Declaration of Dennis W. Carlton and Hal S. Sider

August 21, 2006

I, Dennis W. Carlton, hereby declare the following:

I, Hal S. Sider, hereby declare the following:

I. INTRODUCTION AND OVERVIEW

1. We have previously submitted declarations in this matter dated March 29, 2006 (hereafter, Carlton/Sider Declaration) and June 19, 2006 (hereafter, Carlton/Sider Reply Declaration). Our March 29 declaration presented the bases for our conclusion that the proposed merger of AT&T Inc. (AT&T) and BellSouth Corp. (BellSouth) will not adversely affect competition. Our June 19 declaration responded to claims made by various parties submitted in opposition to the proposed transaction in which we showed that respondents' claims were based on incomplete analysis and did not have empirical support. Our credentials and curricula vitae are included in our March 29 declaration.

A. TASK

2. We have been asked by counsel for AT&T and BellSouth to evaluate claims made by Drs. Stanley M. Besen and Bridger M. Mitchell in their declaration included as Attachment B to Time Warner Telecom's comments filed with the Commission on August 8, 2006.[1] Drs. Besen and Mitchell argue that the proposed merger of AT&T and BellSouth will adversely affect

1. Response of Time Warner Telecom, Inc. to AT&T Inc. and BellSouth Corporation Joint Opposition to Petition to Deny and Reply to Comments, August 8, 2008. The Besen/Mitchell Declaration is dated July 19, 2006.

competition by (i) increasing AT&T's incentive and ability to discriminate against competitive local exchange carriers (CLECs), and (ii) by reducing the number of benchmarks that regulators have available to evaluate the performance of incumbent local exchange carriers (ILECs).

3. With respect to discrimination incentives, Drs. Besen and Mitchell claim that the increased size of the "footprint" served by AT&T that results from the proposed merger increases its incentive to degrade the quality of special access and other services that it provides to Time Warner Telecom and other rival CLECs. According to their theory, discrimination by one ILEC can weaken the performance of CLECs in all areas which, in turn, creates an external benefit to ILECs in other areas. Drs. Besen and Mitchell assert, without providing any empirical evidence, that the increase in the size of AT&T's ILEC footprint resulting from the merger reduces this "externality" and increases AT&T's incentive to discriminate against CLEC rivals by enabling it to capture a larger share of the benefits of discrimination.

4. With respect to the loss of a regulatory benchmark, Drs. Besen and Mitchell argue that the proposed merger will limit regulators' ability to evaluate "best practices" used by ILECs in providing services to CLECs and will reduce the reliability of average measures of ILEC performance. They assert, again without empirical support, that this reduction in regulators' ability to monitor ILEC performance will give ILECs the incentive and ability to engage in increased discrimination against CLECs.

5. Both of the arguments presented by Drs. Besen and Mitchell closely mirror those presented by others during the FCC's review of the proposed merger of SBC and Ameritech in 1999.[2] The FCC cited these concerns when concluding that the SBC/Ameritech and Bell

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2. See Declaration of Dr. Michael L. Katz and Dr. Steven C. Salop, "Using a Big Footprint to Step on Competition," October 14, 1998, and Declaration of Joseph Farrell and Bridger M. Mitchell, "Benchmarking and the Effects of ILEC Mergers," which respectively are included as Attachments B and C to the Petition to Deny of Sprint Communications Company L.P. in re SBC/Ameritech, CC Docket No. 98-141, October 15, 1998. Dr. Besen, along with co-

Atlantic/GTE mergers raised certain competitive concerns.[3] Surprisingly, Drs. Besen and Mitchell do not attempt to show that these concerns have been borne out over the past seven years.

B. OVERVIEW OF REPLY

6. Our March 29 declaration in this matter addressed the concerns that the FCC raised in 1999 regarding the effect of ILEC mergers on competition. We concluded that, whatever the merits of those concerns in 1999, the dramatic changes in competitive conditions in the telecommunications industry since then should significantly reduce if not eliminate any such concerns the FCC may have today. The analysis presented by Drs. Besen and Mitchell does not lead us to alter any of the conclusions expressed in our prior declarations. The principal reasons are as follows:

- The analysis presented by Drs. Besen and Mitchell ignores the dramatic changes in competition and regulation that have occurred in the past seven years and that are expected to continue. In effect, they assume that the rapid growth of facilities-based competition and the implementation of systems that monitor ILEC performance in serving CLECs are of no relevance in evaluating the effect of the proposed merger on competition. Drs. Besen and Mitchell do not respond to our analysis of how changes in industry conditions lessen the concerns raised by the FCC in 1999.[4]

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authors, reiterated certain of the arguments presented by Katz/Salop and Farrell/Mitchell in the Declaration of Stanley M. Besen, Padmanabhan Srignagesh, and John R. Woodbury, "An Economic Analysis of the Proposed SBC/Ameritech Merger," which is included as Attachment A to Sprint's October 15, 1998 filing.

3. FCC, SBC / Ameritech Memorandum Opinion and Order, FCC 99-279, October 8, 1999, ¶¶ 207 – 209. FCC, Bell Atlantic / GTE Memorandum Opinion and Order, FCC 00-221, June 16, 2000, ¶ 96.
4. As discussed further below, the only aspect of our declarations in this matter that Drs. Besen

- Drs. Besen and Mitchell present no empirical analysis whatsoever to support their claims that the proposed merger will harm competition by increasing ILECs' incentives to discriminate. They also fail to address the fundamental tension highlighted in our March analysis (and previous statements) between the footprint theory's assumptions that increased merger-related discrimination (i) is sufficiently strong to discourage CLEC entry and expansion yet (ii) goes undetected by regulators.
- Drs. Besen and Mitchell also present no empirical evidence or analysis to support their claims that the proposed merger will harm competition by reducing the ability of regulators to evaluate ILEC performance. Their benchmarking assertions are based on the unrealistic and unsupported view that quality regulatory oversight depends on the number of ILECs alone, and they ignore the fact that regulators gain information by comparing ILEC performance across states, over time, across a broad number of performance metrics and against various facilities-based competitors.

II. DRS. BESEN AND MITCHELL PRESENT NO EMPIRICAL EVIDENCE TO SUPPORT THEIR CONCERNS REGARDING THE IMPACT OF THE PROPOSED MERGER ON DISCRIMINATION AND FAIL TO ACCOUNT FOR CHANGES IN INDUSTRY CONDITIONS SINCE 1999.

7. As noted above, our March 29 declaration directly addressed the FCC's 1999 concerns that ILEC mergers increase ILECs' incentive to discriminate.[5] We concluded that the emergence of facilities-based competition and other changes in industry conditions should significantly reduce if not eliminate any concern the FCC may have about potential increases in

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and Mitchell address relates to the measurement of CLEC activity used in our 1999 empirical analysis of CLEC entry.

5. Carlton/Sider Declaration, ¶¶ 119-140.

the incentive and ability of ILECs to discriminate against CLECs from an increase in the size of the ILEC's footprint.

8. Our declaration noted that the rapid growth of facilities-based competition reduces ILECs' incentives to discriminate against CLECs by limiting the benefits of such activity. For example, the growth of competing fiber networks means that ILEC discrimination against CLECs using ILEC facilities today is more likely than in 1999 to drive customers to service providers that use rivals' networks. As the FCC has concluded, such competition is "the one sure remedy for the incumbent LEC's threat of discrimination… When local markets are open, discrimination in access cannot succeed because others will compete for access."[6]

9. We also noted in our March 29 declaration that the reduction since 1999 in CLEC reliance on leased facilities (as opposed to more standard forms of interconnection) has further reduced ILECs' ability to discriminate because it is easier for regulators to monitor standard forms of interconnection.

10. Drs. Besen and Mitchell ignore our analysis of the effect of changes in industry conditions on discrimination incentives. They further ignore the dramatic changes in competitive conditions in recent years. As described in our March 19 report, data from GeoTel indicate that 17 firms have now deployed fiber in Atlanta and building lists provided to AT&T indicate that 14 firms provide Type I special access service. In the Miami area, 15 firms have deployed fiber and at least 8 provide Type I service. Even in Greensboro, NC, the 73rd largest metropolitan area in the United States, AT&T building lists identify nine firms that offer Type I service.

11. A further indicator of the growth in CLEC activity since 1999 is the nearly four-fold increase in the number of switched access lines provided over CLEC-owned last-mile

6. FCC, SBC/Ameritech Order, ¶230.

facilities between December 1999 and December 2005.[7] Drs. Besen and Mitchell, however, assume that such changes are not relevant for the purpose of evaluating the effect of changes in the size of an ILEC's footprint on discrimination incentives and the consequences of such discrimination.

12. Drs. Besen and Mitchell also fail to address the fundamental tension in the assumptions that underlie the footprint theory. As noted in our June 19 declaration (as well as prior declarations), the footprint theory requires both that the increased discrimination that ILECs would undertake as the result of the increase in the size of its footprint (i) would be sufficient to deter entry and expansion by ILECs but (ii) would go undetected by regulators, and further would not be reported by CLECs to regulators.[8] They present no basis for their assumption that both of these conditions can co-exist.

13. It is also important to note that Drs. Besen and Mitchell state in their declaration that, aside from the footprint theory, there is no general basis to conclude that vertical integration between ILECs and downstream providers of telecommunications services will adversely affect competition. In particular, in discussing the effect of vertically integration on ILECs' incentive to discriminate against downstream rivals, they acknowledge that:

> [I]t does not automatically follow that any vertically integrated firm will want to disadvantage its customers in order to promote its own downstream division. The integrated firm must balance the forgone profits from lost upstream sales against the increased profits of its downstream division. Under some conditions, it will not be profitable to elevate the input price charged to downstream rivals.[9]

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7. FCC, Local Telephone Competition: Status as of December 31, 2005, Industry Analysis and Technology Division, Wireline Competition Bureau, July 2006, Table 3. In contrast, the number of switched access lines provided by ILECs to business customers fell by more than 20 percent between December 1999 and December 2004. (Table 2.) The FCC does not report comparable statistics for special access lines.
8. Carlton/Sider Reply Declaration, ¶ 96.
9. Besen/Mitchell Declaration, note 19.

14. While Drs. Besen and Mitchell calculate the change in the proportion of Time Warner Telecom's potential base of business customers that would be served by AT&T as a result of the proposed merger, they present no empirical evidence to support their conclusion that the calculated increase is "likely substantial enough to affect the merged AT&T-BellSouth's incentives in its dealings with Time Warner Telecom and other competitors."[10] Nor do they present any empirical evidence that the magnitude of any such effect would be significant. Indeed, we are not aware of any such evidence. Drs. Besen and Mitchell also do not respond to the observation in our March 29 declaration that the widespread entry and expansion by facilities-based CLECs observed in recent years is inconsistent with claims that past ILEC mergers would deter such activity.[11]

15. The only aspect of our March 29 declaration that Drs. Besen and Mitchell address is our observation that a variety of researchers have relied on the same measure of CLEC activity utilized in the empirical analysis of the impact of ILEC mergers on CLEC entry that we presented in the SBC/Ameritech merger proceedings. That study showed that prior CLEC mergers (SBC/Pacific Telesis and Bell Atlantic/NYNEX) did not adversely affect CLEC entry or expansion. Drs. Besen and Mitchell stress that the other analysts that have relied on this measure of CLEC activity have discussed its limitations.

16. The limitations of these data were discussed in our prior analyses, as was the fact that other analysts who used these data discussed their limitations.[12] While the measure of CLEC activity that we used in our analysis in the SBC/Ameritech proceedings is not perfect, it is

10. Besen/Mitchell Declaration, ¶ 55.
11. Carlton/Sider Declaration, ¶¶ 126-131.
12. Carlton/Sider Declaration, ¶ 125. See also Dennis Carlton and Hal Sider, Report to the FCC on Supplemental Analysis of the Katz/Salop Hypothesis, April 13, 1999 and ABA Section of Antitrust Law, *Econometrics: Legal, Practical and Technical Issues* (2005). The FCC also noted in the SBC/Ameritech Order that we acknowledged the limitations of the measure of CLEC activity utilized in the analysis. (SBC/Ameritech Order, ¶ 252).

the best available and that is why we and other researchers have used it.[13] Indeed, many measures of economic activity are subject to measurement error. Drs. Besen and Mitchell fail to suggest any reason why the particular measure of CLEC activity we applied should bias our analysis in any way. As noted above, Drs. Besen and Mitchell report no analyses based on this measure or others that refute our empirical finding that prior CLEC mergers did not adversely affect the entry and expansion of CLECs.

17. Although emphasized in our March 29 declaration, it is important to reiterate that resolution of questions about the reliability of the measure of CLEC activity used in our analysis in the SBC/Ameritech proceedings is not the central issue in this case. Instead, in light of the FCC's concerns about ILEC mergers expressed in 1999, the impact of the dramatic changes in the competitive and regulatory conditions that have occurred over the last seven years and that are expected to continue should be the central issue. Drs. Besen and Mitchell have failed to address this issue.

III. DRS. BESEN AND MITCHELL PRESENT AN UNREALISTIC VIEW OF THE ROLE OF ILEC BENCHMARKS IN THE REGULATORY PROCESS AND FAIL TO ADDRESS CHANGES IN INDUSTRY CONDITIONS SINCE 1999.

18. Drs. Besen and Mitchell's benchmarking analysis is based on an unrealistic view of the regulatory process that exaggerates the importance of the number of ILEC benchmarks. Drs. Besen and Mitchell present three highly stylized models of the regulatory process to describe the effect of the merger on (i) the probability that regulators will observe whether at least one ILEC will adopt a "best practice" in dealing with CLECs; (ii) the reliability of measures

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13. The studies quoted by Drs. Besen and Mitchell's support this view. For example, Drs. Besen and Mitchell quote the paper by J.R. Abel which states that "[a]lthough not a perfect measure of firm entry or fringe size, this measure represents the closest one can come given the data resources currently available." (Besen/Mitchell Declaration, ¶ 61 quoting J. R. Abel, "Entry into Regulated Monopoly Markets: The Development of a Competitive Fringe in the Local Telephone Industry," Journal of Law and Economics, 45, 289-316, p. 299.

of "average" ILEC performance; and (iii) the degree of confidence that regulators place on performance benchmarks.

19. For each model, Drs. Besen and Mitchell make the highly unrealistic assumption that the information available to regulators can be approximated based on the number of independent ILECs alone. More specifically, they assume that if there are four independent ILECs, then regulators have only four "observations" with which to determine the reliability of measures of average performance or to determine whether an ILEC can adopt a particular practice. There is no basis for such an assumption.

20. Data on how ILECs and other carriers perform under different state regulatory requirements, the information on changes in ILEC performance over time; data on ILEC performance with respect to a variety of diverse measures as well as the accumulated knowledge based on prior experience provide additional sources of information available to regulators.[14] The existence of these other sources of information implies that Drs. Besen and Mitchell's approach yields a highly misleading view of the regulatory process and overstates the impact of the proposed merger on information available to regulators.

21. Drs. Besen and Mitchell also fail to address how changes in the telecommunications industry in recent years serve to reduce the concerns expressed by the FCC in 1999 about impact on competition of the loss to regulators of an ILEC benchmark. As discussed in our March 29 declaration, the FCC's 1999 benchmarking concerns were made at a time when the FCC and state regulators were struggling to develop a framework for evaluating

14. See the Joint Declaration of William L. Dysart, Ronald A. Watkins and Brett Kissel, June 19, 2006, and the Joint Declaration of Ronald Pate and Kevin Graulich, June 19, 2006 (both attached to Joint Opposition of AT&T Inc. and BellSouth Corporation to Petitions to Deny and Reply to Comments, June 20, 2006).

ILEC performance and competitive concerns centered on regulators' attempts "to open markets to competition under sections 251 and 271 and state law."[15]

22. As discussed in our March 29 declaration, in recent years regulators have successfully developed and implemented a wide variety of measures for evaluating ILEC performance to meet its obligations under the Act. These changes include the development of increasingly sophisticated operations support systems (OSS) and the establishment of automated systems for penalizing ILECs that fail to provide adequate service to CLECs. Our prior declaration also showed that the dramatic growth in facilities based competition also serves to reduce the FCC's 1999 concerns about the loss of an ILEC benchmark.[16]

23. In addition, the growth in facilities based competition since 1999 has created greater incentives for ILECs to provide efficient wholesale service. For example, ILECs that today fail to provide efficient access to CLEC customers are now more likely than in the past to lose wholesale revenue to rival providers of access.

24. Drs. Besen and Mitchell also do not respond to our analysis of the effect of changes in regulatory practices since 1999 on the competitive significance of ILEC benchmarks. Instead, they ignore the question of how changes in the competitive and regulatory environment since 1999 affect competitive concerns related to the loss of an ILEC benchmark. That is, they assume that the dramatic changes in the competitive and regulatory environment since 1999 are not relevant to an analysis of the impact on competition of the loss of an ILEC benchmark.

25. Finally, Drs. Besen and Mitchell present no empirical analysis suggesting that the reduction in the number of ILEC benchmarks from past mergers has adversely affected

15. Carlton/Sider Declaration, ¶¶ 135-136.
16. Carlton/Sider Declaration, ¶¶ 134-140.

competition. Indeed, we are aware of no empirical studies in the economic literature that support this view.

CONCLUSION

26. In sum, the declaration of Drs. Besen and Mitchell fails to provide any new evidence or analysis that should lead the Commission to be concerned about the “footprint” or “benchmarking” theories of harm resulting from ILEC mergers.

Signed this 21st day of August, 2006.

Dennis W. Carlton

Signed this 21st day of August, 2006.

Hal S. Sider

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