

**Before the Public Utilities Commission  
Of the State of California**

In the Matter of the Joint Application of )  
Pacific Telesis Group (Telesis) and SBC )  
Communications (SBC) for SBC to )  
Control Pacific Bell (U 1001 C), Which Will )  
Occur Indirectly as a Result of Telesis? )  
Merger With a Wholly Owned Subsidiary of )  
SBC, SBC Communications (NV) Inc. )

Application No. 96-04-038

**Direct Testimony of Ronald J. Binz  
Competition Policy Institute**

**On Behalf of Intervener  
Utility Consumers Action Network**

September 30, 1996

## **Direct Testimony of Ronald J. Binz**

**Q. What is your name and address?**

**A.** My name is Ronald J. Binz. My business address is 3773 Cherry Creek North Drive, Suite 1050, Denver, Colorado 80209.

**Q. What is your occupation?**

**A.** I am the President and Policy Director of the Competition Policy Institute (CPI). The Competition Policy Institute is headquartered at 1156 15<sup>th</sup> Street, N.W., Suite 310, Washington, D.C. 20005. In addition, I maintain Public Policy Consulting, a firm specializing in energy and telecommunications regulatory matters.

**Q. Please describe the Competition Policy Institute.**

**A.** CPI is an independent non-profit organization established to promote state and federal policies which will bring competition to telecommunications and energy services in ways that benefit consumers. Consumer advocate Debra Berlyn and I founded the Competition Policy Institute in March 1996 to provide a new voice for consumers in the debate about implementing pro-consumer, pro-competitive policies. We describe CPI as a combination consumer group and "think tank." Its activities include advocacy, research and working with other consumer organizations. CPI is active before state and federal regulatory agencies and in legislative arenas. We frequently comment in proceedings before the Federal Communications Commission (FCC) on the implementation of the Telecommunications Act of 1996, proceedings on Universal Service, rulemakings on local competition, rulemakings involving Customer Proprietary Network Information and licensing of spectrum.

CPI is advised by a group of consumer advocates from across the country which forms its Consumer Advisory Committee. This consumer committee meets periodically to review

the policy positions taken by CPI, and to recommend positions to be taken by the organization. However, the policy positions adopted by CPI are the product of its senior staff. CPI's initial funding was supplied by a broad group of competitive telecommunications carriers, but the Institute is independent of these funding sources. Appendix A to this testimony contains a copy of CPI's Charter which describes our organization, governance, and funding.

**Q. Please summarize your relevant experience in telecommunications policy and regulation.**

**A.** For eleven years prior to founding CPI, I was Consumer Counsel for the State of Colorado. In that role, I represented the interests of residential and small business consumers of telecommunications and energy before the Colorado Public Utilities Commission, the Federal Communications Commission (FCC), the Federal Energy Regulatory Commission, the courts and legislative bodies.

I served as the President of the National Association of State Utility Consumer Advocates (NASUCA) for two years and chaired the organization's Telecommunications Committee for three years. In those roles I testified numerous times before Congressional committees on federal telecommunications and energy legislation. On behalf of NASUCA, I lobbied during the deliberations on S. 652 and H.R. 3636, the Senate and House bills which became the Telecommunications Act of 1996. I have testified before the Federal-State Joint Board on Universal Service and most recently, on September 11, 1996, I testified before the Senate Judiciary Committee on the status of implementation of the 1996 Act and the effect of the proposed mergers involving Regional Bell Operating Companies (RBOCs) on the prospects for local exchange competition.

Prior to my work with the Office of Consumer Counsel, I was a utility rate consultant. I have testified before regulatory commissions in Colorado and in other western states on behalf of a variety of clients, consumer organizations, senior citizen groups, agricultural

utility consumers and local governments. I have attached a resume and summary of my qualifications as Appendix B to this testimony.

**Q. On whose behalf are you testifying in this proceeding?**

**A.** CPI was invited by the Utility Consumers Action Network (UCAN) to present testimony concerning the importance of this merger to consumers. UCAN asked me to discuss the impact it may have on developing competition in the telecommunications industry in California and the nation generally. UCAN Executive Director Michael Shames is a member of the Consumer Advisory Committee for the Competition Policy Institute.

**Q. What is the purpose of your testimony?**

**A.** The California Public Utilities Commission (CPUC or Commission) is considering the joint application of Pacific Telesis Group (PacTel) and SBC Communications (SBC) to control Pacific Bell through the acquisition of PacTel by a subsidiary of SBC. This Commission is required by California statute to review the transfer of control of a public utility registered in California and to approve the transfer only if the proposed merger meets specific statutory conditions. I will offer testimony on the costs and benefits of the proposed merger to California consumers and make recommendations to the Commission as to its compliance with the state statute on mergers.

My testimony is organized into five sections: first, I discuss the landscape of the telecommunications industry against which the Commission should analyze this merger application and the standards the Commission should employ; second, I discuss the costs and benefits of the merger for California consumers and regulators; third, I examine the analysis and testimony of some of the witnesses for the applicants; fourth, I discuss some mitigating conditions that might be attached to approval of the merger application; finally, I conclude with a set of recommendations to the Commission.

**Q. Before turning to the first section of your testimony, what are your conclusions**

**about the proposed merger?**

**A.** After examining the merger application, the testimony of the applicants and discovery provided to UCAN in this case, I have drawn several conclusions about the proposed merger. These conclusions form the basis for my recommendations to the Commission.

? Mergers among large local exchange carriers, such as the SBC/PacTel merger and the Bell Atlantic/NYNEX merger, may threaten the policy goals of the CPUC and the goals of the Telecommunications Act of 1996.

? The California merger statute requires the Commission to find that the merger provides net benefits to consumers before approval. There are costs and potential benefits in this merger. The CPUC can control whether there are net benefits to consumers by mitigating the costs and ensuring that the benefits flow through to ratepayers.

? The CPUC can mitigate the negative effects of this merger on competition by requiring PacTel and SBC to meet the ~~?~~competitive checklist~~?~~ in ~~?~~271 of the Telecommunications Act of 1996 before the merger is permitted to go forward. Further, the CPUC can partially compensate for the harm to competition by insisting on strict adherence to pro-competitive rules for local competition.

? The Commission should approve certain other mitigation measures, recommended by the Utility Consumers Action Network, to ensure that California ratepayers share in any benefits of the merger and that harm from the merger is mitigated.

These four conclusions add up to a single conclusion: **the proposed merger will work against California consumers' interests unless the Commission takes strong action to prevent that from happening.**

**Section 1 ? Telecommunications Industry Background**

**Q. Describe the background in telecommunications which the Commission should consider when evaluating this petition.**

**A.** Pro-competitive actions taken by states like California, together with the passage of the Telecommunications Act of 1996, have fundamentally changed the future of the

telecommunications industry. The speed with which we are moving toward a fully competitive telecommunications industry is impressive. At divestiture of the Bell Operating Companies from AT&T, it was assumed that local exchange service, exchange access service and even short-haul long-distance service would remain a monopoly for the foreseeable future. In the space of a few years, the paradigm for the provision of these services and all other telecommunications services has been changed radically.

The California Legislature and Public Utilities Commission acted early to open telecommunications markets in California. In April 1995 the CPUC proposed rules to open all telecommunications in California to competition by January 1, 1997. After considering comments from parties, the Commission issued a series of orders beginning in July 1995 to adopt interim and final rules. The California Legislature supported this effort by the Commission when it adopted Assembly Bill 3606 which expressed legislative intent that all telecommunications markets should be opened by January 1, 1997.

Also during 1995 the United States Congress debated federal legislation to open all telecommunications markets and remove barriers imposed by the Modification of Final Judgment (MFJ) on the Regional Bell Operating Companies concerning long distance service and equipment manufacturing. The Telecommunications Act of 1996 was passed in early 1996 and signed into law by the President on February 8, 1996.

The 1996 Act superseded the Federal Court's administration of an antitrust settlement which, heretofore, had been the single largest event in the development of competition in the telecommunications industry. The Modification of Final Judgment was replaced with a new statutory scheme designed eventually to permit all telecommunications providers to compete in all markets. Following the opening of local markets and evidence of competition actually occurring, the Regional Bell Operating Companies are allowed to enter markets from which they have been barred since divestiture. The 1996 Act also amended provisions of the 1984 Cable Act, permitting today's large local exchange

companies (LECs) to enter the cable television business.

To ensure that competition did not face legal barriers, the 1996 Act removed legal and regulatory barriers which would prohibit, or have the effect of prohibiting, any entity from offering any telecommunications service. This means that local markets in all states, previously closed to all but monopoly LECs, are now open to competition. Finally, the Act changed, or implied change, for the nature of regulation and the relationship between state and federal regulators.

Congress realized that you cannot create competition merely by passing legislation to remove legal barriers to competition. Decades of law and regulatory practice had affirmed the correctness of the local exchange monopoly. The belief that local service was most efficiently provided by a monopoly is deeply ingrained in the legal system, in state and local laws and in the consciousness of today's local monopolies. In addition, there are substantial practical difficulties that competitors face as they try to compete with a ubiquitous local exchange network. Congress recognized that it was necessary to take strong, affirmative steps to make it possible for new entrants to gain a foothold in local exchange markets.

Thus Congress acted boldly to end monopoly control of local telecommunications markets. To ensure that new entrants are able to enter local markets in spite of the substantial market power of the incumbent local exchange companies, Congress fashioned requirements (duties) for the LECs:

- ? DUTY TO NEGOTIATE
- ? INTERCONNECTION
- ? UNBUNDLED ACCESS
- ? RESALE
- ? NOTICE OF CHANGES
- ? COLLOCATION

- ? NUMBER PORTABILITY
- ? DIALING PARITY
- ? ACCESS TO RIGHTS-OF-WAY
- ? RECIPROCAL COMPENSATION

It is instructive to compare the approach taken by Congress in the 1996 Act with the approach taken in the divestiture fourteen years earlier. The MFJ imposed a structural change from *without*, separating competitive and monopoly services. While there were duties imposed on the surviving local exchange providers (e.g., equal access) the MFJ relied on a traditional antitrust technique: divestiture. Competition in the long distance industry was enabled by removing the opportunity for anti-competitive behavior. In the 1996 Act, Congress is relying on two other techniques: imposing duties (e.g., access to monopoly network elements) and permitting today's monopolies to enter other markets (e.g., cable television and, eventually, interexchange service).

The duties imposed in the 1996 Act, especially the requirements to provide access to network elements and resale opportunities, will create competition and price pressures from *within* the existing monopolies. In many ways, the approach in the 1996 Act can be as successful as divestiture in its effects, assuming state commissions follow through to make network elements and resale available at prices such that entry by competitors is economically rational and feasible. Making these elements available to competitors will inexorably lead to an elimination of the monopoly, with new entrants getting into the market and winning customers.

**Q. How are these considerations relevant to the Commission's consideration of the merger proposal?**

**A.** Because of these simultaneous efforts, the CPUC is a partner, together with other states and the FCC, in changing the model for the provision of telecommunications service in the United States. Because of its size, California is foremost among state jurisdictions and

second only to the FCC in the revenues its decisions affect. Decisions made in California have the predictable influence elsewhere because of the state's size and pre-eminence. For that reason, the Commission's decision in this merger case will influence, directly or indirectly, the development of local competition, not just in California, but across the country.

For reasons I will set out below, the Commission should be very concerned about the effect which this merger has on telecommunications competition in California and the implications of this merger for markets outside of California as well. CPI suggests that the CPUC not view the merger application like it would view an antitrust case, but rather as a benefit/cost analysis in which the Commission can affect the benefits and the costs. As I will develop below, the California merger statute gives the CPUC the authority, indeed the duty, to ensure that the merger does not negatively affect competition. For California's consumers, the CPUC has the opportunity to ensure that consumers receive the long-term benefits of competition while also receiving a fair share of any short-term financial benefits which the merger may produce.

**Q. Please discuss the setting in which this merger is being considered.**

**A.** CPI is deeply concerned about the rapid consolidation of major players in the telecommunications marketplace. The landmark Telecommunications Act of 1996 passed the U.S. Congress by overwhelming majorities earlier this year because the Act contained the right balance between deregulation and competition. The substantial loosening of ownership regulations contained in that legislation was accompanied by equally strong measures to allow the growth of competition.

Unfortunately, the mergers of several key industry players may upset the balance against the interests of competition and consumers. Since passage of the Telecommunications Act, the concentration of ownership in the communications industry has developed much faster than the growth of competition. If industry consolidation continues unchecked, the

pro-competitive goals that Congress endorsed in the 1996 Act may not be achieved, and consumers may end up paying higher rates for lower quality service.

Of the several major announcements over the past year, the proposed merger of SBC and PacTel, as well as the proposed merger of Bell Atlantic and NYNEX, are of particular concern to consumers. First, these mergers eliminate potential competitors in the market for local telephone service. Whether or not the companies planned to compete before the merger announcements, the market forces intended to be set into motion by the Telecommunications Act of 1996 would have driven them to compete with each other in the future. There can be no doubt that each of the mergers eliminates one of the strongest and most experienced potential competitors for local telephone service. At this early stage of local telephone competition, it is too soon to say whether potential competitors will be successful in making local telephone markets reasonably competitive. Mergers which eliminate some of these competitors (while simultaneously increasing the strength of the monopoly incumbents) must be considered significant.

Second, the mergers essentially double the size of two companies (SBC and Bell Atlantic) that have substantial market power in most of the markets in which they operate. The proposed mergers will create companies that will each have significant market power and over 20% of the nation's access lines each. This increase in size comes at exactly the time that the FCC and the states, through the processes set out in the Telecommunications Act of 1996, are attempting to open up these very markets to competition. The mergers will produce companies that are larger than any other communications company in the United States, with the exception of AT&T. The increase in size makes state regulation more difficult and potentially less effective.

The mergers increase the ability and incentives of the carriers to engage in anti-competitive behavior. The substantially larger size of these companies means that they can muster greater resources to spend to retard the development of competition if they choose

to do so. One of the benefits cited by the applicants in this merger is the strengthening of PacTel, today's monopoly provider. In addition, they will have stronger incentives to thwart the development of competition, as they will each have more revenues at risk. Further, the mergers raise the stakes for consumers by doubling the number of consumers who will be at risk from any anti-competitive behavior on the part of these new companies.

My primary concern about these two large RBOC mergers is their timing. It is, of course, not coincidental that the mergers have arisen at exactly the time that these companies are due to face competition in markets that have been traditional monopolies for many decades. The development of local competition is at a very fragile stage, if I can use that term when discussing Fortune 50 companies. The effect of the federal legislation and state legislative and regulatory changes on the development of competition for local telephone service is just beginning to be felt. Only last month the FCC released its initial set of rules governing how competitors may interconnect with the networks of the incumbent local telephone companies. The order has been appealed by several parties and several of the incumbent telephone companies have petitioned to stay the effect of the new rules. Another large LEC, GTE, has asked to be considered as a rural telephone company in some of its service areas and to be exempted from the new unbundling rules.

Competitors to the incumbent telephone companies are growing but are far smaller than the incumbent telephone companies. According to one industry analyst, competitors to the local telephone companies brought in less than 1% of the total revenues for local telephone service in 1995. Moreover, these competitors tend to be very much smaller than the LECs with whom they are beginning to compete. But another way to judge the scope of competition for local telephone service is to examine the consumer perspective. Frankly, I do not know one residential consumer who has a choice among alternative providers of local telephone service today. Under these circumstances, I think regulators should view mergers like the SBC/PacTel merger very warily.

## Section 2 ? Costs and Benefits of the Proposed Merger

**Q. What are the Commission's duties and prerogatives in reviewing this proposed merger?**

**A.** Section 854 of the Public Utility Code describes in detail what the CPUC should consider:

### **?854. Acquisition or control of public utility; approval of commission**

(a) No person or corporation, whether or not organized under the laws of this state, shall acquire or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the commission. The commission may establish by order or rule the definitions of what constitute acquisition or control activities which are subject to this section. Any such acquisition or control without that prior authorization shall be void and of no effect. No public utility organized and doing business under the laws of this state, and no subsidiary or affiliate of, or corporation holding a controlling interest in a public utility, shall aid or abet any violation of this section.

(b) Before authorizing the acquisition or control of any electric, gas, or telephone utility organized and doing business in this state, where the acquiring or to be acquired utility has gross annual California revenues exceeding five hundred million dollars (\$500,000,000), the commission shall find that the proposal does both of the following:

(1) Provide net benefits to ratepayers in both the short-term and long-term, and provide a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short and long-term benefits.

(2) Not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result.

(c) Before authorizing the acquisition or control of any electric, gas, or telephone utility organized and doing business in this state, where the acquiring or to be acquired utility has gross annual California revenues

exceeding five hundred million dollars (\$500,000,000) the commission shall consider each of the criteria listed in paragraphs (1) to (7), inclusive, and find, on balance, that the acquisition or control proposal is in the public interest.

(1) Maintain or improve the financial condition of the resulting public utility doing business in the state.

(2) Maintain or improve the quality of service to public utility ratepayers in the state.

(3) Maintain or improve the quality of management of the resulting public utility doing business in the state.

(4) Be fair and reasonable to affected public utility employees, including both union and nonunion employees.

(5) Be fair and reasonable to the majority of all affected public utility shareholders.

(6) Be beneficial on an overall basis to state and local economies, and to the communities in the area served by the resulting public utility.

(7) Preserve the jurisdiction of the commission and the capacity of the commission to effectively regulate and audit public utility operations in the state.

(8) Generally provide mitigation conditions to prevent significant adverse consequences which may result.

(d) When reviewing an acquisition or control proposal, the commission shall consider reasonable options to the proposal recommended by other parties, including no new acquisition or control, to determine whether comparable short-term and long-term benefits can be achieved through other means while avoiding the possible adverse consequences of the proposal.

(e) The person or corporation seeking acquisition or control of a public utility organized and doing business in this state shall have, before the commission, the burden of proving by a preponderance of the evidence that the requirements of subdivisions (b) and (c) are met.

(f) In determining whether an acquiring utility has gross annual revenues exceeding the amount specified in subdivisions (b) and (c), the revenues of that utility's affiliates shall not be considered unless the affiliate was utilized for the purpose of effecting the merger, acquisition, or control.

The most striking feature of this statute is the recognition that mergers offer both costs and potential benefits to consumers, shareholders, taxpayers and regulators. The CPUC is asked by the statute to examine these various costs and benefits, then determine whether, by a preponderance of the evidence, the applicants have met their burden of showing that net benefits find their way to ratepayers and that competition is not adversely affected. This is truly a "public interest" test.

In the balance of my testimony, I will concentrate on three issues raised by the statute: 1) whether the merger produces net benefits which are received by ratepayers; 2) does the merger adversely affect competition; and 3) does the merger affect the capacity of the commission to effectively regulate. I will conclude with recommendations designed to prevent significant adverse consequences which may result.

**Q. What are the claimed benefits of the merger?**

**A.** The merger of PacTel and SBC is a merger of two firms approximately in the same business, although serving different (geographic) markets today. The applicants, in the testimony of Dr. John Taylor and Dr. Kenneth Gordon (who has adopted the testimony of Dr. Lewis Perl), assert that there are three classes of benefits that derive from the merger. The first claimed benefit is one that is usually asserted about such mergers: increased efficiencies and financial benefits. To the extent that a single larger firm can produce the same output at lower total cost than two separate firms, there is a cost savings and an increase in productive efficiency. A related financial benefit is the assertion that the merger will lower the financing costs of PacTel through its alliance with SBC by reducing the capital costs of PacTel.

The second class of alleged benefits are those that flow to California from the companies' covenant to create one thousand jobs in California beyond those which would have resulted from PacTel's planned business course, absent the purchase by SBC. The applicants estimate that these new jobs, supplemented by the multiplier effect will add about \$100 million to the California economy. Finally, the applicants assert that the combination of the two firms will result in greater competition in California telecommunications markets, with the attendant benefits of lower prices in these markets. The applicants assert, in the testimony of Dr. Gordon, that the merger will have the effect of lowering prices in these markets below what they would have been without the merger, creating consumer surplus and stimulating demand for these telecommunications services. Although Dr. Gordon illustrated this with an hypothetical example and did not supply any estimates of the value of this effect, he asserts that this benefit will be larger than any direct savings that might accrue from efficiencies derived from combining operations.

**Q. If the benefits are shown to exist, do you think that California consumers will realize these benefits?**

**A.** Unless the Commission acts to ensure that tangible benefits of the merger actually accrue to consumers in California, I am concerned that ratepayers will not receive the forecasted short and long-term benefits. To make it more likely that ratepayers will actually see the net benefits, regulators must do two things: 1) take affirmative steps to ensure that any benefits arrive; and 2) act to mitigate costs associated with the merger.

There are also several reasons to think that the applicants' analysis of the benefits are overly optimistic and that, in any event, net benefits may not flow to ratepayers. First, some of the alleged benefits are quite speculative and rely on assumptions that may not materialize. Second, there is no guarantee that even the alleged direct benefits of the merger will find their way to consumers. In fact, in his testimony, Dr. Gordon warns the Commission against even trying to steer these direct benefits to consumers, relying instead

on his belief that a competitive market will ensure that such benefits are delivered. Third, the assumptions about increased competition might be reversed: instead of increasing competition in California, the merger may well delay or reduce the amount of competition in California, turning the applicants' alleged large benefit into a very large cost.

**Q. Why do you think that some of the claimed benefits are speculative?**

**A.** The commitment to additional jobs in California is laudable. I am sure that each of the CEOs intends to try to maintain that commitment. However, there are two reasons why the Commission should doubt whether Dr. Taylor's \$100 million will find its way into California.

First, it will very quickly be impossible to decide whether the number of jobs added to California exceeds what might have been. Any baseline plans by PacTel would have been superseded in a couple years, leading to the unanswerable question "what should we compare?" There is no accounting methodology (indeed there could not be one) by which the Commission can assure itself that the merger has produced 1000 jobs more than what would have been. Even an econometric model of PacTel's labor history would be relatively useless given the change circumstances of the merger and the effects of pro-competitive policies by policymakers.

Second, the jobs commitment represents a policy at war with itself. At the same time SBC and PacTel are promising 1000 more jobs in California than PacTel would have maintained, SBC is girding for a competitive future in California in which all of PacTel's markets will be under attack. It stands to reason that additional jobs in California cannot be sheltered in any special way. SBC could decide to sell or close operations, as it has done in recent years with its publishing businesses, paging operations and its directory printing operations, laying off hundreds of employees. I doubt that SBC is committing never to make that kind of decision in California.

The stock of SBC has achieved the highest total return of any of the RBOCs since divestiture. There is no arguing with the "tale of the tape": SBC's performance is highly valued by Wall Street. In view of the Company's history, I doubt that a poorly performing California-based business will be spared management's attention in order to make good on the jobs commitment. This is not a criticism of SBC. It is a criticism of the proposition that one can reasonably be sure that the California economy will experience a \$100 million growth because of this merger. In view of these considerations, I think the Commission should deeply discount the claims of benefits from increased employment.

The efficiencies inherent in combining operations will also be difficult to detect and measure. Without a doubt, there will be operational changes at PacTel driven by this merger. But it will be difficult to sort out the operational changes which have been brought about by any efficiencies of the merger and those driven by the more general incentive all telecommunications firms now have to cut costs in anticipation of future competition. We must also realize that efficiencies generally translate into reduced labor costs from combining operations of the holding companies, another threat to the promise of increased employment. The testimony of Dr. Gordon is replete with cautions about measuring the claimed benefits. On page 8 he refers to the existence of cost savings merely as "plausible." On page 10 he states: "Attempts to precisely quantify the economic benefits of the merger are likely to fail because they are affected by factors which simply cannot be predicted with great accuracy and because the gains themselves depend upon the synergies and growth which will not be fully understood until after the merger takes place." The Commission must compare this inherent uncertainty against the statutory burden for the applicants to show the existence of "net benefits" by a "preponderance of the evidence."

**Q. Are there costs to the proposed merger for California?**

**A.** Yes. While the claimed benefits to the merger are speculative, there are costs which could be very harmful to consumers. The Commission must examine both sides of the balance

sheet and determine whether the costs are offset by the benefits and in what way the costs could be mitigated.

First, the merger may reduce the future competitiveness of telecommunications markets in California. The merger eliminates a potential new entrant in California telecommunications markets at exactly the time that state and federal policymakers are attempting to open markets to competition. I will discuss this issue below in my comments on the testimony of Dr. Gilbert. In many ways, the timing of the merger could not be worse for the development of local competition in California. The merger strengthens a company which today has durable market power in important markets while eliminating one of the largest telecommunications firms in the country as a future competitor.

A second set of costs relates to the Commission's ability to continue to effectively regulate utility operations in the state: the merger may present a challenge to the Commission's regulatory practice. If the merger is approved, ownership of PacTel will reside with a corporation headquartered outside the region. Although it is now difficult to judge the extent of this control, we should assume that PacTel's policies will be integrated into the holding company's policies in San Antonio. There are some very basic differences in philosophy and tactical approach between these two companies, and I think the Commission should consider carefully the effect of this transfer on its ability to move forward with its pro-competitive agenda in California. Bluntly stated, the merger brings into California an owner whose past use of tactics for delaying competition should be a matter of concern.

**Q. How will the merger affect the ability of the California Public Utilities Commission to regulate the combined entity?**

**A.** The California merger statute requires the CPUC to consider the effect of the merger on the capacity of the Commission to regulate the public utility operations in the state and to

determine that the merger does not adversely affect competition.

An observation about public utility regulation is relevant here. A public utility commission regulates both directly and indirectly. Direct regulation determines rates for specific services, the exact wording of particular rules, and effectuates legal requirements. Indirect regulation refers to the ability of commissions to achieve results and compliance with its policies through influence and suasion. In my experience, this second form of regulation is often as important as the first. It relies on good communications between regulators and the firms they regulate and relies generally on a shared vision of all the stakeholders of the role of regulation and the course of the industry. Closely related is the observation that regulation works well only with the cooperation of the regulated firm.

One significant change in the commission's ability to effectively regulate the resulting firm stems from the fact that decisions of the California Commission will affect a relatively much smaller share of SBC's business post-merger than of PacTel's business today. Furthermore, SBC's center of operations will be San Antonio, Texas, another impediment to the effectiveness of the CPUC's authority.

In protests filed opposing the merger, the Commission heard allegations that SBC has earned the reputation of a fierce (perhaps unfair) competitor and political operative. Recent attitudes about SBC were accumulated by the *Wall Street Journal* in a story about SBC and its advocacy of PURA95, the Texas statute under which SBC is regulated. I have attached a copy of the article as Appendix C. SBC responds to the allegations in the protests with the testimony of Mr. James Kahan (sponsoring the testimony of Mr. John Stupka) who states that the criticism of SBC comes from competitors seeking to divert attention away from the benefits of the merger and gain an advantage over the Company. Mr. Kahan argues that the Company's support for the Texas legislation needs to be put in the context of 1995 before the federal act was passed and at a time when the RBOCs' ability to enter long distance markets was uncertain at best. But this defense of SBC

position cannot explain why SBC continues to support the anti-competitive features of PURA95 even after the passage of the Telecommunications Act of 1996, a fact I will discuss below.

The attitude of SBC toward local competition is clearly relevant to the Commission's consideration of this merger. The Commission reasonably should consider how the merger will affect its ability to regulate effectively and, more generally, on its ability to follow through on the pro-competitive agenda which the Commission has adopted. The Commission would be remiss not to consider the effect which change in ownership will have on these issues. After all, the management of PacTel in San Francisco will report to the management of SBC in San Antonio.

**Q. Can you offer some insights into SBC's attitudes toward competition at the local exchange level?**

**A.** Yes. CPI is active in numerous proceedings at the FCC, including cases concerning the implementation of the Texas telecommunications statute (CCB Pol 96-14) and the FCC's rulemaking on local competition issues (CC Docket No. 98-96). I would like to discuss two issues arising in these dockets which will help examine SBC's approach to local competition and regulation.

In May 1996, CPI filed a Petition for Preemption with the FCC asserting that implementation of the Texas telecommunications statute conflicted with the federal Telecommunications Act of 1996. CPI seeks a ruling from the FCC that portions of the 1995 Texas statute have the effect of prohibiting the entry of competitors into telecommunications markets in Texas, in contravention of several provisions of the 1996 Act. CPI highlighted several provisions of PURA95, including the requirement that certain new entrants in Texas must commit to a build a certain amount of facilities as a condition for receiving a certificate to operate in the state. Specifically, PURA95 requires large carriers to build out facilities to 60% of customers within an area of at least 27

square miles within six years of receiving a certificate. The statute also restricts the percentage of customers of certain new entrants that can be served by resale of the services of a LEC.

In view of the Telecommunications Act of 1996, which preempts state and local barriers to entry and requires the FCC and states to adopt rules governing resale of service, CPI sought to have this provision of the Texas statute preempted. The FCC combined CPI's Petition with several other petitions seeking declaratory judgments as to whether the Texas statute was in conflict with the 1996 Act, including a petition from the Public Utility Commission of Texas. The FCC established a docket, CCB Pol 96-14, and sought comments on the combined petitions. Several parties, including CPI and SBC's subsidiary Southwestern Bell Telephone Company (SWBT), filed comments on the petitions.

In its comments before the FCC, SWBT's support for the controversial provisions of PURA95 is undiminished. SWBT offers a spirited defense of PURA95 and told the Federal Communications Commission:

SWBT opposes the efforts of some petitioners to have the Commission block Texas' enforcement of its laws opening intrastate markets to competition. PURA95 is not only consistent with the purposes of the Telecommunications Act; it materially advances the federal act's stated goals.

I have attached the Summary of SWBT's comments in Docket No. CCB Pol 96-14 as Appendix D.

The "build-out" requirement (and other facets of PURA 95, including a statutory 5% wholesale discount for resale) are strongly anti-competitive and anti-consumer. Under the guise of protecting universal service, SBC pressed for a law in Texas which, unless preempted by the FCC, will stop local competition in its tracks. Notwithstanding the rhetoric of SWBT, the Texas law is widely regarded as one of the most anti-competitive statute in the country and the advocacy of SBC is given credit for its passage. I understand that

SBC continues to use provisions of PURA95 to oppose certification of competitive carriers in Texas. In fact, SWBT appealed the certification of MFS in Texas under PURA95 under the theory that a new entrant had to make a choice under PURA95: become a pure reseller or build facilities, in which case the build-out requirements apply.

Since SBC continues to support the theory and practice of the restrictive language in PURA95, I must respectfully disagree with Mr. Kahan that SBC's prior support of the legislation is explained by the fact that the bill was considered before Congress acted. SBC has shown itself quite willing to use PURA95 to defeat the intention of Congress in removing legal barriers to competition. Its advocacy in Texas stands in sharp contrast to its assurances in this case that the company welcomes local exchange competition.

The second case involves the FCC's Notice of Proposed Rulemaking on Local Competition Issues, CC Docket 96-98. SBC filed comments which were, in my opinion, among the most strident positions taken by any of the incumbent local exchange companies that filed comments. CPI disagreed with most of the positions taken by SBC on such issues as interconnection, unbundling, pricing, and resale. But the most striking position taken by SBC concerned the arbitration process which state commissions must undertake whenever negotiations over terms of interconnection are unsuccessful. Currently, there are numerous petitions for arbitration pending before the California Public Utilities Commission.

In its Comments in CC Docket 96-98, SBC takes the legal position that an arbitration decision by a state commission pursuant to §252 of the Telecommunications Act of 1996 is not binding on the parties to the arbitration. In other words, if a party to an arbitration before the California Public Utilities Commission unilaterally disagrees with the decision of the arbitrator, that party can disregard the ruling in arbitration. I understand that SBC has advanced the same legal position before some state commissions. CPI is unaware of any other LEC that has advanced this argument. I have attached the relevant pages from

SBC's Comments in CC Docket No. 96-98 as Appendix E to this testimony.

I am not suggesting that SBC is not entitled to its interpretation of the 1996 Act, even if it is alone in that opinion. I only wish to point out that SBC approaches these issues with a very aggressive, anti-competitive (or perhaps anti-regulatory) attitude. How else can one explain this curious interpretation of the 1996 Act's arbitration provision?

**Q. Should the concerns you raise about SBC's approach to local competition disqualify the company from acquiring PacTel?**

**A.** No, not on their own. The California merger statute requires the Commission to consider the effect of the merger on the effectiveness of the Commission's regulation. I am suggesting that the Commission take seriously the possibility that it will be regulating the subsidiary of a company which has shown itself to be an outlier on the spectrum of opinions and reactions to a changing telecommunications market. Having reviewed the Commission's policy statements in its local competition dockets, I predict that the regulation of SBC/PacTel will present the Commission with strong new challenges. Later, I will discuss possible approaches to this problem.

### **Section 3 ? Testimony of Dr. Gilbert and Dr. Gordon**

**Q. Please comment on the analysis of Dr. Richard Gilbert.**

**A.** Dr. Gilbert has produced an antitrust analysis in which he concludes that the Commission should find no impediments to the proposed merger. Dr. Gilbert's analysis essentially predicts whether the facts of the merger would trigger an antitrust investigation by the Department of Justice: i.e., whether the merger violates the "merger guidelines" issued by the DOJ. He concludes that 1) SBC is not an actual competitor to PacTel in local and long distance markets today, so that the merger does not eliminate an existing competitor; and 2) that SBC is not an actual potential competitor to PacTel so that the elimination of

SBC as a future competitor does not pose a threat to competition developing in California.

Dr. Gilbert's first conclusion, that SBC is not a competitor to PacTel today, is not surprising. PacTel, like every other local exchange carrier in the country, has faced only trivial amounts of competition in local markets. There are and have been legal and practical barriers to competition in local markets in virtually every state, something that the CPUC and Congress understood when they began their course to open local markets. It is important to realize that SBC's absence as a competitor to PacTel historically (like the absence of AT&T, BellSouth, NYNEX, MCI, or even GTE) is not evidence of its future intention. Competition in local markets simply had not been an option until incumbent LECs opened their markets, provided interconnection, permitted access to bottleneck functions, allowed resale, provided number portability, etc.

Dr. Gilbert's second conclusion, that SBC is not an actual potential competitor to PacTel rests on a premise (that SBC would never become a competitor to PacTel) that is difficult to accept. It is a very generous assumption. We are asked to believe that a company which is interested enough in entering the California market to buy the incumbent local carrier would not have considered entry into this lucrative market through another route. The California local, toll and wireless markets are enormous. We pose this question: if SBC were ever going to enter telecommunications markets outside of its region, would it rule out California? That seems unlikely. The claim that SBC would never have entered the California market is tantamount to saying that SBC would never have ventured outside its region.

It is characteristic of the new telecommunications world created by the 1996 Act that large telecommunications companies, like AT&T, SBC and LDDS are learning to be more flexible and mobile. SBC's action in this merger demonstrates how quickly a carrier can move when it needs to: presumably, before PacTel approached SBC in November 1995, SBC had not made plans to purchase PacTel.

There are several routes to California besides buying PacTel. After all, SBC didn't always have cable properties in Chicago, or cellular operations in Washington, D.C. Nothing prevents SBC from pursuing the same market strategies in California: purchasing cellular franchises in California, then used the "footprint" to expand into other services, including local and toll, much as they have done in other regions. Other technologies, such as the LMDS spectrum about to be auctioned at the FCC would provide a wireless entrepreneur like SBC the ability to establish a presence in one of the nation's premier telecommunications markets. Finally, SBC has already shown its willingness to compete with PacTel in another market: the two companies are competitors for content in the competing Americast and TeleTV consortia.

There are two senses in which Dr. Gilbert's analysis is not useful. First, his argument proves too much. He concludes that the elimination of SBC as a competitor to PacTel would not harm competition in California. He reasons that, since there are other potential competitors that are able to enter the markets in California (IXCs, CAPs, Cable, Wireless and GTE), the merger of SBC and PacTel would not harm competition. Here is the problem with this analysis: Dr. Gilbert would apparently arrive at the same conclusion when confronted with a proposal to merge all seven RBOCs into a single local exchange company owned by SBC. Consider this argument: none of the RBOCs are today competing in each others' territories; presumably each would swear it has no intention of entering another's territory; and, besides, MCI, AT&T, TCI, TCG, GTE and others would still be available to enter local markets of the RBOCs. This analysis could justify the re-assembling of the seven RBOCs.

Second, Dr. Gilbert's analysis is an antitrust analysis, not a public interest analysis. The California statute requires the Commission to conduct essentially a benefit/cost analysis of the proposed merger. Importantly, two of the aspects of the analysis are the effects of the merger on competition and on the Commission's ability to effectively regulate. Dr.

Gilbert's narrow focus is illustrated by his consideration of alleged anticompetitive behavior claimed by the protests to the application. At page 29 of his Direct Testimony, Dr. Gilbert concludes:

But, even if the allegations against SBC are taken as true for the sake of argument, this is not a reason to prevent the merger of SBC and Telesis. An outcome is an anticompetitive effect of a merger only if it is a consequence of market power that is caused by the merger. As discussed in detail above, the merger does not create any market power, either in local exchange service in California or in long distance service. Consequently, the merger does not enhance the ability or incentive of the combined firm to engage in anticompetitive conduct.

Similarly, Dr. Gilbert's analysis does not align with the obligations placed on the Commission by the statute on the question of net benefits of the merger accruing to ratepayers. On page 28 of his Direct testimony, Dr. Gilbert demonstrates that his focus is narrowly on the antitrust issues by concluding:

When there is a clear absence of competitive harms, as with the SBC/Telesis merger, the protection of consumer welfare does not require even a consideration of merger efficiencies, let alone a tally of the benefits that would be derived from the merger.

Given the youth of competition in local telecommunications markets, I think it is implausible to conclude that the merger of SBC and PacTel would have no effect on competition in the California markets. I agree with Dr. Gilbert that the industry is in a state of flux and that many firms are attempting to identify strategic partnerships. I must also agree with Dr. Gilbert that it is difficult to estimate the effect of mergers on the future concentration in the market. But the existence of an independent SBC, able to compete with PacTel in California through alliances with providers not having market power would lessen concentration in the California markets and improve the future prospects of local competition, compared to SBC's entry through this merger. Thus, such an arrangement would be preferable, from the standpoint of consumers and competition, than the purchase of PacTel by SBC.

**Q. Would you comment on the recommendations of Dr. Gordon?**

**A.** Yes. Earlier, I discussed the difficulty in assessing and confirming the direct benefits of the merger. Nevertheless, PacTel asserts that about \$216 million (in net present value) of cost savings could be realized in intrastate services. Unfortunately, it is unlikely that PacTel will flow these savings through to consumers unless regulators make such a flowthrough an explicit part of their approval process.

The California merger statute requires that the Commission approve the merger only after finding that the merger "provide[s] net benefits to ratepayers in both the short-term and long-term, and provide[s] a ratemaking method that will ensure, to the fullest extent possible, that ratepayers will receive the forecasted short and long-term benefits."

Dr. Gordon argues that the Commission, while apparently ignoring the statutory requirement, should take no steps to direct that any portion of the projected savings be explicitly passed on to ratepayers. I think this policy recommendation of Dr. Gordon is ill-advised and rests on some faulty assumptions about the telecommunications market in California. The foundation of Dr. Gordon's position is that PacTel will face sufficient amounts of competition that it will pass on efficiencies gained by the merger in the form of lower rates for services and that PacTel will choose which prices to lower by responding to market pressures.

The faulty assumptions are that competitive pressures are sufficient to force this result and that the market's invisible hand will direct benefits in the manner that the California statute requires. Dr. Gordon's assumption that PacTel will face effective competition is particularly ironic in view of his apparent position at pages 15-16 of his direct testimony that there is not effective competition in the long distance market today, despite the fact that these markets have been open to competition for many years and exhibit many rivalrous firms. Dr. Gordon cannot claim that the interexchange carriers have failed to pass through access cost reductions and simultaneously reason that PacTel will pass

through merger savings. The fact is that the local exchange market in California will be a highly concentrated market for many years to come, with PacTel retaining market power. It is entirely appropriate (and required by the merger statute) for the Commission to direct the manner in which PacTel treats any cost reductions created by this merger.

Requiring the passthrough of merger savings does not constitute double counting, as Dr. Gordon asserts. At page 3, he reasons: "They [rate adjustments] are counterproductive because they represent double-counting: they would implicitly represent an attempt to pass through regulatory means estimated cost savings from which consumers will in any case benefit through market forces." I disagree with that analysis. Ratepayers will either experience reductions in core service rates as a result of this merger or they will not. If PacTel reduces prices as a result of the CPUC's order under the merger statute, this will constitute a flowthrough of benefits to these ratepayers in the form of lower prices whether or not competition is sufficient to achieve that result at the present time. PacTel may eventually respond to competition in these markets at a later time, but it will not return these savings a second time.

Finally, Dr. Gordon suggests that the CPUC may jeopardize the merger if it directs that some portion of benefits be returned to ratepayers. The Commission should also set aside this argument. First, shareholders do not have a right to excess earnings, either in the short run or the long run. Second, the owners and officers of SBC and PacTel are aware of that PacTel is regulated in California and of the existence of the California merger statute. The negotiations for the merger would have understood and considered the California commission's obligations to the ratepayers of this state. This *post hoc* analysis on behalf of the investors should be rejected.

If Dr. Gordon's overall point is that administrative ratemaking decisions are not likely to be as efficient as market-based decisions, he is probably correct. But California does not have a fully competitive telecommunications market. Further, regulation and legislative

policy have other goals than simply serving economic efficiency.

#### **Section 4 ? Mitigating the Negative Effects of the Merger**

**Q. How can the Commission mitigate the negative effects of the merger on California consumers?**

**A.** Sections 854(b)(2) and ?854(c)(8) of the California merger statute each provide that the Commission shall adopt mitigation measures to avoid adverse consequences which may result from an acquisition or control proposal. The Commission has available to it several tools to offset some of the predictable effects of this merger:

**Application of ?271 of the Telecommunications Act of 1996 ?** Section 271 of the Telecommunications Act of 1996 contains a ?competitive checklist?which measures the degree to which an RBOC has opened its network to competition. The CPUC could ?borrow?the checklist and make it a precondition for approval of the merger.

**Implementation of ?251 of the Telecommunications Act of 1996 ?** Now that the FCC has issued its rules, implementation of the local competition provisions of the 1996 Act has moved to the states. The California Commission will affect the competitiveness of telecommunications markets in the state by its decisions on issues like the pricing of unbundled network elements, and the terms and availability of services for resale. Requiring carriers to implement the state? pro-competitive rules on ?251 will help mitigate detrimental effects of the merger on competition.

**Quality of Service Standards ?** For consumers, one of the most important indicators of whether the merger was harmful will be whether quality of service is maintained. In his testimony, UCAN Executive Director Michael Shames discusses the effect which the merger may have on customer service quality and appropriate steps the Commission

should take to ensure that service quality is maintained or improved.

**Flowthrough of Merger Benefits** ? The California merger statute requires that the CPUC find that a proposed merger ?provide net benefits to ratepayers both in the short-term and long-term, and provide a ratemaking method that will ensure, to the greatest extent possible, that ratepayers will receive the forecasted short and long-term benefits.? The Commission can fulfill this requirement by requiring PacTel to quantify accurately any direct benefits of the merger and to flow the savings through to ratepayers in the form of rate reductions or rebates.

**Mitigation Proposals of UCAN** ? The Utility Consumers Action Network asks that the Commission require the merger partners to undertake certain actions designed to ?generally provide mitigation conditions to prevent significant adverse consequences which may result [from the merger]?as required by the California merger statute.

**Q. How can ?271 of the Telecommunications Act of 1996 be used by the Commission to offset adverse competitive effects of this merger?**

**A.** As discussed above, the SBC/PacTel and Bell Atlantic/NYNEX mergers may upset the balance in favor of concentration of ownership before competition for local telephone service has begun to be effective. In other words, these mergers increase the risk that competition will not develop for local telephone service. I recommend that this risk be counter-balanced by measures to make competition more likely for all consumers.

One way to address this imbalance is to require the merging companies to satisfy the competitive checklist in Section 271 of the Telecommunications Act of 1996 before the merger can be considered for approval. Section 271 of the 1996 Act requires that each RBOC must open and unbundle its network to competitors for local telephone service in a

state before being allowed to provide long distance service in that state.

Requiring the carriers to unbundle their networks would mitigate somewhat the risks to competition that are posed by the merger. The unbundling requirements are essential to the development of local competition. Therefore, consumers are more likely to realize the benefits of competition -- greater choices and lower prices -- once the carriers comply with the competitive checklist, even if the merger goes forward.

Here are the terms of the checklist from the Telecommunications Act of 1996:

(B) COMPETITIVE CHECKLIST- Access or interconnection provided or generally offered by a Bell operating company to other telecommunications carriers meets the requirements of this subparagraph if such access and interconnection includes each of the following:

- `(i) Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1).
- `(ii) Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).
- `(iii) Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224.
- `(iv) Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services.
- `(v) Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.
- `(vi) Local switching unbundled from transport, local loop transmission, or other services.
- `(vii) Nondiscriminatory access to--
  - `(I) 911 and E911 services;
  - `(II) directory assistance services to allow the other carrier's customers to obtain telephone numbers; and
  - `(III) operator call completion services.
- `(viii) White pages directory listings for customers

of the other carrier's telephone exchange service.

`(ix) Until the date by which telecommunications numbering administration guidelines, plan, or rules are established, nondiscriminatory access to telephone numbers for assignment to the other carrier's telephone exchange service customers. After that date, compliance with such guidelines, plan, or rules.

`(x) Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.

`(xi) Until the date by which the Commission issues regulations pursuant to section 251 to require number portability, interim telecommunications number portability through remote call forwarding, direct inward dialing trunks, or other comparable arrangements, with as little impairment of functioning, quality, reliability, and convenience as possible. After that date, full compliance with such regulations.

`(xii) Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).

`(xiii) Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).

`(xiv) Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).

**Q. Are you suggesting that the mergers be delayed until the companies are approved to enter interLATA markets?**

**A.** No. I am simply suggesting that the same predicate, that networks be opened to competition, be applied in the case of the mergers. This suggestion does not require the companies to be approved to enter long distance markets before the merger can proceed. Section 271 of the Telecommunications of 1996 provides regulators with a useful benchmark as to whether this predicate has been fulfilled.

To emphasize, this suggestion relates to the merger application, not to long distance applications. It does not increase the preconditions that the SBC or PacTel must meet

before they can provide long distance service. For example, PacTel might meet the preconditions for the merger by satisfying the Section 271 checklist but may not yet be allowed provide long distance service if, for instance, it fails to meet the "public interest test" under the legislation.

By requiring the carriers to satisfy the Section 271 checklist, the CPUC would not have to make a determination of the carrier's market share or market power. Nor would this suggestion involve the Commission in interpreting a new set of standards. Instead, this suggestion would rely upon the checklist already included in the legislation enacted by Congress. This precondition would simply rely on a decision that is going to be made anyway--whether an RBOC has met the competitive checklist. As a result, this standard would not involve any increase in administrative resources by the CPUC.

Similarly, this suggestion does not impose added burden on the carriers. Repeatedly in the testimony in this case, witnesses have described the incentives each company has to meet the checklist requirements. In response to those who might argue that fulfilling the checklist requirements would delay approval of the merger, the answer is that the length of time it will take to comply with the checklist is in the control of the carriers themselves. The sooner that they meet the checklist requirements, the sooner the merger could be approved. The precondition of ensuring that the RBOCs meet the Section 271 checklist is simply an added safeguard to ensure that the merged entity does its part to allow competition to develop.

Finally, CPI thinks that the CPUC has the legal authority to attach this precondition as one of its considerations in examining the merger under the California merger statute.

**Q. Should the CPUC require that the Section 271 checklist be met for each company and for each state before approving the merger?**

?32?

A. This is exactly the recommendation CPI recently made to the FCC concerning the Bell Atlantic/NYNEX merger. We think the FCC has the authority to attach such a condition to its review of the merger. CPI also thinks that the California Commission could attach the same condition to the approval of the merger in California. Although the objection may be made that the CPUC does not regulate in Texas or Nevada, it is reasonable to insist that PacTel and SBC demonstrate their commitment to opening the local exchange to competition by compliance with the checklist in each state they serve, before approving the acquisition of PacTel by SBC. If these two RBOCs have opened their networks sufficiently for competition to develop in all markets, the harm done by the merger to competition in California will be lessened.

**Q. How should the CPUC decide whether this precondition has been met?**

A. There are several options for the Commission. First, each state commission will be conferring with the FCC on the status of the checklist implementation in its state. The CPUC could base its finding on these state commission opinions. Alternatively, the CPUC could decide if the precondition has been met by monitoring whether the FCC has certified compliance in the various states. In this way, the CPUC could use the existing process at the FCC to make its determination.

**Q. Does this recommendation mean that the California Public Utilities Commission would yield its jurisdiction over this merger approval to the FCC?**

A. Not at all. I am simply recommending that the CPUC link consideration of this merger proposal to an external measure of how fully PacTel and SBC have opened their networks to competition. The effect of this recommendation is to synchronize this merger, which has the potential to limit competition, with another event designed to increase local competition: implementation of the 1996 Act and RBOC compliance with the competitive checklist. Under this approach, the California Commission retains full jurisdiction to approve or deny the merger proposal--the CPUC would simply use the §271 process as a benchmark for whether sufficient steps have been taken by these companies to limit the

damage the merger could do to competition.

**Q. Has CPI made a similar proposal concerning the merger of Bell Atlantic and NYNEX?**

**A.** Yes. CPI recommended this approach in testimony before the Antitrust Subcommittee of the Senate Judiciary Committee on September 11, 1996. Further, CPI has filed a Petition to Impose Conditions at the Federal Communications Commission asking the FCC to adopt compliance with the 271 checklist as a precondition to considering the Bell Atlantic/NYNEX merger proposal. That request is now pending at the FCC. I would be happy to provide a copy of the Petition to the Commission.

**Q. Please summarize this recommendation.**

**A.** There are two ways that the California Public Utilities Commission should link approval of this merger to the applicants' compliance with 271 of the 1996 Act.

First, the Commission should require that PacTel, and possibly SBC, meet the competitive checklist as a precondition to approval of the merger. While compliance with the checklist is not equivalent to the existence of effective competition, it will ensure that PacTel and SBC have opened their local market to a substantial degree before the merger proceeds.

Second, the Commission should insist on strict adherence to the terms of the competitive checklist by PacTel when the FCC confers with the CPUC on compliance with the competitive checklist pursuant to the 1996 Act. Section 271 of the Telecommunications Act of 1996 requires the FCC to confer with the States to determine whether a Bell Operating Company has met the terms of the checklist in a given state. Although the State's role is consultative, the FCC has indicated its willingness to work closely with the states on this issue and has expressed its intention to give substantial weight to the advice of the states in this matter. The CPUC should issue clear language in the order in this case

about its expectations for judging checklist compliance.

In line with this, I also recommend that the Commission require PacTel to comply with the list of "Best Practices" developed by the National Association of Regulatory Utility Commissioners (NARUC) when preparing its application for certification of the checklist. A copy of the list of "best practices" is attached as Appendix F.

In summary, I recommend that the CPUC include the following requirements in any order approving the merger:

- ? Before the merger is allowed to go forward, PacTel and SBC must have satisfied the "competitive checklist" in §271 of the Telecommunications Act of 1996.
- ? The CPUC will insist on strict adherence to the terms of the checklist when the Commission performs its consultative role at the FCC.
- ? PacTel should comply with NARUC's "Best Practices" when applying to the CPUC for certification that it has met the competitive checklist.

**Q. How does the Commission's implementation of §251 of the Telecommunications Act of 1996 relate to the proposed merger?**

**A.** As I discussed before, Congress sought to enable and stimulate the development of local exchange competition by imposing "duties" on the Regional Bell Operating Companies. These duties relate to the inter-carrier transactions necessary for a competitor to begin competing with incumbent monopoly companies. Chief among them are requirements to interconnect, to make services available for resale and to provide access to unbundled network elements of the incumbent providers.

The California Public Utilities Commission is mid-way through its implementation of the

local competition provisions of the Telecommunications Act of 1996. The Commission understands the close relationship between the likelihood of competition and the prices for these inter-carrier transactions. The level of prices for unbundled network elements and resale discounts which this Commission approves will determine the likelihood that new entrants (resale, facilities-based and hybrid carriers) will provide competition to the incumbent LECs. The CPUC has substantial discretion under the FCC's interconnection order where it sets those terms and price levels. The CPUC should recognize the special importance which those decisions will have for California consumers, especially in light of this merger application. I am not suggesting that the Commission should be pro-competitor in these decisions, but pro-competition.

Here is the bottom line: if the Commission approves the merger of SBC and PacTel, with the precondition I recommended above, it should also redouble its efforts to ensure that local competition policies are set in way to make vibrant local competition a reality in California.

**Q. What proposals does UCAN make to ensure that the benefits of the merger flow to ratepayers and that negative aspects of the merger are mitigated?**

**A.** I discussed previously the requirement that ratepayers realize an equitable share of the benefits of the merger. There is also a requirement in the merger statute that a merger proposal generally provide mitigation conditions to prevent significant adverse consequences which may result. I have identified several area in which such adverse consequences could occur, including the effect of the merger on competition in California and the implications of the merger for regulation in the state.

There are several ways in which these requirements can be met by the CPUC. I have suggested that the CPUC can reduce the damage to competition by adopting pro-competitive preconditions on the merger and by adopting local competition policies which favor competition. There are additional measures the Commission should take, including:

a rate reduction or rate refund giving consumers an equitable portion of the merger savings; dedicating a portion of the savings to fund mitigation measures or to improve the regulatory process in ways that would stem any adverse consequences. On behalf of UCAN, Mr. Michael Shames will discuss possible approaches to this set of issues.

### **Section 5 ? Summary of Recommendations**

**Q. Mr. Binz, would you summarize your recommendations?**

**A.** The proposed merger of SBC and PacTel will work against the interests of California consumers unless the California Public Utilities Commission acts to mitigate the negative consequences of the merger and capture an equitable portion of the potential benefits of the merger for consumers. Only if the Commission acts in this way will the benefits of the merger exceed its costs.

I recommend that the CPUC take the following steps:

1. Require PacTel and SBC to meet the "competitive checklist" of Section 271 of the Telecommunications Act of 1996 as a precondition of the merger.
2. Recognize that the CPUC's implementation of the pricing policies of Section 251 of the Telecommunications Act of 1996 must be pro-competitive to compensate for damage to competition which may result from the merger.
3. Require that the alleged benefits of the merger be quantified by the applicants and adopt mechanisms to ensure that an equitable portion of these benefits are delivered to California ratepayers, either as direct rate reductions or as funding for mitigation measures.

**Q. Does this conclude your testimony?**

**A. Yes.**

This Direct Testimony of Ronald J. Binz was prepared by Ronald J. Binz and is respectfully submitted to the California Public Utilities Commission on this 30<sup>th</sup> day of September, 1996.

(signed)

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