Report of Gregory L. Rosston and Matthew G. Mercurio

A Economic Analysis of the SBC-Ameritech Merger

April 26, 1999

RECEIVED
APR 26 1999
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Executive Summary

This paper analyzes the competitive effects of the proposed SBC-Ameritech merger. The merger raises competitive concerns in four key areas:

- Elimination of potential competition;
- Reduction in benchmarks for regulators and competitors;
- Increase in incentives to deter competition; and
- Overstatement of competitive benefits from the National-Local Strategy.

The merger may provide pro-competitive cost savings as well. The conclusions of this paper address the tradeoffs necessary to achieve the pro-competitive benefits while ameliorating the competitive concerns.

Elimination of potential competition arises because Ameritech had begun to enter SBC territory and SBC was a likely entrant into Ameritech territory absent the merger. As a result of the merger, neither of these firms will compete in the other's territory. Because of their unique position as large ILECs operating in adjacent territories and within each other's territory, each could have been a significant local exchange competitor and created competitive benefits for consumers.

In the infancy of local competition, benchmarks are important for regulators hoping to ensure that the local exchange is open to competition. Benchmarks are also important to local exchange competitors who rely on the incumbents for interconnection and unbundled elements.

The merger may also increase the incentives and ability of the merged firm to deter competition. This is especially true with respect to new services and interconnection, where technical objections are less likely to be challenged by regulators.

Finally, the proponents of the merger overstate the competitive benefits of the merger. They ignore the fact that the logic of the NLS they have put forth would compel the parties to undertake similar strategies in the absence of the merger. In this way, the additional benefits from the NLS are minimal.

As a result of these concerns, the only way to <u>ensure</u> the merger does not harm local competition is to wait until the local exchange is competitive. However, the best way to get to a more competitive local exchange and achieve the benefits of the merger is to provide some incentives for the merging parties to comply with the market-opening requirements of the Telecommunications Act and the Local Competition Order. One way to do that is to condition approval of the merger on § 271 entry approval in a majority of states before the merger can be consummated.

I. Introduction and Qualifications

My name is Gregory L. Rosston. I am a Research Fellow at the Stanford Institute for Economic Policy Research at Stanford University. I am also a Lecturer in the Public Policy Program and Economics Department at Stanford University. I received my Ph.D. and M.A. in economics from Stanford University, and my A.B. with Honors in economics from the University of California, Berkeley. My specialties in economics are industrial organization and regulation with an emphasis on telecommunications. I have been the author or co-author of a number of articles relating to telecommunications competition policy and spectrum policy. I have also co-edited two books on telecommunications. I served at the Federal Communications Commission for three and one-half years and had significant involvement with Commission's implementation of the Telecommunications Act of 1996.

My name is Matthew G. Mercurio. I am a Vice-President of Economists Incorporated in Washington, D.C. I received my Ph.D. and M.A. in economics from Princeton University, and my B.A. with honors in economics from Boston University. My formal training is in the area of empirical econometric and statistical analysis. I have performed economic analysis in the areas of damages, price fixing, arbitration proceedings, and regulated industries. In particular I have analyzed telecommunications, newspapers, cable and broadcast television, and banking in the course of my work. My previous work in the telecommunications industry includes analysis of local exchange cost models, other § 251 related issues, and telecommunications equipment mergers. I have preciously testified before the Maryland Public Utility Commission on the matter of rates for non-recurring costs (NRCs).

We have been asked by a group of State Attorneys General to analyze the competitive concerns arising from the proposed merger of SBC and Ameritech.

This paper analyzes the competitive effects of the proposed SBC-Ameritech merger. The paper is intended to assess some of the competitive concerns that have been raised in connection with the proposed merger. While there may be cost savings resulting from the merger, this analysis focuses on the competitive, regulatory, and public interest concerns raised by the merger. These concerns fall into four categories: reduction in potential competition, reduction in the availability of regulatory benchmarks, increases in the incentives to raise barriers to competition, and an overstatement of the benefits accruing from the proposed "National-Local" strategy (NLS).

The standards for Federal Communications Commission ("FCC") review of the proposed merger are different than the standards employed by antitrust authorities. The FCC is charged with protecting the "public interest," which encompasses, among other concerns, the nature of future competition, effects on the regulatory process, and the effectiveness of the regulatory process in addition to standard antitrust analysis that focuses on likely reductions in current and potential competition. In its analysis, the FCC should consider traditional competition issues as well as the competitive issues unique to the current state of telecommunications regulation and the ability of regulators to promote competition. In addition, the FCC may be in a better position than antitrust authorities to balance the competitive tradeoffs that can arise across markets. For example, if the merger were to slightly diminish competition in one market and significantly increase competition in other markets, that might be viewed by the FCC as an acceptable outcome. The reverse might also be true – a merger might significantly reduce competition in one set of markets and marginally increase competition in other markets. Finally, the FCC is in a position to consider tradeoffs or conditions rather than to simply accept or reject a merger.

It is also clear from the FCC's decision approving the Bell Atlantic/Nynex merger that evaluating a merger under a broad public interest standard can have procompetitive effects. The FCC concluded that the public interest required procompetitive commitments by the merging parties to offset the potential harm whereas the DOJ simply declined to intervene in the merger.[1]

Potential competition concerns arise from the SBC-Ameritech merger for several reasons. First, there is the possibility that the merger will reduce competition in the "home" regions of the two firms. Absent the merger, there is a strong likelihood that both firms would alone or in combination with another firm have become a strong and significant new entrant into the other firm's territory. In fact, Ameritech was implementing plans to enter St. Louis and SBC has facilities in Ameritech's territory. Because each firm has significant skills and experience relating to local exchange competition, absent the merger they could prove to be important forces in increasing local exchange competition in each other's region. In addition, if the arguments put forth to support the NLS are credible, then, absent the merger, each firm would have the incentive, if not the need, to develop a strategy to follow its in-region customers and to serve their needs out-of-region. Section II below provides a detailed analysis explaining

---

[1] "The Commission also concluded, however, that the commitments proposed by Bell Atlantic and NYNEX on July 19, 1997, both mitigate the negative effects of the transaction in the New York metropolitan area market, and have the pro-competitive benefit of enhancing the pace at which local telecommunications competition will develop throughout the combined Bell Atlantic and NYNEX regions. On balance, these pro-competitive benefits outweighed the potential harms to competition from the merger. The Commission found, therefore, that Bell Atlantic and NYNEX on balance have carried their burden of demonstrating that the transaction is in the public interest." Report No. CC 97-42, Common Carrier Action, August 14, 1997, FCC Approves Bell Atlantic/NYNEX Merger Subject to Market-Opening Conditions.

why the removal of these specific potential competitors is likely to harm local exchange competition.

The merger may also reduce the ability of regulators to promote competition. The FCC and state regulators have enacted regulations that govern the behavior of incumbent local exchange providers. These regulations generally affect price, service offerings, quality, and conduct. Unfortunately, regulation is far from perfect. In particular, regulators have significant uncertainty about what is possible, feasible, and implementable. The ability to use experience from a variety of firms to reduce uncertainty can make significant differences in the actions of the regulator. By reducing the number of independent observations (firms) through merger, the regulator has less information and therefore may not be able to enact regulations that efficiently promote competition.[2] In essence, these points fall under the rubric of what Farrell and Mitchell would call "best practice benchmarks" (or worst practice benchmarks).[3]

Farrell and Mitchell also explain the effects on average practice benchmarking. To the extent that firms realize their interdependence and the influence of their own actions on an average practice, the merger would reduce the effectiveness of regulation. For example, to the extent that price cap regulation relies on historical performance of a few holding companies, mergers among the few firms could affect the price cap productivity factor. While this possibility may be important, we have chosen to focus our

[2] Clearly if competition is sufficient to provide an effective brake on anticompetitive behavior and eliminate the need for regulation, then benchmarks will not be necessary and the reduction in the ability of regulators to compare across ILECs will not be significant.
[3] Declaration of Joseph Farrell and Bridger M. Mitchell. "Benchmarking and the Effects of ILEC Mergers", October 14, 1998.

analysis on the effects of best practice benchmarks because the evidence and the effect on regulators more clear.

The merger also raises concern about the changed incentives of the merged firm with respect to its interactions with competitors. Because ILECs serve as both competitors and suppliers to new entrants, ILEC behavior is critical to the new entrants. For a large majority of their customers, new entrants rely on facilities of their ILEC competitors. The merger may increase the merged firm's incentive to harm its competitors by increasing the returns to such behavior. We use the term "behavior" rather than "discrimination" because actions that harm competition may not be discriminatory at all, or may not fit the term precisely, but are still under ILEC control and can be intended to slow down or stall the growth of competition. These anticompetitive incentives are increased because the merger enables the merged firm to internalize a greater percentage of the anticompetitive benefits that flow from deterring competition. The merger may also increase the ILECs' ability to engage in such behavior because of the regulatory benchmarking issues discussed in the previous paragraph.

The parties have put forth their proposed National/Local Strategy in an effort to show that the merger will lead to procompetitive benefits both outside and within their territories. The plan may indeed foster additional competition outside the service areas of SBC and Ameritech. However, it is extremely likely that these out-of-region competitive benefits could be achieved in the absence of a full merger. By entering on their own, by combining with a non-ILEC, or by setting up an out-of-region joint venture, the firms would be able to achieve many of the same benefits without losing the in-region competition each could provide the other. The arguments that the National Local

Strategy will create incentives for a "tit-for-tat" out-of-region entry plan by other ILECs seem farfetched and illogical, and contradict other arguments put forth by the parties.

Finally, it is worth noting that the arguments put forth by the parties would support nearly any merger in the telecommunications industry. In effect, if this merger is approved, the parties could terminate their plans to enter out-of-region markets and claim that such entry plans are not viable. They could then enter into merger negotiations with any other ILEC, and justify the resulting consolidation on the basis of exactly the same arguments SBC and Ameritech have put forth here about the effectiveness of regulation and the prevalence of local competition. This possibility provides an incentive for the remaining RBOCs to withhold competition out-of-region until all possible mergers have been completed. The FCC should consider that its decision on this merger could have an unfortunate precendential effect on encouraging reducing competition in the hope of possible subsequent mergers.

The remainder of this paper addresses the four principal areas of competitive concern relating to this merger. The conclusion then assesses the balancing of these concerns with the benefits of the merger and attempts to craft a solution that maintains the best of both worlds.

II. Potential competition

Potential competition plays a particularly important role in an industry where the regulatory rules have recently changed. Firms that had been blocked from efficient entry by former regulatory barriers could become important new entrants as regulation becomes more hospitable.

The competitive environment in local telephony has changed significantly as a result of the pro-competitive initiatives in Telecommunications Act of 1996 and the subsequent FCC and state regulatory commission orders. The Act found it important to allow three forms of entry – resale, unbundled elements, and facilities-based – because of uncertainty about which strategy or combination of strategies would be most successful at making the local exchange competitive. In the same way, the uncertainty surrounding which competitors will be the most effective in the new environment should lead one to conclude that the possibility of precluding one type of competitor could significantly harm competition. This concern may be particularly acute when the precluded competitor is an RBOC. As the FCC clearly stated when imposing conditions on the Bell Atlantic/Nynex merger:

> "The Commission found that the merger will eliminate Bell Atlantic as a likely significant independent competitor to NYNEX in telecommunications markets in the New York City area. The Commission concluded that Bell Atlantic and NYNEX are two of the five most likely significant market participants in those markets. The Commission concluded that such a merger, therefore, would likely increase, or slow the decrease of, NYNEX's market power. The merger would also eliminate the pro-competitive effects of Bell Atlantic as an entrant on the market-opening process. The Commission concluded that Bell Atlantic and NYNEX did not demonstrate that the claimed efficiencies of the merger offset the potential adverse effects of the transaction on the development of competition."[4]

Local competition is not ubiquitous and pervasive, but the 1996 Act established a framework that should enable competition to take root and blossom. Key to this framework is the idea that ultimately all telecommunications markets will be open to competition. Of primary importance, both in the Telecommunications Act and in

---

[4] Report No. CC 97-42, Common Carrier Action, August 14, 1997, FCC Approves Bell Atlantic/NYNEX Merger Subject to Market-Opening Conditions.

consideration of this merger, is the local exchange market. The local exchange is where the FCC, DOJ, and state regulatory agencies have (rightly) placed most of their emphasis in implementing the Act.

Competition has begun in certain local areas, primarily for high volume business customers in dense urban areas. But, according to the FCC local competition reports and other available data, ILECs retain a dominant share of the local access lines in every area. In terms of switched access lines there is enough data to estimate the CLEC presence in four states within the serving areas of the merging parties. Within the states of California, Oklahoma, Arkansas, and Michigan, CLECs have on average a 3.2% share of switched access lines.[5] These figures, however, include resale, a less effective form of long-term competition. The figure for facilities-based lines (including UNE loops) is 1.39%.[6] More recent nationwide data from Merrill Lynch indicates that, including all three types of entry, CLECs have captured roughly 2.5% of local lines and 5% of local revenues, but entry may be less effective in SBC territory than in the rest of the country.[7]

The Hearing Examiner for the Illinois Commerce Commission concluded that entry in Illinois to date has been relatively ineffective.

> "As to the third guideline, there is no evidence that SBC would have more impact on Illinois local service than firms like AT&T, MCI or Sprint, which are already providing local service. Over the past three years, we have certificated many carriers providing switched and resold local services, yet this record indicates that there have been few inroads made to the Company's monopoly of the local market."[8]

---

[5] FCC Survey on the State of Local Competition, DA 98-839, March 1998. This figure includes resold lines as well as UNE loops and CLECs own facilities for both residential and business lines.
[6] FCC Survey on the State of Local Competition, DA 98-839, March 1998. This figure includes UNE loops and CLECs own facilities for both residential and business lines.
[7] "The Last Monopolist," *Business Week*, April 1, 1999.
[8] Hearing Examiner's Proposed Order, SBC Communications Inc., SBC Delaware Inc., Ameritech Corporation, Illinois Bell Telephone Company d/b/a Ameritech Illinois and Ameritech Illinois Metro, Inc. Joint Application for approval of the reorganization of Illinois Bell Telephone Company d/b/a Ameritech

Denial of the merger application will have no immediate effect on market shares—Ameritech and SBC will still have the dominant shares in their local serving areas. However, competition by Ameritech in SBC's region and competition from SBC in Ameritech's region could be an extremely important component that is needed to ensure consumers realize the benefits of competition in local telephone markets. The point here is that we do not know who will be the most effective competitor in each of these regions, and the merger might eliminate the most effective alternative.

Because of the uncertainty surrounding the future competitive landscape with regard to local competition, it is not as important to know that SBC *would* be more successful than any of the other entrants as it is to know that SBC *could* be the most successful. The ICC Hearing Officer concluded that SBC "would not have a substantial deconcentrating effect."[9] He reached this conclusion because no other entrant has had that effect either. But the conclusion should be tempered by the fact that SBC could be one that does have the desired effect.

SBC may be a unique entrant into Ameritech's territory for a few reasons. First, in certain areas, the operating territories are adjacent so that SBC's brand name and reputation could be beneficial. Second, SBC has the requisite skills and knowledge to run a local exchange business. Finally, SBC has existing assets, including customer relationships, in the Ameritech region that could be used as a springboard for successful entry.

Illinois, and the reorganization of Ameritech Illinois Metro, Inc. in accordance with Section 7-204 of The Public Utilities Act and for all other appropriate relief. Docket No. 98-0555. Released March 29, 1999.
[9] Id. Emphasis added.

Adjacent ILECs, or simply large ILECs in general, may indeed be particularly well positioned as potential entrants, even though they have yet to make the move to attempt to enter into out-of-region territories. As discussed below, this conclusion is bolstered by the parties' decision to merge rather than attempt to enter each other's territory as a new competitor. It is also supported by the merging parties' own statements in support of the proposed NLS strategy that SBC entry would lead to out-of-region retaliation from other LECs.

If ILECs were not particularly well positioned, then the merger does not make nearly as much sense from an entry point of view. Rather than paying a premium for the entire Ameritech network, SBC could have deployed its resources to buy a CLEC with operations in Chicago as well as a beginning in other regions. Ameritech has an enterprise value of approximately $75 billion.[10] Dennis Carlton claims that there are a lot of entrants. These could be likely targets were SBC (or Ameritech) to follow this strategy and the table below shows their recent enterprise values:

[10] Global Telecommunication Services: Weekly Global Comparables, Morgan Stanley Dean Witter, Comfort, S.G., et al, New York (State Of), Date: March 1, 1999, Investext(tm) Report Number: 2743697, Page 2 of 56.

Company	Enterprise Value [illegible] 3/10/99 ($ millions)
e.spire	791
Electric Lightwave	700
GST	1,388
ICG	2,158
Intermedia	2,492
McLeod	3,254
NEXTLINK	3,207
RCN	1,822
Teligent	2,326
WinStar	2,455

Source: Merrill Lynch, "Telecom Services—Local," March 11, 1999.

Purchasing a regional or national CLEC would give SBC or Ameritech access to the high volume business customers they intend to "follow" as well as the ability to serve them in other areas of the country. It would also make the purchaser a competitor in the other's region.

It is very difficult to reconcile the need for the merger as an entry vehicle with the ILEC argument that entry into local exchange markets is easy and pervasive because of the market opening requirements of the Telecom Act.[11] For example, on the one hand, SBC witness Dennis Carlton states "SBC and Ameritech have concluded that they cannot adequately respond to these changing conditions [large customers' demand for broad geographical coverage] as regionally limited suppliers of local services."[12] But he goes

---

[11] ". . . the local exchange market in Oklahoma has been opened and competition has an opportunity to flourish. Now it is the public's turn, and Southwestern Bell's turn, to benefit from full competition in long distance in Oklahoma." Brief In Support Of Application By SBC Communications Inc., Southwestern Bell Telephone Company, and Southwestern Bell Long Distance For Provision Of In-Region, Interlata Services In Oklahoma.
"The local exchange in Michigan is open to competition. This has been accomplished by the 1996 Act and the Commission's applicable regulations; reforms initiated by the State of Michigan, including the MPSC; and Ameritech's implementation of the Act's competitive checklist." Brief In Support Of Application By Ameritech Michigan For Provision Of In-Region, interLATA Services In Michigan.
[12] Affidavit of Dennis W. Carlton, p 11.

on to state "There are many potential entrants into the provision of local exchange service adopting a variety of strategies."[13] If entry were so easy, then nationwide entry by a stand-alone SBC or Ameritech could be accomplished by a variety strategies, such as self-supply of facilities, use of CLEC networks, and use of ILEC facilities.

The evidence points to the conclusion that ILECs, especially large ILECs like Ameritech and SBC, may in fact be uniquely positioned as entrants in each other's territory absent the merger. Indeed, an Ameritech internal report on its expansion plans lists the following reasons why large ILECs may be better positioned than CLECs to enter out-of-region local exchange markets:

- "Systems, call center, & customer care integration are easier, cheaper.
- Better product knowledge and customer insight on local exchange business.
- Incremental HC [Head Count] is probably lower."[14]

The net conclusion is that the elimination of one *possible* alternative poses an even greater risk because the potential entrant is not simply a different type of entrant, but one that may be differentially advantaged and therefore more competitively significant.

In addition to these general descriptions of why ILECs may be uniquely positioned as entrants, we have examined the specific entry plans of Ameritech in St. Louis and SBC in Chicago.

II.A. Description of Ameritech Entry in St. Louis

In general antitrust analysis, there are three key elements to establishing that a merger would have an adverse effect on competition as a result of eliminating a potential entrant:

---

[13] Affidavit of Dennis W. Carlton, p 24.
[14] AIT0266849, Project Green Test Market Proposal, page 6.

1. The entry must be likely to occur.
2. The entrant must be one of a few firms uniquely situated to enter.
3. The entry must lead to a reduction in concentration in the industry.

II.A.1 Probability of Entry

Ameritech clearly satisfies the first test of potential entry theory—it would likely have entered into the local exchange market in SBC territory. Ameritech had entered the St. Louis market and had plans to expand its presence. Ameritech began to prepare to provide local telephone service in St. Louis in 1996. It pursued entry plans through early 1998. This was done through a series of internal business plans and efforts to put those plans into effect. In addition, Ameritech pursued and negotiated an interconnection agreement with SBC. An Ameritech internal document dated 9/12/1997 states:

> "St. Louis is just the beginning. Ameritech as a corporation will continue to expand outside of the current local service area boundaries."[15]

Even in March 1998 as the merger talks began, Ameritech was still moving forward with its proposed out-of-region local exchange offering by testing it with company employees. The company planned to begin full service in April, 1998.[16] While Ameritech did curtail its initial entry efforts, Ameritech's claim that it dropped plans to enter the St. Louis market before the decision to merge with SBC may not be credible.[17]

---

[15] AIT0387581, email from Mike Mullarkey, 9/12/97.

[16] Project Gateway Chronology, March 18, 1998, AIT0156834. The *New York Times* reported that merger discussions also began in early March 1998. Laura M. Holson, "Telephone Giant: The Genesis," *The New York Times*, May 12, 1998 at D11.

[17] An Ameritech internal email states:
". . . we are evaluating whether it makes sense to move forward [with the St. Louis entry plans] . . . but I'm sure most have interpreted this as full stop. The reason for the evaluation, as Herb discussed in St. Louis is in light of the merger, we have to make sure we look at what a potential buyer might want and how they might approach the market -- so we're evaluating the launch." AIT0167731, email from Mary Beth Hodgkiss to Anne Marie Valencik.

II.A.2 Uniqueness of Entry

Ameritech is a uniquely positioned significant potential entrant into St. Louis. There is no other potential entrant that has served as a local exchange provider, has served the adjacent territory as an incumbent, and has a market presence in SBC's territory through its cellular and alarm services.

Ameritech recognized these unique assets when it evaluated its position. In company documents, it has listed the advantages it possessed for entry into adjacent markets.

Ameritech already has brand name presence in St. Louis, through its provision of cellular services and alarm services in St. Louis. "Ameritech Cellular already has an established customer base and brand name in this market."[18] The FCC recognized the value of brand name in its evaluation of the Bell Atlantic/NYNEX merger. Other firms like AT&T, Sprint and MCI also have well known brand names in the St. Louis area. As a result, this alone does not make Ameritech a unique potential competitor. But it may be an important feature of the overall competitive impact of Ameritech entry.

In addition to its brand name, Ameritech recognized its position as a nearby local telephone provider and could leverage that reputation. "It's a natural extension for us...we have been serving customers in the metro east for more than 100 years."[19]

> "There are a lot of efficiencies in this expansion. We're already in St. Louis in a big way. Our brand is established. We have customers service people here. We have distribution already in place—through retail centers and agents. And we already are a major advertiser in this market."[20]

---

[18] Ameritech Full Service Products and Services (St. Louis, Missouri), Full Service Workbook, 1/26/98, AIT0434476.
[19] St. Louis Key Messages – Draft 7/15/97, AIT0418686.
[20] Background Q's and A's: Project Gateway, AIT 0609595.

The proximity of the service areas gives Ameritech at least two distinct benefits in competing for local exchange customers. First, nearby customers are likely to have heard of Ameritech and view it as a local telephone provider. In fact, some decision-makers for St. Louis business are among the 500,000 Ameritech customers living in the Illinois portions of the St. Louis metro area. Second, there is the possibility over time of sharing resources. This may not be feasible at the initial start-up phase where resale may be expected to be the primary means of service delivery. However, as more of Ameritech's own facilities would be used to serve the St. Louis local exchange customers over time, sharing of infrastructure and personnel across the border could create significant efficiencies.

II.A.3 Entry Could Lead to Reductions in Concentration

The final inquiry in the potential competition analysis is whether entry could lead to a reduction in concentration. At this point it is impossible to know which entrant or type of entrant will ultimately prove successful in creating a competitive local exchange. However, according to the data no entrants have yet been able to make significant inroads into the local exchange markets in the three years since the passage of the Telecommunications Act. Ameritech was the first RBOC to make an incursion into another RBOC territory. Ameritech clearly felt that it had unique capabilities for this competitive challenge. If this assessment is accurate, it is possible that Ameritech could be the catalyst necessary to spark effective local competition and that the merger would extinguish this chance.

II.B Analysis of SBC Potential Entry In Chicago

In the same way as Ameritech had plans to enter St. Louis, SBC could have been a significant competitor in Chicago.

II.B.1 Probability of Entry

There was a significant probability SBC would enter the local exchange market in Illinois. SBC would likely enter the market independently of the merger, despite their statements to the contrary. Ameritech generated $2.3 billion in revenue in Chicago in 1997.

In fact, the logic behind the NLS leads directly to the conclusion that SBC would develop an out-of-region strategy even if it did not merge. Mr. Kahan of SBC stated:

> "...SBC must develop the capability to compete for the business of large national and global customers both in-region and out-of-region. We cannot remain idle while our competitors capture the huge traffic volumes generated by a relatively small number of larger customers."[21]

In fact, SBC had plans to enter Chicago through its cellular affiliate. SBC obtained certification to provide local exchange service throughout Illinois and in other states. In 1996, in the California SBC/Pacific Telesis merger proceeding, James Kahan of SBC, testified that SBC had significant complementary assets for competitive entry into Chicago.[22] Since then, Southwestern Bell Mobile Systems (SBMS) has become

---

[21] Kahan Affidavit, para. 13, FCC Docket 98-141, July 20, 1998.
[22] California Public Utilities Commission, 96-05-038, In the Matter of the Joint Application of Pacific Telesis Group ("Telesis") and SBC Communications Inc.("SBC") for SBC to Control Pacific Bell, Rebuttal Testimony of James S. Kahan (SBC), October 15, 1996, at 2.
"[W]e have concluded that it would make sense to enter the local exchange market in Chicago but not in Los Angeles. In Chicago, we have an extensive wireless network consisting of 10 switches and over 600 cell sites. That network also includes extensive backbone network of microwave, leased facilities, and connections to a SONET ring. This network is supported by a sophisticated billing system, a responsive care unit, as well as sales and distribution marketing, accounting finance, installation and maintenance and

authorized to offer facilities based and resale based local exchange service in Illinois. Dane Ershen of SBMS Illinois Service, Inc. testified that SBC would use the local exchange certificates to compete with Ameritech Illinois by providing facilities based local exchange service directly in competition with Ameritech Illinois.[23]

Ameritech documents also recognize the threat of SBC entry:

> "In addition to the cellular threat, SBC now poses a challenge to Ameritech landline in Illinois as well. The will probably use the FreedomPlus cordless/cellular phone as an entrée into the local service market, reselling Ameritech's local loop and bundling it with cellular and long distance service."[24]

II.B.2 Uniqueness of Entry

SBC is one of a few significant potential entrants into Chicago. According to the FCC analysis in Bell Atlantic/NYNEX, there are likely five most significant market participants in the market for local exchange and exchange access services to the Chicago mass market: Ameritech, SBC, AT&T, MCI WorldCom, and Sprint.[25] Among this group of potential entrants, SBC has unique features. Like Ameritech in St. Louis, it is the only

---

other personnel who reside in and understand the Chicago market. In addition, we have a well recognized brand name since we operate under the Cellular One name in Chicago. We also have a large existing customer base to which we send bills every month and to whom we could market services."

[23] ICC Docket No. 97-0118, Testimony of Dane Ershen on behalf of SBMS Illinois Services, Inc., Ordered May 21, 1997, pp. 7-8. "While the constantly changing events have slowed us down, I believe it has allowed us to better refine our plans and has led to the decision to seek expanded certificate authority since we believe we can begin providing service in other geographic areas of the state outside of the Chicago metropolitan area. Hopefully, unless other intervening events slow us down, we will be able to begin providing service initially in Chicago and subsequently elsewhere within the next few months. At this point, it is our intention to initially resell service of other carriers and may subsequently deploy our own facilities based on market conditions."

[24] Competitor Profile – SWOT, AIT 0400750, 1/10/97.

[25] Bell Atlantic/Nynex order, para 70. One might include Bell Atlantic, US West or Bell South in this list because they are adjacent to the Ameritech operating territory, but SBC is the only one adjacent to Illinois and the only one with its own cellular system in Chicago.

ILEC among the group of potential entrants. Second, it is a cellular provider in Chicago, and according to its own testimony, this gives it a unique advantage.

II.B.3 Entry Could Lead to a Reduction in Concentration

Once again, while it is not clear who will break the local telephone market wide open, it could be that SBC as an adjacent ILEC with a cellular presence could provide the competition necessary to make the Chicago local exchange market workably competitive. This could bring significant benefits to both business and residential customers as they reap the benefits of competition. But removal of SBC as a potential competitor could delay or deny these benefits.

II.C Potential Competition Is Reduced by the Merger

Potential competition is an important consideration in this proceeding. As set forth above, both Ameritech and SBC were likely entrants into each others' territory. Their status as adjacent providers of local exchange service combined with their cellular operations make them uniquely advantaged potential entrants for local competition. Because of this uniqueness, the merger would remove one promising avenue of local competitive entry into the companies' residential markets, an avenue that might yield significant benefits to consumers.