
2 testimony.

3  
4 The eight service quality measures and standards that are included in the Service Quality  
5 Index (SQI) in Ameritech Illinois' price cap plan are as follow.<sup>52</sup>

6  
7 TABLE 3

8 Service Quality Measures and Standards  
9 in Ameritech Illinois Price Cap Plan

10

11	% installations within 5 days	95.44%
12	Trouble reports per 100 access lines	2.66
13	% out of service for more than 24 hours	5.0%
14	% dial tone speed within 3 seconds	96.8%
15	Operator average speed of answer—toll and assistance	3.6 seconds
16	Operator average speed of answer—information	5.9 seconds
17	Operator average speed of answer—intercept	6.2 seconds
18	Trunk groups below objective	4.5/year

19

20 In Docket 96-0178, which is still pending, CUB recommended that several additional  
21 measurements be reported and incorporated into the SQI. This need for more extensive  
22 end user customer-oriented reporting requirements becomes even more critical if the  
23 merger is consummated.

24  
25 The measurements and associated standards recommended by CUB in Docket 96-0178  
26 include the following:

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% calls answered within 20 seconds—business office	80%
% calls answered within 20 seconds—repair office	90%
Installation repeat trouble report rate (7 days)	10%
% repair appointments missed:	
Residential	12%
Business	12%
Repeat trouble report rate:	
Residential	15%
Business	15%
% installation appointments missed—company reasons:	
Residential	1%
Business	3%

The standards recommended for business office calls and repair office calls are based on standards in effect in other Ameritech states, as explained by CUB witness Barbara R. Alexander in Docket 96-0178. The remaining standards listed above are based on Ameritech Illinois' historical performance and its informal recommendations in the multi-state Ameritech Regional Regulatory Committee discussions.<sup>53</sup>

Ameritech collects data on a fairly extensive list of internal operating metrics, which include the following:<sup>54</sup>

- POTS Install % Missed Appointments
- POTS Installed > 6 Days

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<sup>52</sup> SBC-Ameritech Ex. 3.0 at 6.  
<sup>53</sup> Docket 96-0178, CUB Ex. 1.0 at 22.  
<sup>54</sup> Ameritech Illinois response to Attorney General data request AG-20.

1 POTS % I Reports (within 7 days)  
2 HICAP (On Net) Install % Missed Due Dates  
3 HICAP (Off Net) Install % Missed Due Dates  
4 HICAP (ALL) Install % Missed Due Dates  
5 HICAP % New Circuits Failed (30 days)  
6 HICAP DVA Dates Not On Time  
7 SUBRATE Install % Missed Appointments  
8 SUBRATE % New Circuits Failed (30 Days)  
9 ISDN Basic Install % Missed Appointments  
10 ISDN Primary Install % Missed Appointments  
11 POTS Repair % Missed Appointments  
12 POTS Trouble Report Rate  
13 POTS Mean Time To Repair (Hrs.)  
14 POTS % Repeat Reports  
15 HICAP Trouble Report Rate  
16 HICAP (On-Net) Time to Repair (Hours)  
17 HICAP Overall Time To Repair (Hours)  
18 HICAP (On-Net) % Repair > 2 Hrs.  
19 HICAP (Off-Net) % Repair > 3 Hrs.  
20 HICAP (Overall) % Repair > 3 Hrs.  
21 HICAP % Repeat Reports  
22 SUBRATE Trouble Report Rate  
23 SUBRATE Time to Repair (Hours)  
24 SUBRATE Repair > 3.5 Hours  
25 SUBRATE % Repeat Reports  
26 ISDN Basic Repair % Missed Appointments  
27 ISDN Basic Trouble Report Rate  
28 ISDN Basic Time To Repair (Hours)  
29 ISDN Basic % Repeat Reports  
30 FCC Reportable Outages  
31 Unplanned Switch Outage Bulk Minutes  
32 Operator Services Directory Assistance Speed Of Answer (state-specific)  
33 Operator Services Toll Speed of Answer (state-specific)  
34 Operator Services Intercept Speed of Answer (Illinois)  
35 SAFETY: Occupational Injuries/Illness  
36 SAFETY: Motor Vehicle  
37  
38

1 Ameritech has internal standards for each metric, which it considers to be confidential.<sup>55</sup>

2 Most of Ameritech's internal metrics regarding POTS service are included in the  
3 reporting requirements recommended by CUB in Docket 96-0178.

4  
5 I agree with CUB that the Commission should require that Ameritech Illinois report the  
6 additional measurements recommended in Docket 96-0178, and that the associated  
7 standards listed above should be adopted. The Commission may wish to require that  
8 Ameritech Illinois report measurements of all of Ameritech's internal metrics, in order to  
9 monitor service quality for private lines and ISDN lines, among other things. If so,  
10 Ameritech Illinois should be required to provide the Commission with its internal  
11 standards for these metrics, so that the Commission may evaluate their reasonableness.

12  
13 As a final point, Ameritech Illinois should be required to include its service quality  
14 measurements in the annual merger report to the Commission, with posting of the  
15 complete report on the Internet so that all parties have easy access to the information.

16  
17 Q. What are your recommendations regarding changes to the price cap mechanism if the  
18 merger is approved?

19 A. The SQI in the price cap plan should be strengthened to provide stronger monetary  
20 incentives for Ameritech Illinois to not let service quality deteriorate. The service quality  
21 measurements in the SQI should be modified to more accurately and completely capture

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<sup>55</sup> Ameritech Illinois response to Attorney General data request AG-21.

1 the most important service quality measurements. In addition, the penalty for failure to  
2 meet a service quality measurement should be strengthened. While these changes to the  
3 SQI automatic enforcement mechanism would be appropriate anyway, they become even  
4 more necessary if the merger is approved.

5  
6 The issue of composition of the SQI is currently pending before the Commission in  
7 Docket 96-0178. CUB recommends that certain indicators be removed from the SQI,  
8 others be combined, and the additional measurements I have discussed above be added.

9 A summary of the SQI that CUB proposes in Docket 96-0178 is attached to my direct  
10 testimony as Attachment 2. I agree with CUB's recommendations regarding the changes  
11 to the composition of the SQI.

12  
13 CUB also recommends in Docket 96-0178 that the SQI penalty be strengthened, with  
14 options including an increase in the penalty for missing a benchmark from the current  
15 0.25% assessment against the price cap index to a 0.75% assessment, a three-fold  
16 increase in the penalty. Alternatively, CUB suggests that the mechanism could be  
17 structured so that the amount of the penalty depends on the degree of service quality  
18 deterioration.<sup>56</sup>

19  
20 I particularly agree with CUB's alternative that would separate the penalty mechanism  
21 from the price cap index. The SQI penalty for each missed standard should be set at a

1 monetary amount rather than the current percentage reduction in the price cap index.

2 With the price cap mechanism applying to an ever smaller proportion of Ameritech  
3 Illinois' services as services are reclassified as competitive, the service quality penalty is  
4 actually declining with each reclassification of a service as competitive.

5  
6 While stabilizing the SQI penalty would be a step in the right direction, that is not  
7 sufficient to entice Ameritech Illinois to correct big-ticket service quality problems, as  
8 demonstrated by the multi-year problems with Ameritech Illinois' failure to meet the out-  
9 of-service-over-24-hours standard. In Docket 96-0178, CUB recommended that the  
10 amount of the penalty be increased, with alternatives including either a flat tripling of the  
11 penalty or a structure in which the amount of the penalty depends on the degree of service  
12 quality deterioration. Either of those alternatives would help. In addition, I recommend  
13 that the SQI penalty for failure to meet a particular standard be doubled each time that  
14 standard is missed. For example, the current penalty of about \$4 million per year for  
15 repeatedly missing the out-of-service-over-24-hours would become \$8 million the second  
16 year the standard is not met, then \$16 million the third year, and so on. If that approach  
17 had been adopted when the price cap mechanism was adopted, the penalty for 1998  
18 would be \$32 million. Whether this amount would be adequate, at some point an  
19 escalating penalty will become large enough to entice Ameritech Illinois to comply.

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20  
<sup>36</sup> CUB's recommendations regarding the penalty mechanism are summarized in its Amended Initial Brief in Docket 96-0178 at 28-31.

1 Q. Are there other steps that the Commission could take to help ensure that service quality is  
2 maintained?

3 A. Another approach that may be effective for some service quality problems is to require  
4 that Ameritech Illinois provide rebates or bill credits to the specific customers whose  
5 service is impaired. Illinois Administrative Code Part 735 requires that Ameritech  
6 Illinois provide a rebate to customers who are without service for more than 12 hours.  
7 This requirement could be expanded for other failures to provide quality service, e.g., for  
8 missed appointments or for installations that take longer than the adopted benchmark.  
9 For example, SBC credits a customer \$25 if installation is not timely.

10

11 While customer rebates would assist those customers directly affected by particular  
12 instances of substandard service, the current rebate mechanism clearly is not sufficiently  
13 large to entice Ameritech Illinois to bring its repair record to acceptable standards.

14

15 III. EFFECTS ON COMPETITION—SECTION 7-204(b)(6)

16 Q. How do the Applicants characterize the proposed merger's potential effects on  
17 competition?

18 A. SBC asserts that the merger would not harm, and indeed would benefit competition. Dr.  
19 Harris characterizes the merger as extending the market of two non-competitors which  
20 operate in different geographic markets. He then contends simplistically that, "from an  
21 economic and public policy perspective," geographic market extension mergers create no  
22 harm to existing competition. He concludes further that, even if SBC is a potential

1 entrant into the Illinois telecommunications markets, “the merger would not have a  
2 significant adverse effect on competition because there are so many other actual and  
3 potential entrants in those markets. Indeed, if anything, the merger will stimulate the rate  
4 of entry by those actual and potential entrants, thereby increasing competition in  
5 Illinois.”<sup>57</sup>

6

7 A. Current Status of Local Competition

8 Q. Please describe the current status of local competition in the Ameritech and SBC regions.

9 A. Ameritech and SBC have provided information regarding the amount of local  
10 competition in each state in their regions as of June 30, 1998. Mr. Kahan characterizes  
11 SBC’s data regarding the current amount of competition in SBC’s states as “the strongest  
12 indication you can have that our markets are open to competition.”<sup>58</sup> Contrary to Mr.  
13 Kahan’s conclusion, putting the current amount of competition in context provides,  
14 instead, an indication of how little success CLECs have achieved. State-by-state  
15 comparisons also show how far the original SBC states are behind California, Nevada,  
16 and most of the Ameritech states, in terms of the amount of facilities-based local  
17 competition that has developed. While Texas and Kansas have amounts of resale  
18 competition comparable to Illinois and Michigan, Texas has seen almost no facilities-  
19 based CLEC activity to date.

20

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<sup>57</sup> SBC-Ameritech Ex. 4.0 at 7-9.

<sup>58</sup> SBC-Ameritech Ex. 1.0 at 46-47.

1 The following table summarizes the data Ameritech provided and shows the percentages  
2 of the access lines in Ameritech's regions that are provided by CLECs, either on a  
3 facilities basis or through the resale of Ameritech lines.<sup>59</sup>

4  
5 **TABLE 4**

6 **Local Competition in Ameritech Illinois Region**

7	8	9	10	11	12	13	14	15	16
State	Am. Retail Access Lines	CLEC Lines	% CLEC	Am. Resold Lines	% Resale				
11	6,748,641	80,507	1.1	227,988	3.2				
12	2,203,323	*	*	9,769	0.4				
13	5,227,548	63,276	1.2	171,886	3.1				
14	3,979,515	38,787	0.9	83,793	2.0				
15	2,210,333	2,439	0.1	33,978	1.5				
17	TOTALS	20,369,360	185,009	0.9	527,414	2.5			

18  
19 \* Number of CLEC lines omitted for Indiana, due to proprietary classification.

20  
21 The following table, which is based on Table 3 in Mr. Kahan's direct testimony (SBC-  
22 Ameritech Ex. 1.0), contains comparable information for SBC states.

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24  
25  
26  
27  
28  

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<sup>59</sup> Ameritech Illinois response to Attorney General data request AG-24.

TABLE 5

Local Competition in SBC Region

State	SBC Retail Access Lines <sup>60</sup>	CLEC Lines	% CLEC	SBC Resold Lines	% Resale
AR	943,473	11,147	1.2	14,588	1.5
CA	17,489,136	261,051	1.4	255,011	1.4
KS	1,296,906	2,053	0.2	50,265	3.7
MO*	2,502,865	4,094	0.2	22,519	0.9
NV	334,771	13,048	3.7	1,908	0.5
OK	1,608,352	17,446	1.1	21,428	1.3
TX	9,151,364	59,082	0.6	284,243	3.0
TOTALS	35,337,137	367,921	1.0	649,962	1.8

The numbers in the above tables reflect the total number of CLEC facilities-based lines obtained from E-911 data.<sup>61</sup> The E-911 data include both the number of lines provisioned using the incumbent carrier's unbundled loops and the number of lines provisioned using end-to-end CLEC facilities.

The above data indicate that SBC still retains 97.2 percent of the local market in its region. The SBC state with the largest percentage of lines provisioned by CLECs is Nevada (with 3.7 percent), with Arkansas, California, and Oklahoma each indicating slightly more than one percent. Texas has only 0.6 percent. Of the SBC states, Kansas and Texas show the most resale (3.7 percent and 3.0 percent, respectively).

<sup>60</sup> SBC response to Attorney General data request AG-17.

<sup>61</sup> SBC response to Attorney General data request AG-18.

1 In Ameritech's region, Ameritech retains a 96.6 percent market share. Among the  
2 Ameritech states, Illinois and Michigan exhibit the largest percentages of lines  
3 provisioned by CLECs and of Ameritech lines sold by CLECs. The data are summarized  
4 graphically in Attachment 3 for Ameritech, SBC, and selected states.

5  
6 The number of unbundled loops being sold to CLECs is an important direct indicator of  
7 the extent to which the incumbent carrier is providing interconnection and access to its  
8 facilities on reasonable terms and conditions. This is because, in order to utilize the  
9 incumbent's unbundled loops, a CLEC must be able to interconnect at the incumbent's  
10 end offices and must use the incumbent's operations support systems. Resale requires  
11 use of the incumbent's operations support systems but does not involve physical  
12 interconnection. CLEC service using the CLEC's own facilities on an end-to-end basis is  
13 the least reliant on the incumbent LEC; as a result, the incumbent carrier is less able to  
14 impede this form of competition. I have compiled the following information regarding  
15 the use of unbundled loops and indicating the percentage of total lines in each state that  
16 are being provisioned through use of unbundled loops.

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TABLE 6  
Use of Unbundled Loops  
in Ameritech and SBC Regions

	Number of Unbundled Loops <sup>62</sup>	% of Access Lines <sup>63</sup>
Ameritech states:		
IL	15,120	0.21%
IN	0	0%
MI	41,494	0.75%
OH	17,306	0.42%
WI	2,129	0.09%
SBC states:		
AR	331	0.03%
CA	52,092	0.29%
KS	361	0.03%
MO	1,620	0.06%
NV	3,591	1.03%
OK	1,345	0.08%
TX	331	0.00%

These data show that the original SBC states lag far behind California, Nevada, and all of the Ameritech states except Indiana in terms of unbundled loops utilized by CLECs. For all of SBC's rhetoric, Texas has the smallest percentage of loop utilization (except for Indiana, where unbundled loops are not yet being used), with its 331 loops representing less than 1/100 of one percent of total access lines in Texas.

<sup>62</sup> Ameritech data is for September 1, 1998, provided in response to Attorney General data request AG-26. SBC data is for June 30, 1998, provided in response to Attorney General data request AG-30.

<sup>63</sup> Calculated using total CLEC lines in the Ameritech region provided in response to Attorney General data request AG-15 and total Ameritech lines as of September 1, 1998 provided in response to Attorney General data request AG-25. SBC calculations based on total CLEC lines and SBC lines from table above.

1  
2 While resale is a critical aspect of local competition, it is not as important as facilities-  
3 based competition in evaluations of progress toward sustainable competition. Resale is  
4 not an effective force in disciplining the market. As long as a reseller can obtain capacity  
5 only from the incumbent carrier, it remains in many respects hostage to the incumbent,  
6 e.g., regarding prices, quality of service, ordering and provisioning, technologies used,  
7 and the services (including calling scopes and billing plans) it can offer its customers.  
8 Because of this, BOCs could take steps to make resale unattractive to CLECs and their  
9 customers and could eliminate gains achieved to date.

10  
11 As the above data indicate, CLECs have managed to carve out only a precarious toehold  
12 in Illinois. Even absent the proposed merger, the achievements to date are not guaranteed  
13 to grow. Indeed, Ameritech Illinois has reported an alarming trend: the number of lines  
14 and loops provisioned by Ameritech Illinois for CLECs each month has been cut by more  
15 than half since May 1997 (26,160 in May 1997, compared to only 11,492 in July 1998).<sup>64</sup>  
16 Similarly, the total number of residential resold lines in Illinois has declined during  
17 1998.<sup>65</sup> While the total amount of CLEC activity in Illinois has continued to increase,  
18 these indications that segments of the CLEC market are slowing and, indeed, that  
19 residential resale has declined should be taken as a warning that the limited success to  
20 date must be guarded carefully if it is to survive and grow.

21

1           B.     Effect of Corporate "Attitude" on Competition

2    Q.     How important to the development of competition is the willingness of the incumbent  
3           local exchange carrier to open its markets to competition?

4    A.     The extent to which the incumbent local exchange carrier cooperates and complies with  
5           government polices regarding competition has a critical effect on the ability of new  
6           entrants to enter and operate in the market. Resistance and obstructionist behavior by the  
7           incumbent carrier can create a severe barrier to entry, which can thwart or, at a minimum,  
8           delay significantly, entry by CLECs.

9  
10           One of the central aims of Section 271 of the 1996 Act was to create incentives for the  
11           BOCs to cooperate with implementation of the portions of the 1996 Act that require that  
12           local markets be opened to competition. The interLATA entry incentive in Section 271  
13           stands as Congress' recognition of the fact that the statutorily-imposed market-opening  
14           requirements of Section 251 may be difficult to enforce without such an incentive.

15  
16    Q.     Please evaluate the role that corporate "attitude" should play in the Commission's  
17           evaluation of the proposed merger.

18    A.     Mr. Kahan recognizes that, "the State of Illinois, the Commission, and Ameritech have  
19           been among the leaders of the industry in opening local exchange markets to  
20           competition," and assures us that the merger "will not change the attitudes ...of Ameritech

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<sup>64</sup> Ameritech Illinois response to ICC Staff data request SSM 002.

<sup>65</sup> Ameritech Illinois response to Attorney General data request AG-19.

1 regarding the value of competition in Illinois.”<sup>66</sup> Mr. Gebhardt states that he expects that  
2 Ameritech Illinois’ current regulatory policies regarding competition, the services it  
3 offers to competitors, and its business relationships with them will continue after the  
4 merger.<sup>67</sup>

5  
6 If reliable, the assurances by Mr. Kahan and Mr. Gebhardt that new corporate leadership  
7 would not make Ameritech Illinois less willing to open its local markets would be  
8 somewhat encouraging, although Ameritech Illinois has been less than cooperative in  
9 many respects. These assurances ring hollow, however, since they are directly  
10 contradicted by Mr. Kahan’s recognition that “general corporate goals, commitments, and  
11 business principles will emanate from SBC’s headquarters...”<sup>68</sup> Mr. Kahan’s claim that  
12 SBC is equally committed to competition is simply not credible, for reasons detailed  
13 elsewhere in this testimony and in Dr. Selwyn’s testimony.

14  
15 After reviewing the record in SBC’s Section 271 proceeding in Texas, the Public Utility  
16 Commission of Texas concluded succinctly that SBC needs to change its “corporate  
17 attitude” toward CLECs.<sup>69</sup> Further, the post-merger experiences in the Pacific Telesis  
18 region make clear that we can expect a marked change in Ameritech’s attitude toward  
19 opening its local markets if the merger goes through. Allowing SBC to take over the

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<sup>66</sup> SBC-Ameritech Ex. 1.0 at 43.

<sup>67</sup> SBC-Ameritech Ex. 3.0 at 15.

<sup>68</sup> SBC-Ameritech Ex. 1.0 at 41.

<sup>69</sup> Investigation of Southwestern Bell Telephone Company’s Entry into the Texas InterLATA Telecommunications Market, PUC Project No. 16251, Commission Recommendation, Public Interest Recommendation No. 2.

1           reins in Illinois could make it even less likely that Illinois would achieve price-  
2           constraining competition.

3  
4           For both SBC and Bell Atlantic, we have already seen instances in which the incumbent  
5           carrier taking over another carrier comes in and unilaterally modifies the treatment of  
6           CLECs. Dr. Selwyn describes problems that have been identified in California following  
7           SBC's acquisition of Pacific Telesis.

8  
9           In New York and other NYNEX states, Bell Atlantic modified NYNEX's position  
10          regarding the assignment of existing customer contracts to resellers. NYNEX had  
11          allowed such assignments without treating the assignments as contract terminations and  
12          without triggering termination penalties. However, Bell Atlantic reversed that position  
13          after their merger, refusing to honor assignment requests submitted by resellers. Since  
14          large business customers typically have multiple contracts with varying termination dates,  
15          a prohibition on assignment of such contracts to resellers seriously injures the resale  
16          market for such customers, since few are willing to incur the often hefty termination  
17          penalties. Resellers have had to litigate this issue state-by-state, with success in New  
18          York and New Hampshire, the two states where cases have been decided to date.<sup>70</sup>

19  

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<sup>70</sup> The Massachusetts Commission also agreed with resellers on this issue, but has agreed to reconsider its Order.

1 I raise the issue of contract assignment because such disputes may occur in Illinois if the  
2 merger is approved. Ameritech allows contract assignments without termination fees,<sup>71</sup>  
3 whereas SBC views such a change to be a contract termination for which liabilities may  
4 be assessed.<sup>72</sup> Thus, the Commission may expect to litigate this issue if the merger is  
5 approved. There are likely to be other areas of conflict between Ameritech and SBC  
6 policies which, based on SBC's positions in other states, SBC can be expected to attempt  
7 to resolve in a manner restrictive to competition. The Commission may expect numerous  
8 additional proceedings as the CLECs grapple with the change from Ameritech to SBC as  
9 the ILEC policy setter in Illinois.

10  
11 Just as for other aspects of SBC's and Ameritech's businesses, it is important that the  
12 companies adopt the "best practices" of each company related to its interactions with  
13 CLECs if a merger is effected. In the area of competition, the term "best practices"  
14 should be interpreted to mean the practice that best opens up markets to competition and  
15 best removes entry barriers. Practices that create or maintain entry barriers should not be  
16 considered "best practices," even though they may be beneficial to the company's  
17 shareholders. I discuss the importance of monitoring SBC's treatment of CLECs more in  
18 Section III.G of this testimony.

<sup>71</sup> Ameritech Illinois response to Attorney General data request AG-10.

<sup>72</sup> SBC response to Attorney General data request AG-22.