

Before the

**WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

In re Application of Bell Atlantic
Corporation and GTE Corporation
for Approval of the GTE Corporation
- Bell Atlantic Corporation Merger

UT - 981367

Direct Testimony

of

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on behalf of the

Public Counsel Section

Attorney General of Washington

August 2, 1998

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Exhibit No. ____ (SMB-1):	Statement of Qualifications, Susan M. Baldwin
Exhibit No. ____ (SMB-2):	Affidavit of Susan M. Baldwin and Helen E. Golding CC Docket No. 98-184 December 18, 1998

Exhibit No. ____ (SMB-3): *Ex parte* filing of Bell Atlantic and GTE, April 8, 1999, CC Docket No. 98-184: Letter from Bell Atlantic and GTE regarding long distance issues

Exhibit No. ____ (SMB-4): *Ex parte* filing of Bell Atlantic and GTE, April 14, 1999, CC Docket No. 98-184: Letter from Bell Atlantic and GTE withdrawing February 24, 1999 request for “limited interLATA relief” and requesting FCC deferral of action on proposed merger

Exhibit No. ____ (SMB-5): Excerpt from GTE’s Response to a Consumer Advocate information request (Consumer Advocate/GTE-IR-132) in Hawaii Docket No. 98-0345: Before the Public Utilities Commission of the State of Hawaii, *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for Expedited Approval to Transfer Control of GTE Corporation to Bell Atlantic Corporation*. Data provided on March 15, 1999.

INTRODUCTION

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Qualifications

Q. Please state your name, position and business address.

A. My name is Susan M. Baldwin; I am a Senior Vice President of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108. Economics and Technology, Inc. (ETI) is a research and consulting firm specializing in telecommunications economics, regulation, management and public policy.

Q. Please summarize your educational background and previous experience in the field of telecommunications regulation and policy.

A. I have prepared a Statement of Qualifications, which is annexed hereto as Exhibit No. ___ (SMB-1).

Q. Have you previously testified before the Washington Utilities and Transportation (Commission or WUTC)?

A. No, I have not. However, I have participated previously in several telecommunications projects in Washington State. In 1995, I contributed to ETI's analysis conducted on behalf of the Staff of the Washington Utilities and Transportation Commission in two proceedings: Dockets UT-941464, UT-941465, UT-950146 and UT 950265, regarding the cost studies filed by US West in support of its proposed local transport restructure and expanded interconnection tariffs; and Docket UT-950200 concerning US West's request for an increase in its rates and charges. In 1997, I contributed to ETI's analysis in Docket UT-961638 on behalf of Public Counsel and TRACER in response to USWC's request to be relieved of its

1 obligation to serve. In 1998, I assisted the Public Counsel in its analysis of access charge
2 reform in Docket UT-970325.

3
4 Q. Have you participated previously in analyses of other mergers of incumbent local exchange
5 carriers?

6
7 A. Yes. I presented testimony on behalf of the Office of Ratepayer Advocates of the California
8 Public Utilities Commission in its investigation of the proposed merger of Bell Atlantic
9 Corporation (Bell Atlantic) and GTE Corporation (GTE). On behalf of coalitions of
10 consumer advocates, I co-authored an affidavit concerning the proposed merger between
11 Ameritech Corporation (Ameritech) and SBC Communications Inc. (SBC) that was filed in
12 the Federal Communications Commission's CC Docket No. 98-141, and I co-authored an
13 affidavit concerning the proposed merger of Bell Atlantic and GTE that was filed in the
14 FCC's CC Docket No. 98-184.¹ I presented testimony, with Dr. Lee L. Selwyn, on the
15 merger of SBC and The Southern New England Telecommunications Corporation (SNET)
16 on behalf of the State of Connecticut Office of Consumer Counsel in Connecticut DPUC
17 Docket No. 98-02-20. I presented testimony on the proposed merger of SBC and Ameritech
18 on behalf of the Ohio Consumers' Counsel in Public Utilities Commission of Ohio Case No.
19 98-1082-TP-AMT and on behalf of the Indiana Office of Utility Consumer Counselor in
20 Indiana Utility Regulatory Commission Cause No. 41255. I also assisted the State of Hawaii
21 Division of Consumer Advocacy in its preparation of a statement of position on the proposed
22 merger of Bell Atlantic and GTE that was submitted to the Hawaii Public Utilities
23 Commission in Docket No. 98-0345.

24
25 **Assignment**
26

27 Q. By whom were you engaged, and what was your assignment in this proceeding?
28

1. I co-authored these affidavits with Helen E. Golding, Vice President, ETI.

1 A. The Public Counsel Section of the Attorney General of Washington (Public Counsel) asked
2 ETI to provide expert assistance and analysis with respect to the Public Counsel's
3 examination of the issues raised by the proposed merger of Bell Atlantic and GTE
4 (Applicants), and to present testimony before the Commission setting forth the results of that
5 analysis.

6

7 **Summary of testimony**

8

9 Q. Please summarize your testimony.

10

11 A. My testimony analyzes the proposed merger of Bell Atlantic Corporation and GTE
12 Corporation, and presents the following specific conclusions:

13

14 • The merger, as proposed, is not in the public interest, and therefore the Commission
15 should not authorize the transaction.

16

17 • Absent adequate safeguards and a sufficient flow-through of merger-related economic
18 benefits to GTE Northwest ratepayers, the Applicants' entry into out-of-franchise local
19 markets, to the extent it actually arises, may well be funded by anticompetitive cross-
20 subsidization of such entry from excess profits generated by home region, regulated
21 operations. Furthermore, there is no guarantee that the Applicants will actually enter the
22 Seattle market or other out-of-franchise markets, and even if they do, that they will serve
23 residential and small business customers.

24

25 • Assuming that the national bundled services market is the relevant market for
26 considering the impact of the merger on industry concentration, then the proposed
27 merger *would* increase concentration in the telecommunications industry precisely at a
28 time when the national (and state) goal is to facilitate and promote competition.

29

- 1 • There has been negligible change in GTE Northwest's status as a near-monopoly
2 provider of local exchange service within the areas in which it presently offers service in
3 Washington since the *Telecommunications Act of 1996* was enacted.
4

5 Q. In the event that the Commission considers approval of the proposed merger, are there
6 conditions that should also be imposed upon the post-merger GTE that would mitigate at
7 least some of the adverse effects that you have identified?
8

9 A. Yes. Key safeguards, in the event that the Commission decides to let the merger go forward,
10 include, at a minimum, the following:
11

- 12 • The Commission should find that because the Applicants anticipate substantial merger
13 synergies and because there is no effective competition in Washington, regulatory
14 intervention is necessary to ensure that an appropriate share of these synergies is
15 returned to consumers. Merger-driven synergies should be flowed through to customers
16 of GTE Northwest's noncompetitive retail and wholesale services. As discussed in detail
17 later, the only offset to this amount would be a relatively small portion of merger
18 implementation costs; that is, a proportional share for GTE Northwest intrastate
19 noncompetitive services of the aggregate implementation costs. Net of this minor
20 adjustment for allocated implementation costs, a total of \$85.31-million should be flowed
21 through to customers of GTE Northwest intrastate noncompetitive services. This flow-
22 through should be accomplished via an amortization, calculated for illustrative purposes
23 on the basis of a 10% discount rate, over a ten-year period commencing with the closing
24 date of the acquisition. On an annual basis, this flow-through would amount to
25 approximately \$13.88-million per year.²

2. Because the flow-through would constitute a reduction of GTE Northwest's earnings, the annual flow-through would need to be adjusted from an after-tax to a pre-tax basis. Furthermore my recommendation is entirely separate from any review of GTE Northwest's rates that may be undertaken by the Commission independent of the Commission's review of the proposed Bell Atlantic/GTE merger.

- 1 • The Commission should establish conditions to ensure that GTE Northwest eliminates
2 barriers to entry in its local markets in a timely manner, and, in so doing, should address,
3 at a minimum, the performance of the service that GTE Northwest provides to its
4 wholesale customers relative to that provided to its own retail customers, OSS
5 improvements, and GTE Northwest's compliance with market-opening requirements.
6
- 7 • The Commission should establish comprehensive post-merger reporting requirements
8 that would enable the Commission to assess the level of infrastructure investment and
9 new service deployment in Washington relative to Bell Atlantic/GTE's investment and
10 service deployment in its other in-region states, and that also would enable the
11 Commission to detect and to address any disparate deployment within the state of
12 Washington.
13
- 14 • Furthermore, the Commission should impose an exchange-specific component of the
15 service quality monitoring that applies to GTE Northwest and should incorporate a
16 significant service quality penalty to ensure that the Applicants provide comparable
17 service quality throughout its serving area in Washington and to all customers.
18
- 19 • The Commission should await the FCC's final decision in its investigation of the
20 proposed Bell Atlantic/GTE merger in CC Docket 98-184 so that the Commission can
21 establish conditions and safeguards that complement any conditions that the FCC
22 imposes, and, as necessary, counteract any incentives that the FCC creates for the
23 Applicants to use home-region resources to enter out-of-franchise territories.

1 THE REGULATORY CONTEXT OF THE PROPOSED MERGER
23 **Introduction**
4

5 Q. Please describe briefly the transaction under investigation in the present proceeding.
6

7 A. The present proceeding concerns the request of GTE and Bell Atlantic for this Commission's
8 approval of their proposed merger. GTE, the largest independent (non-Bell) incumbent local
9 exchange carrier (ILEC), proposes to merge with Bell Atlantic, the largest of the five
10 surviving Regional Bell Holding Companies (RBOCs) and, at the present time, the country's
11 largest ILEC. Together, these two companies serve approximately 35 percent of the
12 country's access lines.³
13

14 The proposed merger was publicly announced by Bell Atlantic and GTE on July 28, 1998.⁴
15 Bell Atlantic and GTE filed an application for approval of their merger with the FCC on
16 October 2, 1998, and with the Washington Utilities and Transportation Commission on May
17 11, 1999.⁵ The proposed merger is also subject to an antitrust review by the US Department
18 of Justice (DoJ). The DoJ recently gave its consent to the merger, subject to agreement by
19 the parties to divest numerous wireless (cellular and PCS) licenses in overlapping markets.⁶
20 The FCC has not approved the merger. Moreover, after first having requested "interim

3. Federal Communications Commission, ARMIS Report 43-08, 1998, Table II: Switched Access Lines in Service by Technology ("ARMIS 43-08, 1998").

4. Joint Proxy Statement for 1999 Annual Meetings of Shareholders and Prospectus, April 13, 1999 ("Joint Proxy Statement"), at I-22.

5. FCC CC Docket No. 98-184, *In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, for Consent to Transfer of Control*, Application for Transfer of Control, October 2, 1998 ("FCC Application"); Joint Application of GTE Corporation and Bell Atlantic Corporation before the Washington Utilities and Transportation Commission, *In re Application of Bell Atlantic Corporation and GTE Corporation for Approval of the GTE Corporation - Bell Atlantic Corporation*, May 11, 1999 ("Joint Application").

6. United States of America, Plaintiff, v. Bell Atlantic Corporation and GTE Corporation, Defendants, Civil No. 1:99CV01119, *Proposed Final Judgment*, filed May 7, 1999.

1 relief” regarding the post-merger entity’s offering of long distance services, Bell Atlantic and
2 GTE subsequently sent a letter to the FCC withdrawing this request and asking the FCC to
3 hold off acting on the merger application until after Bell Atlantic was ready to proceed with
4 its Section 271 application for New York State.⁷ Thus, there is uncertainty about both when
5 the FCC will be act on the Bell Atlantic/GTE merger and what its disposition will be, when it
6 does finally act.

7
8 Q. Are other state commissions also being asked to approve the merger?

9
10 A. Yes. The merger is subject to review, in varying degrees, by a number of state public utilities
11 commissions in the combined Bell Atlantic and GTE regions. While some commissions have
12 completed their reviews, other PUCs appear likely to scrutinize the proposed merger for
13 some time to come — particularly in states where both companies have major ILEC
14 operations (principally Pennsylvania and Virginia). Bell Atlantic and GTE have come under
15 criticism for failing to provide state regulators with sufficient information to conclude that the
16 proposed merger would not harm customers.⁸ The California Public Utilities Commission is
17 presently investigating the proposed merger, and, under the present procedural schedule,
18 anticipates issuing a final decision on January 20, 2000.⁹

7. *Ex parte* filings of Bell Atlantic and GTE, April 8, 1999 [Exhibit No. ___(SMB-3)] and April 14, 1999 [Exhibit No. ___(SMB-4)], CC Docket No. 98-184. The New York Section 271 application has not been filed and has recently been put off again because of further delays in complying with directives of the Public Service Commission regarding OSS compliance. See, *Telecommunications Reports*, May 10, 1999, “N.Y. PSC Nixes ‘Field Test’ for OSS, Delays Hearings.”

8. Virginia State Corporation Commission, News Release, “SCC Dismisses Bell Atlantic-GTE Merger Petition; Identifies Information needed upon Refiling,” March 31, 1999; Kentucky Public Service Commission, *Joint Application of Bell Atlantic Corporation And GTE Corporation For Order Authorizing Transfer of Utility Control*, “Order,” Case No. 98-519, April 14, 1999, mimeo at 5.

9. Calif. PUC A.98-12-005, *In the Matter of the Joint Application of GTE Corporation (“GTE”) and Bell Atlantic Corporation (“Bell Atlantic”) to Transfer Control of GTE’s California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE’s Merger with Bell Atlantic*, A. 98-12-005, Administrative Law Judge’s Ruling Adjusting Schedule, (continued...)

1 Q. Have the Applicants agreed to any additional specific benefits elsewhere, other than the
2 general purported benefits described in their applications to state and federal regulators?

3

4 A. Yes. In Pennsylvania, the Applicants recently agreed to several specific benefits in an
5 agreement reached with the Pennsylvania Attorney General's Office. Among the benefits are:
6 an agreement to cap rates for basic local exchange telephone service at current levels until
7 December 31, 2003, the elimination of touch tone charges for residence and business
8 customers,¹⁰ the accelerated deployment of CLASS services, access charge reductions, an
9 agreement to invest more than \$2.5-billion in capital investments in the state, and certain
10 market opening measures.¹¹

11

12 **Regulatory context for assessing the competitive impact of the proposed merger.**

13

14 Q. What industry and regulatory developments have occurred that are relevant to the
15 Commission's consideration of the proposed Bell Atlantic/GTE merger?

16

17 A. There are several. First, there have been many ILEC mergers both completed and announced
18 since the first major ILEC merger (SBC/Pacific Telesis) was initially announced in April,
19 1996. Since its acquisition of Pacific, SBC has continued to expand through additional
20 mergers/acquisitions. Last year, SBC acquired SNET, Connecticut's principal ILEC. Like

9. (...continued)
April 23, 1999.

10. GTE North's monthly rates for touch tone service in Pennsylvania are \$1.50 per residence line, \$4.00 per business trunk, and \$2.50 per business line. GTE North Incorporated, Telephone-PA. P.U.C. No. 4, Section 6, Twelfth Revised Sheet 1, Effective August 23, 1991.

11. Pennsylvania PUC Docket No. A-310200F0002, A-311350F0002, A-310222F0002, A-310291F0003, *In re the Joint Application of Bell Atlantic Corporation and GTE Corporation for Approval of Agreement and Plan of Merger*, Memorandum of Understanding and Stipulation of the Pennsylvania Office of Attorney General, Bell Atlantic Corporation, and GTE Corporation, July 29, 1999 ("Pennsylvania Stipulation").

1 GTE, SNET is not a “Bell operating company” as defined in the 1996 federal legislation,¹²
2 and was thus not subject to Section 271 of the *Telecommunications Act of 1996* (1996 Act)
3 SBC is now pursuing a merger with Ameritech, the country’s fourth largest ILEC, after Bell
4 Atlantic, SBC, and BellSouth. If the SBC/Ameritech merger and the proposed Bell
5 Atlantic/GTE mergers are both approved, these two mega-ILECs will control approximately
6 sixty-nine percent of the country’s ILEC access lines.¹³

7
8 Second, while some progress has been made toward implementing the competitive policies of
9 the United States Congress and the state of Washington, as set forth in the *1996 Act* and in
10 RCW 80.36.300, that progress has been slower and more limited than most had expected.
11 The results of the FCC Common Carrier Bureau’s Survey on the State of Local Competition
12 (most recently made available in June, 1999) show that there is not yet any state in which a
13 large ILEC faces more than nominal competition for local exchange service.¹⁴ Three years
14 after mandates for interconnection and unbundling became law, many fundamental barriers to
15 competitive entry persist.

16
17 Q. But won’t its affiliation with Bell Atlantic improve GTE’s ability to compete in US West’s
18 service areas relative to the condition that exists today?

19
20 A. That is, of course, one of the contentions being advanced by the Applicants. One of the 21
21 out-of-franchise markets that the Applicants have stated an intention to enter is Seattle.¹⁵

22 However, it is far from obvious what, precisely, Bell Atlantic will be bringing to the table that

12. 47 U.S.C. 153(r)(35).

13. ARMIS 43-08, 1998.

14. FCC, Common Carrier Bureau’s Fourth Survey on the State of Local Competition, data as of December 31, 1998. See: www.fcc.gov/ccb/local_competition/survey4/responses/ (“FCC CCB Fourth Survey”).

15. FCC Application, Exhibit A: Public Interest Statement, at 6-7; Direct Testimony of Timothy J. McCallion On Behalf of GTE Corporation, June 18, 1999 (“McCallion (GTE), Direct”), at 17-18.

1 GTE Northwest and its parent GTE Corporation do not presently possess. The promises that
2 merging companies have made about pro-competitive effects of their respective mergers have
3 not materialized in the past three years, and there is no reason to believe that this situation
4 will change dramatically with the creation of yet another mega-ILEC. Indeed, despite the
5 enhanced size and financial capabilities resulting from their earlier mergers, neither
6 SBC/Pacific/SNET nor Bell Atlantic/NYNEX have launched any effective out-of-region
7 competitive local exchange carrier (CLEC) entry. Neither of these mega-ILECs have
8 demonstrated to the FCC, with respect to any of states in which they operate as an incumbent
9 local telephone company, that the ILEC has fully eliminated barriers to entry and in so doing
10 has facilitated the development of effective competition. Furthermore, there is no guarantee
11 that the Applicants will enter Seattle within 18 months and certainly no guarantee that Bell
12 Atlantic/GTE will serve residential and small business consumers in Seattle if they do actually
13 enter US West's territory.

14
15 Q. What other experience may be pertinent to the Commission's consideration of the merger's
16 potential competitive impacts?

17
18 A. Experience at the state level also demonstrates the need for this Commission to exercise
19 caution in how it implements any conditions that are intended to apply to the post-merger
20 entity (as opposed to being satisfied prior to consummation of the merger). For example,
21 when the Maine Public Utilities Commission gave its consent to the Bell Atlantic/NYNEX
22 merger, it ordered the merged entity to comply with Section 271 of the *1996 Act within eight*
23 *months of the decision approving the merger* (i.e., by September 30, 1997). When this did
24 not occur, the Maine PUC had no effective alternative conditions or sanctions, and the
25 requirement was essentially ignored.¹⁶ As of the date of this testimony, Bell Atlantic has still
26 not satisfied its Section 271 requirements in Maine or, for that matter, anywhere else.

16. State of Maine Public Utilities Commission, Docket No. 96-338, *Order* (Part II), September 30, 1997 (substituted a reporting requirement for the condition requiring checklist compliance).

1 **The proposed merger affects a broad array of consumer interests.**
2

3 Q. Please discuss generally how the proposed merger affects consumer interests.
4

5 A. The proposed merger of Bell Atlantic with GTE comes at a critical juncture in the
6 telecommunications industry. Under policies that have taken many years to develop, there
7 are now both state and federal mandates for implementing local competition. It is hoped that,
8 with effective competition for local exchange service, consumers of all types will pay lower
9 prices and obtain higher quality and more diverse services than under a sole-supplier model.
10 However, as the experience of the past three years clearly demonstrates, achieving effective
11 local competition takes more than strong public policy pronouncements. It must be fostered,
12 under the vigilant oversight of state and federal regulators, and it requires the active
13 cooperation of the ILECs.
14

15 In this regard, the goal of competition is not simply the concern of would-be competitors.
16 Consumers have a direct and tangible stake in whether, when, and how competition for local
17 exchange service develops. If the proposed merger diminishes the likelihood that competition
18 in the relevant markets will develop, significantly extends the time it would otherwise take to
19 achieve effective competition, or substantially reduces the number of competitors who can
20 enter and remain viable, there will be a negative impact on consumers. If this merger is
21 permitted to go forward, it should be with conditions that protect not only the long-standing
22 consumer interests addressed by traditional utility regulation (just and reasonable rates,
23 service quality, and the integrity of long-term investments in the network), but also ensures
24 that competition develops within a reasonable time frame and in a manner that can be
25 sustained over the long run.
26

27 Consumers also have legitimate concerns that the merger not diminish the Commission's
28 ability to effectively regulate GTE Northwest. While it may be true that jurisdiction over
29 GTE's telephone operating company subsidiary will be relatively unaffected by a merger at

1 the corporate level, the merger will, by the Applicants' own admission, give rise to changes in
2 business objectives, priority, and operations that will have a direct impact on GTE Northwest
3 consumers.

4
5 **Other state utility consumer advocates have concluded that the proposed merger is not in**
6 **the public interest and have recommended to the FCC that the proposed merger not be**
7 **permitted.**
8

9 Q. Have you conducted an analysis of the Bell Atlantic/GTE merger previously on behalf of
10 consumer advocates in the FCC's proceeding?

11
12 A. Yes. A coalition of consumer advocates sponsored an affidavit on the proposed Bell
13 Atlantic/GTE merger that Helen E. Golding, also of Economics and Technology, Inc., and I
14 prepared ("Baldwin/Golding Affidavit") and that was submitted to the FCC.¹⁷ The affidavit is
15 appended hereto as Exhibit No. ___(SMB-2) and is made a part hereof. In its federal filing,
16 the consumer coalition recommended that the FCC deny the proposed merger on the grounds
17 that this merger, at the present time, would be inconsistent with the public interest.

18 Specifically, the filing demonstrates, among other things, that:

- 19
20 • Quantitative measures of competition show little progress toward breaking ILEC
21 dominance of the local exchange market, nationwide, and in the Bell Atlantic/GTE
22 region. Furthermore, significant barriers to entry into local exchange market still
23 persist.¹⁸
24

17. In the Matter of GTE Corporation Transferor, and Bell Atlantic Corporation Transferee, CC Docket, No. 98-184, Affidavit of Susan M. Baldwin and Helen E. Golding, on behalf of the Consumer Groups: The Delaware Division of Public Advocacy, The Hawaii Division of Consumer Advocacy, The Maine Public Advocate, The Maryland People's Counsel, The Missouri Public Counsel, The Ohio Consumers' Counsel, The Citizens Utility Board of Oregon, The Consumer Advocate Division of the Public Service commission of West Virginia, The Michigan Consumer Federation, The Edgemont Neighborhood Coalition, December 18, 1998 ("Baldwin/Golding Affidavit").

18. Baldwin/Golding Affidavit, at ¶¶ 11-21.

- 1 • The proposed merger will further reduce the number of remaining large ILECs, a step
2 that the FCC has already recognized has a detrimental impact upon the public interest.
3 As the FCC observed in the *BA/NYNEX Merger Order*, “[f]urther reductions ... become
4 more and more problematic as the potential for coordinated behavior increases and the
5 impact of individual company actions on our aggregate measures of the industry’s
6 performance grows ... [thus] further reductions in the number of Bell Companies or
7 comparable incumbent LECs would present serious public interest concerns.”¹⁹
8
- 9 • Rather than helping to speed up the transition to competition, the trend toward ILEC
10 consolidation (beginning with the SBC/Pacific Telesis, SBC/SNET, and Bell Atlantic/
11 NYNEX mergers, now followed by the proposed SBC/Ameritech and Bell Atlantic/GTE
12 mergers) represents a move away from the pro-competitive goals set by the *1996 Act*.
13 Mergers among the remaining few large ILECs pose risks to the development of
14 competition that are not posed by other recent mergers involving non-ILECs, such as
15 interexchange carriers, CAPs, and cable companies.²⁰
16
- 17 • The large ILECs have unique advantages that make them more likely than other large
18 telecommunications companies to be successful at penetrating other ILECs’ home region
19 markets *if they actually choose to do so*. Thus, reducing their number through
20 successive mergers plainly diminishes actual potential competition.²¹
21
- 22 • The Applicants fail to demonstrate that the merger is necessary for them to compete for
23 customers beyond their present ILEC operating territories. If one accepts the

19. *Id.*, at ¶¶ 22-25, citing *Applications of NYNEX Corporation, Transferor, and Bell Atlantic Corporation, Transferee. For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*. File No. NSD-L-96-10, Memorandum Opinion and Order, 12 FCC Rcd 19988 (1997) (*Bell Atlantic/NYNEX Merger Order*), at ¶ 156.

20. Baldwin/Golding Affidavit, at ¶¶ 26-27.

21. *Id.*, at ¶¶ 40-42.

1 Applicants' contention that even the existing Bell Atlantic is smaller than the minimum
2 viable scale needed to compete effectively, then the prospects for competition in the local
3 market are gloomy at best.²²

- 4
- 5 • Although GTE's provision of long distance services is not legally dependent on its
6 compliance with the terms of Section 271, its poor performance to date in implementing
7 the competitive mandates of Sections 251 and 252 of the *1996 Act* should be considered
8 with respect to its desire to leverage its existing long distance market and Internet
9 backbone by merging with Bell Atlantic.²³
 - 10
 - 11 • The merger would harm in-region customers of noncompetitive services. Home-region
12 customers would involuntarily subsidize the Applicants' pursuit of out-of-franchise
13 markets, development of the bundled services market, and expansion of Internet business
14 plans.²⁴
 - 15
 - 16 • The merger would diminish the ability of regulators, competitors, and consumers to
17 benchmark ILECs' performance, thus leading to a loss of innovation, service quality, and
18 competition.²⁵
 - 19
 - 20 • The benefits that the Applicants contend will occur as a result of the proposed merger
21 include consequences that should instead be seen as risks or that, at best, are
22 speculative. The Applicants claim that the synergies are a major benefit of their proposed
23 merger, but make no attempt to show how this benefit would flow to consumers. The

22. *Id.*, at ¶¶ 43-50.

23. *Id.*, at ¶¶ 51-55.

24. *Id.*, at ¶¶ 58-66.

25. *Id.*, at ¶¶ 67-73.

1 merger will not increase competition for Internet and other data services, but instead will
2 reduce the level of competition for these services.²⁶

3
4 The consumer advocates' filing identified numerous substantive reservations about the FCC's
5 ability to develop and enforce specific conditions that could overcome the adverse impacts of
6 the merger, at the national level. For this reason, I recommended to the FCC that denial of
7 the merger would best serve the public interest.²⁷

8
9 Q. Have you changed your position since your affidavit was filed with the FCC in December
10 1998?

11
12 A. No. I continue to believe that the proposed merger will not promote the public interest nor
13 result in just and reasonable rates for telecommunications services, and, therefore, should be
14 rejected.

15
16 Q. Does your testimony in this proceeding address the option of approving the change of control
17 with conditions?

18
19 A. Yes. I cannot, however, conclude that approval with conditions would be as effective as
20 outright rejection of the merger in safeguarding the important competitive and rate-related
21 concerns that I identify in my testimony and in the attached affidavit. There are definite
22 problems with the approach of imposing conditions, since it may not fully prevent or redress
23 the harms to the public interest, including negative rate impacts. The merger cannot be
24 "undone" if the conditions fall short of achieving their objectives.

25
26. *Id.*, at ¶¶ 74-91.

27. *Id.*, at ¶¶ 92-105.

1 Furthermore, if it approves the merger, the Commission should exercise its authority to
2 impose all conditions that it deems necessary and appropriate to redress the potential harms
3 of the merger and restore the positive balance of risks and rewards to which Washington
4 consumers are entitled. The Applicants have ample grounds to pursue their merger, even
5 with such conditions. Neither firm would rationally walk away from such an opportunity
6 based on a requirement to flow through a fair share of the synergies to consumers of
7 noncompetitive services and a requirement to meet other pre-merger and post-merger
8 conditions. On the other hand, if the reason that the Applicants would abandon their merger
9 is because of reluctance or inability to comply with pro-competitive and pro-consumer
10 conditions, then it may well be that the loss of their proposed union is a good thing for
11 Washington consumers.

1 EFFECT OF THE MERGER UPON COMPETITION IN WASHINGTON
2

3 **Competition is not now, and will not be, sufficient to ensure that the efficiencies, savings,**
4 **and benefits of enhanced revenue opportunities made possible by the merger will flow**
5 **through to Washington consumers.**
6

7 Q. What is the current state of local competition within GTE's operating areas and, in particular,
8 within Washington?
9

10 A. Local competition has gotten off to a very disappointing start in GTE's service territories.

11 Based on the result of the most recent survey on the state of local competition conducted by
12 the FCC's Common Carrier Bureau, only about 0.59% of all of GTE's switched access lines
13 are being resold on a "bundled" (*total service resale* or *TSR*) basis and approximately 0.14%
14 of GTE's local service lines are being provided over UNE loops purchased by CLECs.²⁸

15 Furthermore, as of year-end 1997, only 0.005% of local numbers (or 937) had been "ported"
16 by GTE to competing local service providers via interim local number portability.²⁹
17

18 In Washington, the state of local competition is even more disappointing. Only 0.10% of
19 GTE Northwest's lines are being resold on a TSR basis as of December 31, 1998. No local
20 service lines are being provided over UNE loops purchased by CLECs,³⁰ and only seventy
21 local numbers had been "ported" by GTE to competing local service providers via interim
22 local number portability as of December 1997.³¹ Similarly, the proportion of residential lines
23 served through all resale arrangements is 0.10%, or 679 of the 617,267, residential lines GTE

28. FCC CCB Fourth Survey.

29. FCC, Common Carrier Bureau's First Survey on the State of Local Competition, data as of December 31, 1997 ("FCC CCB First Survey"). Permanent local number portability has replaced "interim number portability" (INP) for most access lines in Washington, however, historical local competition survey data reflect the earlier technology.

30. FCC CCB Fourth Survey.

31. FCC CCB First Survey.

1 Northwest controls in Washington.³² Accordingly, CLECs have only obtained a minuscule
2 share of the local market (and a minuscule share of the residential local market) and, while
3 some growth is occurring, there is no indication that the CLECs' market share will be
4 significantly larger anytime soon.

5
6 Q. What is the status of collocation in GTE Northwest Washington's switching centers?

7
8 A. CLECs are collocated in 24% of GTE Northwest Washington's switching centers, compared
9 to an average of 52% of the RBOCs' switching centers nationwide. Furthermore, only 21%
10 of GTE Northwest's residential lines in Washington are in switching centers where at least
11 one CLEC is collocated.³³

12
13 Q. Why is this of interest in Washington?

14
15 A. The consequence of having *no collocation presence* in a particular central office, and in this
16 case this is the reality for over three-quarters of the customers in GTE Northwest
17 Washington's territory, is that GTE Northwest will be under no pressure to reduce rates in
18 areas where it confronts no competition and, if given the opportunity to do so, might actually
19 *increase* rates for those customers as a means for supporting lower rates in areas that
20 confront relatively more competition. Thus, even if GTE Northwest were to begin to face
21 competition in limited portions of its operating areas, there is no assurance that those
22 customers who do not confront competitive choices will realize any of the economic benefits
23 arising from the merger.

24
25 Q. One might argue that the merger with Bell Atlantic may produce more local competition if
26 Bell Atlantic has a better record. Is this the case?

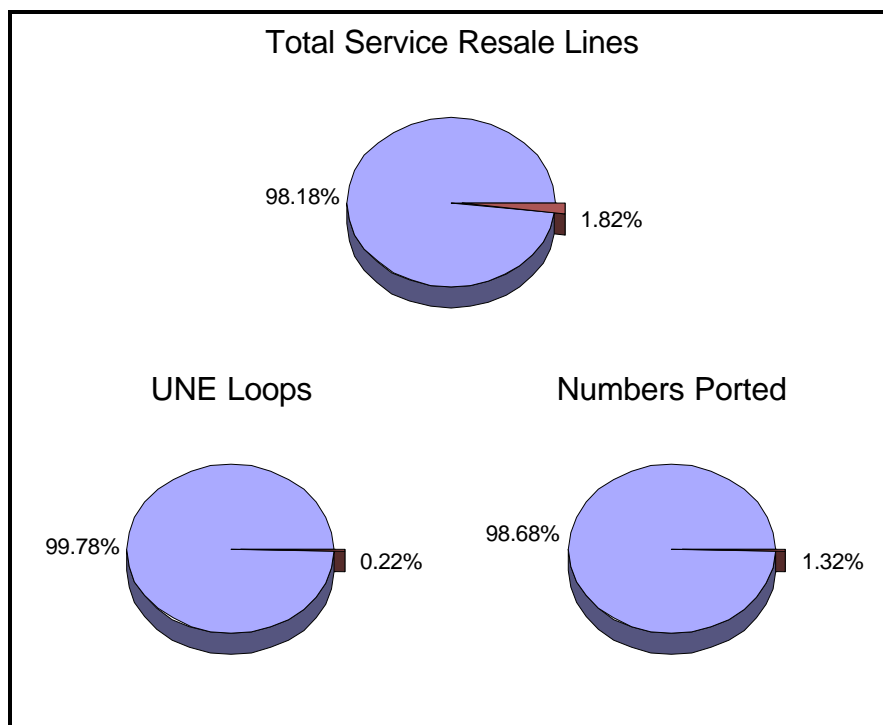
32. FCC CCB Fourth Survey.

33. *Id.*

1 A. While Bell Atlantic does in fact have a slightly higher rate of resale, the level of competition
 2 in Bell Atlantic's local exchange markets is also very low. Bell Atlantic has been as effective
 3 as the other RBOCs in resisting competitive entry into its local telephone markets, and, as a
 4 result, most customers in Bell Atlantic's states have seen little growth in their choices for
 5 local telephone service. Bell Atlantic sells just 1.45% of its total lines as TSR and just 0.21%
 6 of its lines as UNE loops to CLECs.

7

8 Figure 1 below summarizes, on a nationwide basis, the latest available estimates of the
 9 state of local competition.³⁴ These measures indicate that, in aggregate, RBOCs
 10 continue to supply roughly 99% of the retail local telephone service provided over the
 11 existing, non-CLEC infrastructure.



12

Figure 1. Competitive Entry into the Local Market, Nationwide.

34. Total Service Resale and UNE Loop percentages are from the FCC CCB Fourth Survey and the Numbers Ported percentages are from the *Active Subscriptions Version Report*. Lockheed Martin IMS, Number Portability Administration Center (NPAC) website. www.npac.com/docs/sv_cnt.txt. Access Date, July 26, 1999. The cumulative total of numbers ported nationwide through June of 1999 was 2,228,066. This represents 1.32% of all ILEC switched access lines.

1 **The merger will impede progress toward developing competition in Washington.**
2

3 Q. Please summarize briefly the guidelines used by the federal government to conduct antitrust
4 analyses of proposed mergers.

5
6 A. A combination of two sets of merger guidelines assist the federal government in its antitrust
7 analysis. The (DoJ) and the Federal Trade Commission (FTC), the two federal agencies that
8 share antitrust enforcement jurisdiction, jointly issued *Horizontal Merger Guidelines* in
9 1992,³⁵ which update portions of the 1984 Merger Guidelines.³⁶ The 1992 *Merger*
10 *Guidelines* do not address the horizontal effects of non-horizontal mergers (e.g., the
11 elimination of specific potential entrants and competitive problems from vertical mergers).
12 When they released the *1992 Merger Guidelines*, the DoJ and the FTC specifically stated that
13 “[n]either agency has changed its policy with respect to non-horizontal mergers” and that
14 “[s]pecific guidance on non-horizontal mergers is provided in Section 4 of the Department’s
15 *1984 Merger Guidelines*, read in the context of today’s revisions to the treatment of
16 horizontal mergers.”³⁷ Therefore, the enforcement agencies rely upon a combination of the
17 *1984* and *1992 Merger Guidelines* to assess whether a merger “create[s] or enhance[s]
18 market power or ... facilitate[s] its exercise.”³⁸

19
20 Q. Please describe briefly your understanding of the way in which the FCC applied the merger
21 guidelines in its analysis of the proposed Bell Atlantic/NYNEX merger.
22

35. U.S. Department of Justice and Federal Trade Commission. *1992 Horizontal Guidelines*, April 2, 1992 (Revised April 8, 1997) (“*1992 Merger Guidelines*”).

36. The doctrine of “actual potential competition” that is reflected in the *1984 Merger Guidelines* continues to apply. *1984 Merger Guidelines*, 49 Fed. Reg. 26823 (“*1984 Merger Guidelines*”).

37. *1992 Merger Guidelines*.

38. *Id.*, at 0.2 (“Purpose and Underlying Policy Assumptions of the Guidelines”).

1 A. Based upon my reading of the FCC's order in that proceeding,³⁹ the FCC was informed but
2 not limited by the application of traditional merger guidelines. In particular, the FCC
3 recognized the distinction between the markets to which merger guidelines are typically
4 applied and today's more volatile telecommunications markets, stating that "the doctrine of
5 actual potential competition as reflected in the *1984 Merger Guidelines* has usually been
6 applied to stable markets that potential entrants have decided not to enter. In contrast,
7 telecommunications markets are undergoing major change, with new entry anticipated as
8 implementation of the *1996 Act* progresses."⁴⁰ In distinguishing between the analytical
9 framework addressed in more typical applications of the merger guidelines and the somewhat
10 more fluid framework that must necessarily apply to the analysis of the competitive effects of
11 ILEC mergers, the FCC also stated:

12
13 In some cases, however, the transaction will have a greater effect on future,
14 rather than present, market performance. This is especially true if a merger may
15 be a strategic response to declining entry barriers, in which an incumbent firm is
16 seeking to avoid competition by eliminating a potentially significant future
17 competitor. In the case of local telecommunications markets, competition is
18 only now emerging and a merger between a current monopolist and one of the
19 new competitors may have a substantial adverse impact on future market
20 performance even though the new competitor currently has only a small number
21 of customers.⁴¹
22

23 Q. How would you classify the proposed merger?
24

25 A. With respect to the local market, the proposed merger between Bell Atlantic and GTE
26 represents, in part, a market extension: the merger is not strictly considered a horizontal
27 merger because the Applicants are not presently rivals in GTE Northwest's territory in
28 Washington, and thus the proposed merger would not reduce the number of actual suppliers
29 in Washington. However, because the proposed merger could eliminate a potential
30 competitor, the antitrust concern is similar to that raised by a horizontal merger: Market

39. *Bell Atlantic/NYNEX Merger Order*.

40. *Id.*, at ¶ 67 (footnotes omitted).

41. *Id.*, at ¶ 96.

1 extensions can eliminate potential competitors and horizontal mergers can eliminate actual
2 competitors.

3
4 However, the Applicants also refer repeatedly to their business objective of being a “top-tier”
5 global supplier of bundled services,⁴² and thus the merger then could be construed as taking
6 on the attributes of a horizontal merger (since both Applicants are potential rivals in the
7 bundled services market), and a vertical merger (because each of the Applicants could have,
8 in the absence of the merger, purchased products from each other such as unbundled network
9 elements).

10
11 Q. Would the proposed merger increase concentration in the telecommunications industry?
12

13 A. Viewed from the narrow perspective of the highly concentrated local exchange services
14 market in Washington, the merger clearly could not increase concentration, because Bell
15 Atlantic is not presently an actual competitor in that market. However, if one considers the
16 national bundled services market to be the relevant market, the merger would indisputably
17 increase concentration. The DoJ uses the Herfindahl-Hirschman Index (HHI) as an indicator
18 of market concentration.⁴³ Concentration indices reflect the present market power. Where a
19 merger significantly increases the HHI, the DoJ is more likely to be concerned about the
20 anticompetitive impact of the merger.

42. See, for example, Joint Proxy Statement, at I-24; California PUC A.98-12-005, Joint Application of GTE Corporation and Bell Atlantic Corporation before the Public Utilities Commission of the State of California, *In the Matter of the Joint Application of GTE Corporation (“GTE”) and Bell Atlantic Corporation (“Bell Atlantic”) to Transfer Control of GTE’s California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE’s Merger with Bell Atlantic*, December 2, 1998 (“California Application”), at 12; and McCallion (GTE), Direct, at 17.

43. The HHI of an industry with a single seller is 10,000, which is computed as the market share (measured by the firm’s percentage of total industry sales) of the single seller (1.00) times 100 and that amount squared. If an industry had, for example, four sellers each with a 25% market share, the HHI would be computed by adding 25-squared four times (yielding an HHI of 2500). There are three categories of market concentration: unconcentrated (the HHI is below 1000), moderately concentrated (the HHI is between 1000 and 1800) and highly concentrated (the HHI is above 1800). *1992 Merger Guidelines*, at 1.5.

1 Again, considering the narrowly defined local exchange services market, where one company
2 is acquiring the *non-overlapping* market of another company, the merger does not alter the
3 concentration index.⁴⁴ In that instance, the relevant question for the Commission is not the
4 impact of the merger upon the concentration of the market immediately after the merger
5 (there would be none), but rather the impact of the merger upon the prospects for the
6 diminution of that concentration in the future. In other words, one might conclude that
7 because the “delta” in the HHI from the merger is zero, the merger has no impact upon
8 market power or concentration. This conclusion is misleading because the industry in
9 question is one in transition potentially from a single-supplier non-competitive market to a
10 multi-supplier, competitive market. The relevant and harder question then is the impact of
11 the proposed merger upon the likelihood that concentration in the relevant market will begin
12 to diminish.

13
14 Q. Is there an alternative approach to calculating the HHI that might be applicable in the present
15 situation?

16
17 A. Yes. The situation that we have just described *assumed* that Bell Atlantic was not an actual
18 competitor of GTE, and thus the proposed merger would not affect the present HHI.
19 However, in both this and the SBC/Ameritech merger, the respective Applicants have
20 explicitly stated their respective intentions to compete out-of-region, and contend that their
21 ability to engage in out-of-region CLEC activities *requires* that their respective scales of
22 operations be increased by these proposed mergers.⁴⁵ Hence, an alternative method of
23 calculating the HHI for the Applicants here would be to treat the entire country as the

44. As a separate matter, the merger increases the quantity of calls that will both originate and terminate within a single ILEC’s region, which could cause anticompetitive concerns particularly at such time as when the post-merger Bell Atlantic is authorized to provide interLATA services.

45. Merger of SBC Communications Inc. and Ameritech Corporation, *Description of the Transaction, Public Interest Showing and Related Demonstrations*, filed with the FCC on July 24, 1998, CC Docket No. 98-141, Affidavit of James S. Kahan, July 20, 1998, at ¶ 12; and FCC Application, Exhibit A: Public Interest Statement, at 1-2.

1 “relevant market” and to perform the HHI analysis across all ILECs, pre- and post-mergers.
2 This is consistent with the Applicants’ assertion that one of the benefits to the merger is that
3 it will “bring into existence a fifth competitive enterprise with the necessary scale and scope
4 to participate in the emerging national market for packaged services.”⁴⁶
5

6 Q. Have you performed that calculation?
7

8 A. Yes. Figures 2 and 3 below compare the market shares of the major ILECs before and
9 following approval of the two pending mergers. The pre-mergers HHI can be calculated
10 (ignoring the small ILECs) at 1621, while the ILEC market HHI following consummation of
11 both pending mergers would increase to 2677. Thus, under a market definition that expressly
12 conforms to both sets of the Applicants’ visions of the conditions they will confront in the
13 future (whether or not they merge), there can be no question but that the two pending
14 mergers, if allowed to go forward, would result in a substantial increase in market
15 concentration.

46. McCallion (GTE) Direct, at 17.

1

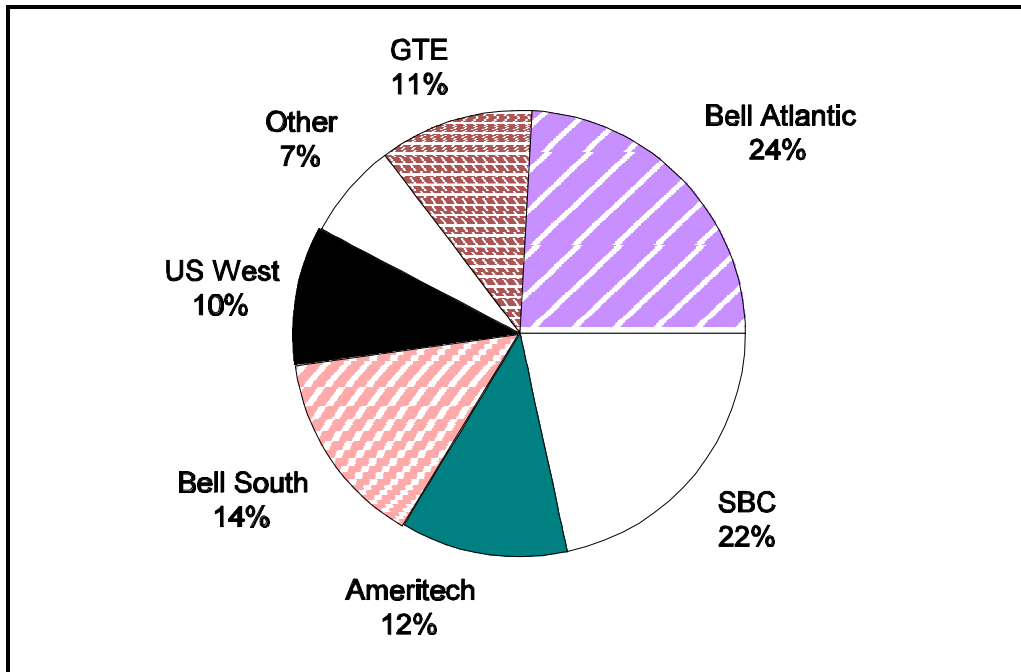


Figure 2. Existing (pre-mergers) ILEC Access Line Shares.
 $HHI=24^2+22^2+14^2+12^2+11^2+10^2=1621$.
 Source: ARMIS Report 43-08, Table II, 1998.

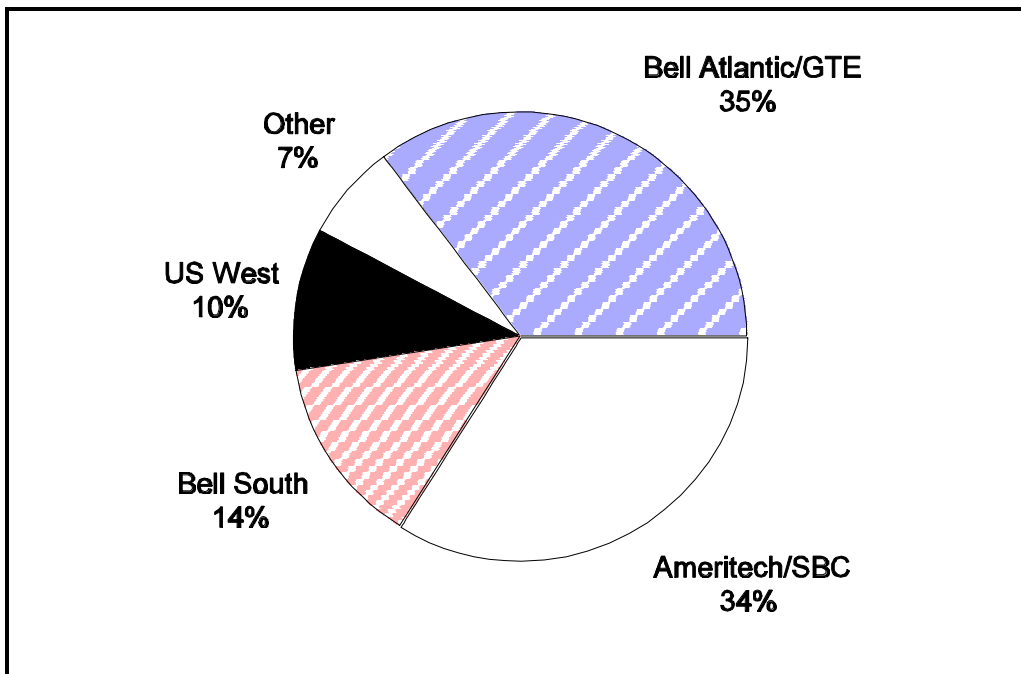


Figure 3. ILEC Access Line Shares After Pending Mergers. $HHI=35^2+34^2+14^2+10^2=2677$.
 Source: ARMIS Report 43-08, Table II, 1998.

1 Q. Should present and potential CLECs such as AT&T and MCI be included in this expanded
2 market definition?

3

4 A. Yes, but only to the extent of their current local exchange market shares, which are *de*
5 *minimis* at the present time and would not materially affect the LEC market HHI
6 calculation.⁴⁷

7

8 Q. Would the proposed merger pose fewer anticompetitive risks if it were occurring after the
9 development of effective local exchange competition, rather than before?

10

11 A. Yes. This merger would have a very different impact if it were occurring after there was
12 effective competition for local exchange and exchange access services rather than at the
13 present time, when no such competition exists. As Brookings Institution economists Robert
14 Litan and Roger Noll conclude in a policy brief, there is little to gain and much to lose by
15 enhancing the ability and incentive of such large ILECs as Bell Atlantic and GTE to thwart
16 competition at a time when competition has barely gained any strength.⁴⁸ Their analysis
17 suggests that, conversely, the harm inherent in this proposed merger may not exist
18 indefinitely. If there are significant benefits to be obtained, they could still be realized in the
19 future, when the large downside risk has been removed or at least mitigated by the presence
20 of viable competitors.

21

47. The *1992 Merger Guidelines* state that “[a]lthough it is desirable to include all firms in the calculation, lack of information about small firms is not critical because such firms do not affect the HHI significantly.” *1992 Merger Guidelines*, at footnote 17.

48. Litan, Robert E. and Roger G. Noll, “Unleashing Telecommunications: The Case for True Competition,” Brookings Institution, Policy Brief #39, November 1998 (www.brook.edu/comm/policybriefs/pb039/pb39.html). Litan and Noll recommend that regulators adopt the principle to “first, do no harm” and conclude that, under this standard, both of the pending mega-ILEC mergers should be denied, at 2.

1 **If the Commission intends to approve the proposed merger, it should explore fully**
2 **measures to mitigate the anticompetitive consequences of the transaction.**
3

4 Q. Should the Commission establish mitigation measures to address the potential anticompetitive
5 consequences of the proposed merger?
6

7 A. Yes. For the many reasons discussed herein, I recommend that the Commission reject the
8 proposed merger. Should the Commission, nonetheless, contemplate approving the
9 transaction, it should provide for detailed workshops and comments from all interested
10 parties in order to address the specific and complex competitive issues that are intrinsic to the
11 merger, and to identify the appropriate measures for mitigating the anticompetitive
12 consequences of the merger. The purposes of these measures should be (1) to facilitate and
13 to expedite the elimination of barriers to entry into GTE's local market; and (2) to deter and
14 to detect anticompetitive cross-subsidization of the merged entity's pursuit of competitive
15 ventures from its in-franchise, regulated operations. The conditions should:
16

- 17 • *Impose penalties where GTE fails to abide by state and federal requirements:* Because
18 GTE does not require Section 271 authority in order to offer interLATA services, GTE
19 lacks the incentive that the BOCs confront to comply with Sections 251 and 252 of the
20 *Telecommunications Act*. Therefore, the Commission should establish financial penalties
21 of sufficient consequence so as to deter anticompetitive foot-dragging by GTE in its
22 attempts at compliance with the requirements of the *1996 Act*, the FCC, and the
23 Commission.
24
- 25 • *Increase accountability by GTE Northwest.* Ascertaining that GTE Northwest is
26 complying with state and federal regulatory requirements is essential, in part because of
27 the complexity of the market-opening requirements that GTE Northwest must fulfill, and
28 in part because, once the merger has been approved and completed, GTE Northwest will
29 not face any substantial economic incentive to cooperate in eliminating entry barriers.
30

1 Q. Are there particular aspects of GTE Northwest's operations that merit attention?

2

3 A. Yes. The Commission, working in collaboration with the Applicants, CLECs, Commission
4 Staff, and the Public Counsel should develop meaningful safeguards that address the
5 following:

6

7 • *Performance Parity*: The purpose of establishing a detailed performance parity plan is to
8 ensure that the quality of the service that the Applicants provide to their wholesale
9 customers is comparable to that provided to their retail customers (e.g., such a plan
10 should assess the relative timeliness of GTE Northwest's UNE loop installation versus
11 the installation of GTE Northwest's retail local exchange service). A performance parity
12 plan should include verifiable benchmarks for measuring the relative performance of
13 GTE's wholesale and retail services, and meaningful financial liabilities should GTE fail
14 to achieve established benchmarks. Also the performance parity plan should rely upon
15 the independent validation of compliance.

16

17 • *Audits by competitively neutral parties, and remedies for noncompliance*: A persistent
18 problem with the market-opening measures entailed in the *Telecommunications Act*
19 concerns ILECs' failure to abide by regulatory requirements. Therefore, audits with
20 appropriate remedies are essential in order to detect and to deter noncompliance with
21 issues such as collocation, interconnection, and access by entrants to the Applicants'
22 operations support systems.

23

24 • *Enhancements to OSS*: Timely improvement to GTE's OSS, including the imple-
25 mentation of uniform interfaces, is an essential step toward facilitating competition in
26 local markets. Third-party testing, such as that occurring in Bell Atlantic's New York
27 region, is an important component of such improvement.

28

- 1 • *Alternative Dispute Resolution*: Disputes between the incumbent carrier and those
2 seeking to break into the market are inevitable, and any delay in resolving those disputes
3 invariably favors the incumbent carrier. Therefore, a process for expeditiously resolving
4 disputed issues is essential.
5
- 6 • *Prevent anticompetitive cross-subsidization*: The most effective way in which the
7 Commission can discourage the anticompetitive cross-subsidization of the Applicants'
8 CLEC ventures is to reduce GTE Northwest's in-franchise regulated rates
9 commensurate with a fair share of the merger synergies.
10

11 Q. Is your proposed list of measures intended to be exhaustive?
12

13 A. Not at all. In the event that the Commission considers approving the Bell Atlantic/GTE
14 merger, it should, at a minimum, include conditions that address the areas that I have
15 discussed, but it should also specifically seek additional suggestions from all parties affected
16 by the proposed merger. I recommend that the Commission request detailed input from the
17 Applicants, the CLECs, Commission Staff, and the Public Counsel in developing specific
18 measures.
19

20 Q. Why is it so important for the Commission to solicit suggestions from a broad range of
21 interests?
22

23 A. It is my understanding that the federal Proposed Conditions for SBC/Ameritech were
24 developed almost entirely by the two merging ILECs and FCC Staff, and thus did not benefit
25 from the input of other industry members and consumer representatives during the "design
26 phase" of the development of the many proposed conditions. Other industry and consumer
27 stakeholders are now being permitted to comment incrementally and after-the-fact to these
28 Proposed Conditions. Thus, although the detailed Proposed Conditions are purportedly
29 intended to address competitive and consumer issues, neither new entrants nor consumer

1 representatives were afforded ample opportunity to participate in the original development of
2 these measures. Therefore, the paradigm used to develop federal conditions for the
3 SBC/Ameritech merger should not be followed in Washington State. Instead, should the
4 Washington Commission seek to develop conditions that would apply to Bell Atlantic/GTE,
5 it should garner more diverse input during the development of the conditions than apparently
6 had been provided to the development of the federal SBC/Ameritech Proposed Conditions.
7

8 Q. Won't the process that you are describing unnecessarily delay the Commission's review of
9 the merger?
10

11 A. No. There is ample time for this critically important process. As I discussed earlier, the
12 California Public Utilities Commission is not expected to render a decision on the proposed
13 merger until January 2000. Furthermore, it is entirely unclear when the FCC will complete its
14 investigation of the proposed merger, in part because, in April 1999, the Applicants requested
15 that the Federal Communications Commission postpone a decision on the proposed
16 transaction pending the Applicants' submission of additional information on their interLATA
17 plans.⁴⁹
18

19 Q. One of the purported benefits of the proposed merger is that GTE will enter Seattle, thus
20 offering US West customers the prospect of greater competition. Should the Commission
21 condition its approval of the proposed merger on such entry and should the Commission
22 impose a financial sanction if GTE fails to enter Seattle as a CLEC within a specified time
23 period?
24

25 A. My primary recommendation is that the Commission reject the merger, in part because I am
26 concerned that SBC and Bell Atlantic are developing a duopoly position in the
27 telecommunications market. If the merger is to occur, however, there could be benefit to

49. Exhibit No. ___(SMB-3) and Exhibit No. ___(SMB-4).

1 ensuring that Bell Atlantic actually does compete with other RBOCs, rather than simply
2 tacitly carving up the market with the other ILECs. Also, as I discuss in more detail in the
3 next section of my testimony, the primary focus of this Commission should be on ensuring
4 that GTE Northwest flows through an appropriate share of the merger synergies to
5 customers of its noncompetitive services. Any regulatory mandate to the Applicants to enter
6 out-of-franchise areas should be constructed in such a manner so as to not undermine or
7 substitute for that objective.

8
9 That being said, because the Applicants identify out-of-franchise entry as a specific benefit of
10 the proposed merger, and because they specifically identify Seattle as an intended market,⁵⁰ it
11 would be entirely appropriate for the Commission to translate this intention into a condition.

12 ⁵¹ Additionally, the Commission should require the Applicants to serve residential and small
13 business customers in any out-of-franchise markets that they enter in Washington.

14 Furthermore, the Commission should establish a financial sanction of sufficient magnitude in
15 order to create an incentive to follow-through on this condition,

50. Joint Application, at 11; McCallion (GTE) Direct, at 17.

51. The Proposed Conditions for SBC/Ameritech that the FCC is presently considering encompass financial penalties for SBC/Ameritech should they fail to enter 30 markets within 30 months.

MERGER SYNERGIES

1
2
3 **The Applicants' overriding economic incentive is to maximize the amount of merger**
4 **synergies that they can retain as profit.**
5

6 Q. Have the Applicants quantified the expected merger-related synergies in their filing before the
7 Commission?
8

9 A. No. The Applicants' filing says little beyond the fact that synergies are expected to make the
10 merged entity "more efficient and responsive in the marketplace."⁵² However, one of the
11 predicted outcomes of and prominent reasons for the merger, repeatedly touted to investors
12 and to regulators, is the anticipated merger-related synergies.⁵³ In their filing to the FCC, the
13 Applicants indicate that they anticipate achieving total annual synergies of \$4.5-billion,
14 exclusive of implementation and transaction costs.⁵⁴
15

16 One component of the potential gain is the reduction in costs associated with the provision of
17 telecommunications services; that is, all else being equal, the costs necessary to produce the
18 same volume of telecommunications services may decline as a result of reduced expenses
19 (e.g., through elimination of redundant functions and positions).⁵⁵ Indeed, in its original

52. Joint Application, at 13.

53. The Applicants mention synergies as a consumer benefit in their application before this Commission. Joint Application, at 13. The Applicants told investors before their vote on merger approval that, based on estimated synergies, earnings per share were expected to rise. Joint Proxy Statement, at I-25.

54. *In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee. For Consent to Transfer of Control.* Declaration of Doreen Toben, September 30, 1998 ("Toben (Bell Atlantic), Declaration"), at ¶ 2.

55. All else may not be equal, however. To the extent that the merger has the effect of diminishing competition generally, the result will be losses in economic efficiency that could lead to higher prices, fewer choices, and less innovation overall. Unless consumers can be *assured* of some tangible participation in the specific merger synergies that are realized by a post-merger Bell Atlantic/GTE, and adequate measures are adopted to address the anticompetitive aspects of the proposed transaction, consumers and the economy generally will likely sustain a net loss if the

(continued...)

1 filing submitted to the FCC, one of the Applicants' declarants stated that the "public interest
2 is indisputably advanced by the use of fewer economic resources to produce the same
3 services."⁵⁶ The other component of the potential gain to the Applicants arises from their
4 expected ability to enhance their combined revenues by expanding the scope and quantity of
5 services produced by their existing resources — and in particular by stimulating consumer
6 demand for premium services for which consumers may be willing to pay prices that are well
7 in excess of long-run incremental cost. By expanding output to an extent that exceeds the
8 growth in inputs, the effect is to reduce the per-unit cost of *existing* services.

9
10 The Commission needs to balance the potential benefit of these synergies with the potential
11 harm to competition, infrastructure, and service quality that the merger poses. Furthermore,
12 absent regulatory intervention or effective competition, the Applicants are unlikely to share
13 gains in economic efficiency with consumers because the Applicants' overriding economic
14 incentive is to maximize profits. Therefore, for a company such as GTE Northwest that
15 offers *noncompetitive* services, the merger raises *distributional* issues, i.e., how society
16 should distribute the anticipated gain between the producer (the Applicants) and the
17 consumers (customers of GTE Northwest's noncompetitive services). As we discuss in more
18 detail below, because of the lack of competitive forces, it is essential that the Commission
19 affirmatively lower rates for GTE Northwest's noncompetitive services (retail and wholesale)
20 to reflect the merger's substantial impact upon GTE Northwest's operating expenses and
21 revenues.

22
23 **The Applicants express confidence in their ability to achieve or to exceed their projected**
24 **merger synergies.**
25

26 Q. Where the Applicants have quantified their synergy estimates related to the Bell Atlantic/GTE
27 merger, have they expressed a degree of certainty as to their estimates?

55. (...continued)
transaction is permitted to go through.

56. Toben (Bell Atlantic), Declaration, at ¶ 5.

- 1 A. Yes. The Applicants anticipate substantial synergies as a result of merging the operations of
2 their two companies, and have provided numerous documents that support this expectation.⁵⁷
3 According to Bell Atlantic, the predicted synergies associated with its proposed merger with
4 GTE are “hard, real, and certain.”⁵⁸ The Applicants intend to rely on the merger synergies to
5 “provide the resources to fund many of the competitive initiatives” that they describe in their
6 application.⁵⁹ Furthermore, “Bell Atlantic and GTE have publicly committed to Wall Street
7 analysts and their investors that they will achieve these financial efficiencies” which include
8 \$2.5-billion in cost savings and \$2.0-billion in revenue enhancements.⁶⁰
9
- 10 Q. Are the Applicants’ estimates of synergies outside of the norm for what has been predicted in
11 previous telecommunications mergers?
12
- 13 A. No. The categories of synergies that the Applicants identify are typical of mergers of
14 incumbent local exchange carriers.⁶¹ According to SBC, it has achieved, and, in some
15 instances, exceeded its projected savings and revenue enhancement resulting from its merger
16 with Pacific Telesis. SBC has stated that “[e]xperience shows that SBC’s *ex ante* estimates
17 of the benefits of its merger with Pacific Telesis were on target.”⁶² When addressing the

57. See, for example, Toben (Bell Atlantic), Declaration; *In the Matter of GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee. For Consent to Transfer of Control*. Reply Declaration of Doreen Toben, December 23, 1998 (“Toben (Bell Atlantic), Reply”); Before the Public Utilities Commission of the State of Hawaii, *In the Matter of the Application of GTE Corporation for Expedited Approval to Transfer Control of GTE Corporation to Bell Atlantic Corporation*, Docket No. 98-0345 (“Hawaii Application”); California Application; and Joint Proxy Statement.

58. Toben (Bell Atlantic) Declaration, at ¶ 2.

59. FCC Application, Exhibit A: Public Interest Statement, at 4.

60. Toben (Bell Atlantic) Declaration, at ¶ 4.

61. The other Tier 1 ILEC mergers which have occurred thus far include SBC’s acquisition of Pacific Telesis; Bell Atlantic’s merger with NYNEX; and SBC’s acquisition of SNET.

62. FCC CC Docket No. 98-141, *Ameritech/SBC Merger*, Affidavit of Richard J. Gilbert and Robert G. Harris, at ¶ 4.

1 investment community, SBC's Executive Vice President, Marty Kaplan stated that "you can
2 count on more savings will be committed to you for the Pacific merger and we will deliver *at*
3 *least* the \$2.5-billion in total synergies for this new transaction."⁶³ Also, although
4 procurement savings in California had been anticipated to be 3%, within only a year after the
5 SBC/Pacific Telesis merger was finalized, SBC reported actual procurement savings of 7%-
6 10%, *more than twice the original projections*.⁶⁴

7
8 Q. Did the Bell Atlantic/NYNEX merger produce the magnitude of synergies that the Applicants
9 had predicted in those proceedings?

10
11 A. Yes. Bell Atlantic indicates that it is on track to achieve savings resulting from its merger
12 with NYNEX. Furthermore, in part based upon that experience, Bell Atlantic emphasizes its
13 confidence in its ability to achieve the predicted Bell Atlantic/GTE merger synergies of \$4.5-
14 billion *annually*. Bell Atlantic's Vice President and Controller states:

15
16 Still more recently, the experience with the Bell Atlantic-NYNEX merger has
17 reconfirmed that these merger efficiencies are real. The very substantial cost
18 savings estimated at the time of the Bell Atlantic-NYNEX merger were
19 subsequently increased and the increased targets are being achieved. For 1998,
20 we projected an increased expense savings of \$450 million, and we are
21 achieving those savings. By 2000, we projected annual expense savings of \$1.1
22 billion; we are on track to achieve those savings. In addition, for 1998 and
23 beyond, we projected annual capital savings of \$300 million; we are achieving
24 those savings as well.⁶⁵

25
26 Therefore, it is certainly plausible that Bell Atlantic and GTE will achieve the synergies that
27 they predict in an amount that is generally consistent with their expectations. Indeed, the

63. Connecticut Docket No. 98-02-20, *SBC/SNET Merger*, SBC revised response to MCI-4, SBC-Ameritech Analyst Conference, Bates page 011969, (emphasis added).

64. Connecticut Docket No. 98-02-20, *SBC/SNET Merger*, SBC Response to OCC-12; California Public Utilities Commission, 96-05-038, *In the Matter of the Joint Application of Pacific Telesis Group ("Telesis") and SBC Communications Inc. ("SBC") for SBC to Control Pacific Bell*, Decision 97-03-067, March 31, 1997, at 30.

65. Toben (Bell Atlantic), Declaration, at ¶ 7.

1 expectation of the synergies is a major motive for the firms to merge.⁶⁶ Salomon Smith
2 Barney, the financial advisors to GTE, estimated the net present value of the synergies to be
3 between \$17.7-billion and \$23.1-billion.⁶⁷ This estimate reflects “only the incremental
4 benefits expected by the management of GTE to result from the merger compared to GTE on
5 a stand-alone basis and include revenue, expense and capital expenditure synergies.”⁶⁸ Bell
6 Atlantic’s financial advisors computed a “net after-tax value of approximately \$13.5-billion”
7 for “expected combination benefits.”⁶⁹ The magnitude of these numbers underscores the
8 confidence that the Applicants and the financial community stake in the anticipated synergies
9 flowing from the merger.

10
11 **The Applicants’ projected increase in the sale of regulated discretionary services raises**
12 **several policy concerns.**
13

14 Q. Are there any other concerns you have with the Applicants’ estimates of merger-related
15 synergies?

16
17 A. Yes. The Applicants intend to increase penetration of discretionary services (e.g., caller
18 identification, call waiting, and additional local exchange service lines) through more active
19 marketing of these services⁷⁰ and estimate a national increase in annual revenues of \$300-
20 million from the sale of these services.⁷¹ The Applicants further indicate that these are not net
21 revenues because they do not reflect the associated costs of selling and providing these

66. Joint Proxy Statement, at I-4.

67. *Id.*, at I-44.

68. *Id.*

69. *Id.*, at I-50.

70. *Id.*, at I-25.

71. Toben (Bell Atlantic), Reply, at ¶ 6.

1 services.⁷² They also anticipate substantially increasing revenues from long distance, large
2 business, data and web hosting services,⁷³ which I have excluded in my discussion below on
3 the assumption that these revenues are associated with non-regulated services. Although the
4 Applicants have not estimated *net* revenues, the incremental cost of supplying services such
5 as call waiting, and caller identification is negligible, and, therefore, the gross revenues
6 provide a reasonable measure of the anticipated merger-related increase in GTE Northwest's
7 revenue stream.

8
9 Q. What issues are raised by the Applicants' increased sale of discretionary services?

10
11 A. The increased sale of discretionary services raises two issues. First, today's prices for
12 discretionary services are set substantially in excess of marginal cost, reflecting GTE
13 Northwest's effort to maximize the profits it derives from the supply of these noncompetitive
14 products (within the constraint of its rate of regulation framework). In their merger filings,
15 the Applicants describe their intention to increase sales of discretionary services. This
16 intention suggests a heightened need for adequate consumer understanding of discretionary
17 telecommunications services. In a competitive market, multiple producers will supply
18 consumers with information about products thus broadly informing consumer understanding
19 and awareness of diverse products. By contrast, GTE Northwest is virtually the sole supplier
20 of discretionary services and thus consumers rely largely on one firm for information about
21 new products. The quality of the information provided to consumers directly affects the
22 efficiency of consumers' purchasing transactions. In its post-merger pursuit of additional
23 revenues, GTE Northwest would face a compelling economic incentive to market new
24 services aggressively to residential and business customers in Washington. Therefore, the
25 Commission should assess the need for the establishment of standards to prevent

72. *Id.*

73. *Id.*

1 inappropriately aggressive sales practices, and if it determines that such a need exists, it
2 should design and establish such standards.

3
4 Q. What is the second public policy issue that the Commission should address?

5
6 A. The second issue concerns the impact of the anticipated merger-related revenue stream on
7 GTE Northwest's rates. Because GTE Northwest does not price discretionary services
8 competitively, the revenues associated with their sale significantly exceeds the associated
9 cost. GTE Northwest's ability to offer these services at a negligible incremental cost results
10 from its long-standing position as a monopoly provider of local telecommunications services
11 to Washington consumers and its associated ability to recover the cost of its ubiquitous
12 network from its rate-regulated customers.

13
14 Q. How do you recommend that the Commission address this issue?

15
16 A. As a condition of the merger, GTE Northwest should lower its prices for services charged for
17 regulated services in Washington to flow through the significant benefit of the anticipated
18 substantial increases in sales for these highly lucrative noncompetitive products. I have
19 computed a Washington-specific share of these synergy benefits below.

20
21 Q. What do you estimate this share to be?

22
23 A. Applying the 4.60% Washington factor (discussed in more detail below and shown in Table 1
24 on page 41) to the anticipated increase in revenues yields an annual anticipated increase in
25 regulated intrastate revenues for Washington of \$4.35-million. The merger synergy analysis
26 presented in Tables 2 and 3 (on pages 46 and 47, respectively) assumes that the Applicants
27 achieve this revenue stream during a three-year period, such that in Year 3, 100% of the
28 revenue stream is achieved. This calculation further assumes that the increase in revenues
29 will occur throughout the combined Bell Atlantic/GTE region, in proportion to the

1 percentage of access lines that each jurisdiction represents. However, there may well be
2 different opportunities for increasing revenues among the 42 Bell Atlantic/GTE states
3 (including the District of Columbia). The Commission could improve this calculation by
4 comparing the penetration rates of vertical services in GTE Northwest's territory in
5 Washington with GTE Northwest's penetration rates in other GTE states and, also with Bell
6 Atlantic's penetration rates for vertical services in Bell Atlantic's region. This comparison
7 would enable the Commission to better compute the potential for increased revenues in
8 Washington relative to the potential in the other Bell Atlantic and GTE jurisdictions.

9
10 **Applicants' proposed factors for determining expense and capital procurement savings in**
11 **other state proceedings can be used as a basis for computing a Washington-specific share of**
12 **the merger synergies.**
13

14 Q. Have the Applicants provided any information to guide this Commission as to the
15 Washington-specific merger-related synergies?

16
17 A. No, they have not. The Joint Application fails to quantify the synergies even on a total
18 merged company basis.

19
20 Q. How then did you calculate the Washington-specific expected synergies?

21
22 A. Although the Applicants have not quantified their estimates of anticipated synergies before
23 this Commission, there is ample publicly available information that addresses the merger
24 synergies, which can be adjusted for Washington. Wherever possible I have followed the
25 methodology for computing synergies that the Applicants have used elsewhere. Where I use
26 alternative methodology or data sources, I explicitly acknowledge this and explain my
27 reasoning for so doing.

28
29 Q. Please describe the basic allocation strategy you have used.
30

1 A. In the Bell Atlantic/GTE merger proceeding before the Public Utilities Commission of the
2 State of Hawaii, Docket No. 98-03445,⁷⁴ the Applicants provided projections of expense
3 savings, capital procurement savings, and implementation costs associated with the proposed
4 merger and disaggregated them among the Applicants' operations. I have used this
5 information to apportion the net merger synergies among the different operations for
6 Washington state, and have updated the information, where applicable, using 1998 data
7 rather than the 1997 data that the Applicants used.

8
9 Also, I have calculated the appropriate share of vertical services revenue synergies the same
10 way as the Applicants treat expense savings because the Applicants have not provided any
11 public data which disaggregates the revenue synergies beyond the merged company level.
12 Table 1 below summarizes my derivation of Washington state's allocation of the merger
13 synergies. Where I refer to the Applicants' methodology, I am referring specifically to the
14 methodology reflected in information that they provided to the Hawaii Public Utilities
15 Commission.

74. The Applicants describe the methodology in their response (submitted on March 15, 1999) to the Consumer Advocate's data request Consumer Advocate/GTE-IR-132, at 15-22 in the Bell Atlantic/GTE merger proceeding before the Public Utilities Commission of the State of Hawaii, Docket No. 98-0345, *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for Expedited Approval to Transfer Control of GTE Corporation to Bell Atlantic Corporation* ("Hawaii Data Response"). I have included these pages as Exhibit No. ___(SMB-5) to my testimony.

Table 1									
Derivation of Merger Synergy Allocation Factors for Washington									
	BA/GTE Total	Total GTE		GTE Network Services		GTE NW Washington		GTE NW - Washington regulated intrastate	
(\$ Millions)	(a)	% (b)	\$	% (c)	\$	% (d)	\$	% (e)	\$
EXPENSE SAVINGS (annual)									
<u>Regulated/ILEC Operations</u>									
1. Information Systems	\$ 250.0	32.65%	\$ 81.63						
2. Consumer & Business	\$ 135.0	32.65%	\$ 44.08						
3. Network/Customer Service	\$ 140.0	32.65%	\$ 45.71						
4. Procurement	\$ 200.0	32.65%	\$ 65.30						
5. Prod Mgmt/Advertising	\$ 110.0	32.65%	\$ 35.92						
6. Wholesale	\$ 15.0	32.65%	\$ 4.90						
7. Research & Devel	\$ 50.0	32.65%	\$ 16.33						
Subtotal	\$ 900.0	32.65%	\$ 293.85	100.00%	\$ 293.85	4.34%	\$ 12.75	66.73%	\$ 8.51
Corporate G&A	\$ 300.0	44.70%	\$ 134.10	78.00%	\$ 104.60	4.34%	\$ 4.54	66.73%	\$ 3.03
Directory	\$ 100.0	32.65%	\$ 32.65	100.00%	\$ 32.65	4.34%	\$ 1.42	100.00%	\$ 1.42
Total Expense Savings	\$ 1,300.0		\$ 460.60		\$ 431.10		\$ 18.71		\$ 12.96
CAPITAL SYNERGIES (annual)									
Telephone Operations ¹	\$ 350.0	32.65%	\$ 114.28	100.00%	\$ 114.28	4.34%	\$ 4.96	66.73%	\$ 3.31
MERGER COSTS									
<u>Transaction Costs (one-time)</u>									
			\$ (215.50)	78.00%	\$ (168.09)	4.34%	\$ (7.30)	66.73%	\$ (4.87)
<u>Implementation Costs (3-year)</u>									
Telephone Operations									
1. Information Systems	\$ (233.8)	32.65%							
2. Consumer & Business	\$ (85.7)	32.65%							
3. Network/Customer Service	\$ (88.9)	32.65%							
4. Procurement	\$ (187.0)	32.65%							
5. Prod Mgmt/Advertising	\$ (102.9)	32.65%							
6. Wholesale	\$ (9.5)	32.65%							
7. Research & Devel	\$ (31.8)	32.65%							
8. Subtotal	\$ (739.5)	32.65%	\$ (241.45)	100.00%	\$ (241.45)	4.34%	\$ (10.48)	66.73%	\$ (6.99)
Corporate G&A	\$ (323.5)	44.70%	\$ (144.60)	78.00%	\$ (112.79)	4.34%	\$ (4.90)	66.73%	\$ (3.27)
Directories	\$ (81.5)	32.65%	\$ (36.43)	100.00%	\$ (36.43)	4.34%	\$ (1.58)	66.73%	\$ (1.06)
Total Implementation Costs	\$ (1,144.5)		\$ (422.48)		\$ (390.67)		\$ (16.96)		\$ (11.31)
Total Merger Costs	\$ (1,144.5)		\$ (637.98)		\$ (558.76)		\$ (24.25)		\$ (16.18)
REVENUE SYNERGIES (annual)									
Vertical Services ²	\$ 300.0	31.54%	\$ 94.62	100.00%	\$ 94.62	4.60%	\$ 4.35	100.00%	\$ 4.35

Notes:

¹The figures in this table do not yet take account of the carrying charges associated with the capital merger synergies.²Vertical services revenues are allocated based on switched access line shares, from ARMIS 43-08: Table III. Access Lines in Service by Customer, 1998.

Vertical services revenues may include services that are considered competitive and also have not been adjusted for the cost of marketing and providing these services. As a result, this estimate is biased slightly upwards.

All calculations use year-end 1998 data, unless otherwise indicated.

Sources:

(a) GTE's response, on March 15, 1999, to the Consumer Advocate's data requests of GTE (Consumer Advocate/GTE-IR-132, at 15-22) in the Bell Atlantic/GTE merger proceeding before the Public Utilities Commission of the State of Hawaii, Docket No. 98-0345, *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for Expedited Approval to Transfer Control of GTE Corporation to Bell Atlantic Corporation* ("Hawaii Data Response").

(b) 1998 Annual Reports of GTE Corporation and Bell Atlantic Corporation; ARMIS Table 43-08; ARMIS Table 43-03.

(c) Hawaii Data Response.

(d) ARMIS Table 43-08; ARMIS Table 43-03.

(e) ARMIS Table 43-01. This factor reflects the jurisdictional separation and the exclusion of nonregulated services.

1 Q. Please provide a more detailed explanation of your derivation of the Washington share of the
2 merger synergies.

3

4 A. The following describes this derivation:

5

6 **GTE Portion:** In order to split the merger synergies between Bell Atlantic and GTE, in
7 Hawaii, the Applicants allocated a percentage of the Telephone Operations Expense Savings,
8 Capital Synergies and Merger Costs to GTE based upon 1997 ARMIS data for the “Big
9 Three Expenses” (Plant Specific, Plant Non-specific, and Customer Operations). I have
10 calculated that the percent of total Big Three (Bell Atlantic and GTE) attributable to GTE,
11 based upon 1998 ARMIS data, is 32.65%.⁷⁵

12

13 The Applicants also allocate a percentage of the Corporate G&A Expense Savings and
14 Implementation Costs to GTE by calculating the percent of total Operating Expenses and
15 Taxes (less Income Tax) attributable to GTE. I calculate this to be 44.7% in 1998.⁷⁶
16 Merger Transaction Costs were calculated for Bell Atlantic and GTE separately by the
17 Applicants and I have used the same results in my calculations.

18

19 Finally, I have allocated revenue synergies to GTE based on its share of total switched access
20 lines.⁷⁷ GTE serves 31.54% of the total access lines controlled by the two companies.

21

22 **GTE Network Services:** To disaggregate the synergies between GTE Corporation and
23 GTE Network Services, the Applicants determine that GTE Network Services’ Telephone
24 Operations should be allocated 100% of Savings, Synergies and Costs from GTE.

25

75. ARMIS 43-03: Table I. Regulated/Nonregulated Data, 1998.

76. Annual Reports of GTE Corporation and Bell Atlantic Corporation for 1998.

77. ARMIS 43-08, 1998.

1 The Applicants allocate 78% of Corporate G&A and Transaction Costs to GTE Network
2 Services based on a weighted factor produced by the results of a time study and current
3 expense allocation practices. I use this factor as well in my analysis.
4

5 **GTE Washington:** The Applicants determine the portion of GTE Network Services'
6 Telephone Operations Expense Savings, Capital Synergies, and Implementation Costs
7 attributable to GTE Hawaii operations "based on the percentage relationship of GTE Hawaii
8 Big Three Expenses to total Big Three Expenses for all of GTE Network Services
9 combined".⁷⁸ I have calculated a comparable factor of 4.34% for Washington state using
10 1998 ARMIS data. I have also used this factor for Corporate G&A and Transaction Costs.
11

12 Finally, I have calculated that Washington consumers will be responsible for at least 4.60% of
13 GTE Network Services' revenue synergies, based upon GTE Northwest's Washington's
14 share of total switched access lines.⁷⁹
15

16 **Regulated Intrastate portion of GTE Washington:** In Hawaii, the Applicants determine
17 the regulated portion of GTE based on the percent of total regulated and non-regulated
18 Operating Expenses attributable to the regulated portion of Operating Expenses using 1997
19 ARMIS data (Table 43-01). For Washington, using 1998 data, I calculate that the regulated
20 portion of GTE's business is 85.25%.
21

78. Hawaii Data Response, at 20.

79. This assumption may underestimate the appropriate Washington share of revenue synergies. In a recent submission to the California Public Utilities Commission, the Applicants contend that they do not foresee raising penetration rates for vertical services in California. Before the Public Utilities Commission of the State of California, A.98-12-005, *In the Matter of the Joint Application of GTE Corporation ("GTE") and Bell Atlantic Corporation ("Bell Atlantic") to Transfer Control of GTE's California Utility Subsidiaries to Bell Atlantic, Which Will Occur Indirectly as a Result of GTE's Merger with Bell Atlantic*, Rebuttal Testimony of Jeffrey C. Kissell, June 21, 1999, at 37-39. My calculation assumes that penetration rates for vertical services will increase proportionally throughout the combined Bell Atlantic/GTE region.

1 Using the same ARMIS table for 1998, I calculate that intrastate Operating Expenses
2 represent 78.28% of regulated Operating Expenses. Non-competitive services represent
3 100% of the Regulated Intrastate Portion of GTE Washington. Therefore the composite
4 factor (85.25% multiplied by 78.28%) is used to determine that the Regulated Intrastate
5 portion of GTE Washington is 66.73%.

6
7 **Approximation of the impact of the merger on GTE's expenses and revenues over a ten-**
8 **year period.**
9

10 Q. What changes have you made to the Applicants' previous representations of the merger-
11 related synergies.

12
13 A. I have made the following changes:

- 14
- 15 • The Applicants' analysis begins with "Year 1" and ends with "Year 3," thus over-
16 emphasizing the more costly ramp-up years and ignoring the enduring nature of the
17 synergies. I revise the analysis to reflect a ten-year-period so that the costs and revenues
18 are more evenly distributed and one-time transaction and implementation costs are
19 effectively "normalized."
 - 20
 - 21 • The Applicants have failed to include the revenue enhancement associated with the
22 Applicants' clearly stated expectations of increased penetration of regulated
23 discretionary services (such as call waiting). I include these synergies in my analysis.
24
 - 25 • The Applicants have failed to include the Directories portion of their business in their
26 synergy calculations. I include Directories in my analysis.
27

28 Table 2 below summarizes the Applicants' predictions of the timing of the synergy
29 categories. Table 3 below computes the net present value of these synergies over a ten-year
30 period and then levelizes the net synergies over the same time period (thus effectively

1 amortizing the one-time transaction and implementation costs and computing a level stream
2 of net synergies).⁸⁰ The resulting levelized stream of synergies over a ten-year period is
3 \$10.16-million for net savings and \$3.73-million for increased revenues, yielding total annual
4 synergies (excluding the negligible cost associated with increasing sales of regulated services)
5 of \$13.88-million for GTE's intrastate regulated operations in Washington.

80. The discount rate can be modified to reflect the most recent rate of return authorized by the Commission for GTE. I have used 10% for illustrative purposes.

1

Table 2				
GTE Northwest - Washington Share of Synergies Regulated Intrastate Portion of Business 10 Year, Non-Discounted Projections				
(\$ Millions,	Year 1 (2000)	Year 2 (2001)	Year 3 (2002)	Years 4-10 (2003-2009) (Annual)
EXPENSE SAVINGS				
Telephone Operations	33%	67%	100%	100%
	\$ 2.81	\$ 5.70	\$ 8.51	\$ 8.51
Corporate G&A	33%	67%	100%	100%
	\$ 1.00	\$ 2.03	\$ 3.03	\$ 3.03
Directories	33%	67%	100%	100%
	\$ 0.47	\$ 0.95	\$ 1.42	\$ 1.42
Total Expense Savings	\$ 4.28	\$ 8.68	\$ 12.96	\$ 12.96
CAPITAL SYNERGIES				
Telephone Operations ¹	43%	71%	100%	100%
	\$ 0.27	\$ 0.74	\$ 1.70	\$ 1.70
MERGER COSTS				
<u>Transactions Cost</u>	100%			
	\$ (4.87)	\$ -	\$ -	\$ -
<u>Implementation costs</u>				
Telephone Operations	50%	35%	15%	
	\$ (3.50)	\$ (2.45)	\$ (1.05)	\$ -
Corporate G&A	54%	33%	13%	
	\$ (1.76)	\$ (1.08)	\$ (0.42)	\$ -
Directories	50%	35%	15%	
	\$ (0.53)	\$ (0.37)	\$ (0.16)	\$ -
Total Implementation Costs	\$ (5.79)	\$ (3.89)	\$ (1.63)	\$ -
Total Merger Costs	\$ (10.66)	\$ (3.89)	\$ (1.63)	\$ -
NET SAVINGS	(6.11)	5.53	13.02	14.66
Revenue Synergies²	33% 1.44	67% 2.92	100% 4.35	100% 4.35
Net Savings + Revenue	(4.67)	8.44	17.38	19.01

Notes:

¹The capital synergies presented in this table reflect the carrying charges associated with the synergies as presented in the Hawaii Data Response and thus do not simply reflect the percent share of the "3rd Year Level".

²The Applicants characterize the revenue synergies as similar to the expense savings in that they will occur "within three years of the closing of the merger", [Toben (Bell Atlantic) Reply, at par. 6]. Therefore, they have been calculated for Years 1 and 2 with the same "ramp up" formula that the Applicants use for expense savings, reaching their "100% level" in Year 3.

Sources:

Synergies and merger costs percentages are allocated to each year as given in the Hawaii Data Response.

See Table 1 for an explanation of the initial figures.

Table 3											
Annualized Merger Synergies in Washington (Ten-Year Period)¹											
(\$ Millions)	NPV ²	Year 1 (2000)	Year 2 (2001)	Year 3 (2002)	Year 4 (2003)	Year 5 (2004)	Year 6 (2005)	Year 7 (2006)	Year 8 (2007)	Year 9 (2008)	Year 10 (2009)
EXPENSE SAVINGS											
Telephone Operations	\$44.79	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29	\$ 7.29
Corporate G&A	\$15.94	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59	\$ 2.59
Directories	\$7.46	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21	\$ 1.21
Total Expense Savings	\$68.19	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10	\$11.10
CAPITAL SYNERGIES											
Telephone Operations	\$8.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36	\$ 1.36
MERGER COSTS											
Transactions Cost	\$ (4.43)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)	\$ (0.72)
Implementation costs											
Telephone Operations	\$ (5.99)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)	\$ (0.97)
Corporate G&A	\$ (2.81)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)	\$ (0.46)
Directories	\$ (0.90)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)	\$ (0.15)
Total Implementation Costs	\$ (9.71)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)	\$ (1.58)
Total Merger Costs	\$(14.13)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)	\$(2.30)
NET SAVINGS	\$62.41	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16	\$10.16
REVENUE SYNERGIES	\$22.91	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73	\$ 3.73
Net Savings + Revenue	\$85.31	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88	\$13.88

Notes:

¹ See Table 1 for an explanation of the derivation of the initial figures. This table represents the calculated "annualized" estimate of merger synergies.

² The NPV, or Net Present Value, is based on the estimated costs and savings for Year 1 through Year 10 from Table 2, using a discount rate of 10%.

1 **Existing levels of competition and those for the foreseeable future will not flow through the**
 2 **substantial merger synergies to consumers.**
 3

4 Q. You have calculated substantial merger-related synergies for GTE Northwest's regulated
 5 operations in Washington. Will the current and foreseeable levels of competition provide for
 6 flow-through of the expected synergies to consumers?
 7

8 A. No. As I demonstrate in the previous section of my testimony, by any measure, there is
 9 absolutely no competition in the local market in Washington. GTE Northwest has lost
 10 negligible market share to new entrants and significant barriers to entry persist and are not
 11 likely to be eliminated in the foreseeable future.

1 Q. Is there any evidence that the Applicants anticipate significant competition in their home
2 region in the foreseeable future?

3

4 A. No. In fact, a speech by the Chairman and CEO of GTE Corporation, Charles Lee, suggests
5 that GTE has been successful in its efforts to prevent local competition. He indicates that
6 GTE's rural and suburban markets are actually an advantage because they have successfully
7 "prevented significant competitive erosion. In fact, GTE has lost just one-half of one percent
8 of domestic access lines to resale. The RBOCs, in contrast, have resale losses in the low
9 single digits. And half of GTE's losses have gone to our own CLEC, so they're still in the
10 family."⁸¹ Thus, not only has there been little competitive progress in GTE's Washington
11 territory, but it is likely that half of these competitive "losses" have been resale to a GTE
12 subsidiary. Therefore, the Commission cannot rely on competitive forces to cause the
13 Applicants to flow through these synergies to consumers.

14

15 **Regulatory intervention is necessary to ensure that GTE Northwest's rates for its**
16 **noncompetitive services are just and reasonable.**

17

18 Q. What do you propose the Commission do to ensure that flow-through of synergies occurs?

19

20 A. Affirmative regulatory intervention is essential so that GTE Northwest's rates will be just and
21 reasonable. The Applicants' expectation of substantial synergies poses one of the most
22 important public policy concerns raised by the proposed merger of Bell Atlantic and GTE,
23 namely the determination of if and how residents and businesses in Washington can be
24 ensured of receiving an appropriate share of the financial benefit flowing from the merger.
25 Absent regulatory intervention, the Applicants are highly unlikely to flow through the
26 merger-related synergies to consumers of GTE Northwest's noncompetitive
27 telecommunications services by lowering rates for these services. Because the economic

81. Remarks of Chuck Lee, Salomon Smith Barney Global Entertainment Media and Telecommunications Conference, January 13, 1999, transcript available at www.gte.com/AboutGTE/NewsCenter/Executive/salsmithbarney.html.

1 incentives favor GTE's shareholders, regulatory intervention is essential to ensure that rates
2 charged to consumers of noncompetitive services reflect the substantial merger synergies and
3 are just and reasonable. Therefore I recommend that the Commission adjust GTE
4 Northwest's rates to reflect an annualized share of the synergies in the amount of \$13.88-
5 million.⁸²

82. Because the flow-through would constitute a reduction of GTE Northwest's earnings, the annual flow-through would need to be adjusted from an after-tax to a pre-tax basis. Furthermore my recommendation is entirely separate from any review of GTE Northwest's rates that may be undertaken by the Commission independent of the Commission's review of the proposed Bell Atlantic/GTE merger.

1 OTHER POTENTIAL HARMS TO CONSUMERS

2

3 **The Commission should enhance service quality safeguards to ensure that those customers**
4 **with the fewest competitive alternatives do not suffer service quality deterioration.**

5

6 Q. How might the proposed merger affect service quality in Washington?

7

8 A. In seeking to achieve their projected merger synergies, the Applicants will expose consumers
9 to the risk of cost-cutting through the selective deterioration of service quality. Operating
10 with the new, enlarged company, eager and financially committed to wooing and retaining
11 large business customers, Bell Atlantic/GTE may well focus its operational and customer
12 assistance service quality efforts on urban customers with large telecommunications demands
13 and overlook other consumers' needs. In the absence of widespread competition in the local
14 exchange services market, GTE Northwest does not have an economic incentive to install
15 basic local exchange service lines in a timely manner, to address trouble reports for customers
16 in rural areas, or to maintain service quality generally for customers without an opportunity
17 to change suppliers. The Applicants have not provided evidence that would overcome
18 concerns about their economic incentive to allow service quality to deteriorate for residential
19 and small business customers, especially those in more remote areas that have the least
20 prospect for obtaining competitive services.

21

22 Q. Do the Applicants' contend that the merger will cause service quality to improve?

23

24 A. In their Joint Application, the Applicants provide a vague statement that their
25 "complementary skills will, when combined, allow both companies to better maintain and
26 improve the quality and efficiency of the service they provide."⁸³ Bell Atlantic asserts that the
27 merger will enhance service quality and that the recent Bell Atlantic/NYNEX merger is

83. Joint Application, at 14.

1 instructive since service quality has been enhanced in that case.⁸⁴ Bell Atlantic contends that
2 service quality has “remained strong and steady” in Vermont, and also that FCC quality of
3 service reports indicate that complaints about residential service in Bell Atlantic’s entire
4 region have decreased by 17% from 1996 to 1997.⁸⁵

5
6 Historical record aside, it is still reasonable and indeed essential to establish safeguards that
7 translate the Applicants’ expectations into commitments. Although continued mechanization
8 of ILEC operations could generally reduce the ILEC’s personnel requirements over time, in
9 selecting ILEC personnel to staff its high-risk, high-stakes competitive initiatives (such as
10 their planned expansion into a number of out-of-region markets within 18 months of the
11 merger),⁸⁶ Bell Atlantic/GTE will have a strong incentive to choose the most experienced,
12 highly qualified people for assignment to the new out-of-region CLEC operations. This, in
13 turn, would work to diminish the overall quality of GTE Northwest’s retail and wholesale
14 operations in Washington and ILEC managerial and labor forces, which could result in a
15 diminution of service quality overall.

16
17 Q. What are some of the Applicants’ representations of Washington-specific service quality
18 issues?

19
20 A. The Applicants offer nothing more than vague commitments to maintain or improve service
21 quality. One of the Applicants’ witnesses states that the “merger itself will not affect service
22 quality in Washington.”⁸⁷

84. Direct Testimony of Louise McCarren On Behalf of Bell Atlantic Corporation, June 18, 1999 (“McCarren (Bell Atlantic), Direct”), at 3.

85. *Id.*, at 9.

86. McCallion (GTE), Direct, at 17-18.

87. Direct Testimony of Eileen O’Neill Odum On Behalf of GTE Corporation, June 18, 1999 (“Odum (GTE), Direct”), at 3.

1 Q. What are your recommendations regarding service quality?

2

3 A. Quality of service standards (particularly for installation of basic telephone service) should be
4 based on an exchange-specific (or at a minimum, a district-specific) quality measurement so
5 that the post-merger entity does not allow service quality to slip in exchanges where
6 competitive pressures do not motivate it to maintain service quality on a par with areas where
7 competition exists. Viewed on an average, statewide basis, GTE Northwest may well comply
8 with standards, but the average could well be masking substandard performance in certain
9 parts of the state, and thus geographically disaggregated data and penalties are critical.
10 Similarly, above-average quality of service performance for business customers could well
11 disguise inferior quality of service being offered to residential customers. Therefore, quality
12 of service standards should be disaggregated between residential customers and business
13 customers and meaningful incentives and/or penalties should be established to ensure
14 compliance with these standards.

15

16 **The Commission should establish comprehensive reporting requirements so that GTE**
17 **Northwest's investment and new service deployment in Washington can be monitored.**

18

19 Q. Have the Applicants' addressed the issue of infrastructure investment?

20

21 A. Yes. The Applicants indicate that the merged companies' financial position will enable it to
22 maintain "appropriate investments in infrastructure."⁸⁸ However, the Applicants do not
23 commit to an even distribution of infrastructure investment and the likely source for any
24 infrastructure investment is in major metropolitan areas, such as Seattle, where the Applicants
25 plan to compete out-of-franchise. Infrastructure investment for new, competitive ventures
26 should not come at the expense of GTE Northwest's home-region customers of
27 noncompetitive services.

28

88. McCarren (Bell Atlantic) Direct, at 11.

1 Q. Could the proposed merger adversely affect GTE Northwest's telecommunications
2 infrastructure and deployment of new services?

3

4 A. Yes. In seeking to achieve merger synergies and to enter out-of-franchise markets, the
5 Applicants could lessen their investment in GTE Northwest's network. The Commission
6 should seek to prevent or at least to discourage disinvestment by Bell Atlantic/GTE in
7 Washington's telecommunications infrastructure. Specifically, the Commission should
8 monitor Bell Atlantic/GTE's performance in Washington relative to GTE's historical
9 investments in Washington, and also relative to Bell Atlantic/GTE's investment in other Bell
10 Atlantic/GTE states. Also the Commission would monitor Atlantic/GTE's pattern of
11 investment within regions of the state. To the extent that competition emerges at all, it is
12 likely to do so in certain parts of the state and for certain customers. Bell Atlantic/GTE
13 should be required not only to provide information about its total levels of investment but
14 also should demonstrate that investment is being made throughout the state.

15

16 The Commission should instruct Bell Atlantic/GTE to submit disaggregated investment data
17 by exchange within the state, so that the Commission can ensure that no parts of the state are
18 being short-changed as the Washington telecommunications infrastructure continues to
19 evolve. The Commission should impose similar reporting requirements relative to the
20 deployment of new services, and specifically should request the submission of comparable
21 information about new service within GTE Northwest's territory and throughout Bell
22 Atlantic/GTE's region. The purpose of this information would be to enable the Commission
23 to detect any patterns of disinvestment and/or any significant disparities in the deployment of
24 new services.

25

26 Q. Have other state commissions imposed similar requirements?

27

1 A. Yes. The Connecticut Department of Public Utility Control adopted a similar
2 recommendation made by the Connecticut Office of Consumer Counsel regarding SBC's
3 acquisition of SNET:

4
5 The Department agrees with the OCC that the approved Merger should ensure that
6 Connecticut consumers receive some benefits while the risk to the development of
7 competition, the integrity of Connecticut's telecommunications infrastructure,
8 quality of telecommunications services, and the Department's ability to regulate a
9 company controlled by out-of-state management be minimized.⁸⁹
10

11 The DPUC specifically required the following:

12
13 No later than April 30, 1999, and for a period of three years thereafter, SBC shall
14 provide a multi-year technology plan, reports of actual deployment of technology,
15 summaries of actual and projected costs of deployment and associated new products
16 and services, and summaries of any studies regarding technological development or
17 new services that could have a significant impact on the nature or schedule of
18 infrastructure deployment in the Telco and Woodbury infrastructures. The level of
19 infrastructure investment shall be geographically disaggregated, if applicable, with
20 specific reasons for such investment.
21

22 The Department also ordered that:

23
24 No later than April 3, 1999, and for three years thereafter, SBC shall file a list
25 of all new regulated telecommunications products and services offered in its
26 operating states that by Connecticut definition are noncompetitive. The report
27 shall also compare and contrast those new services with those services offered
28 in Connecticut.⁹⁰
29

30 Also, the Vermont Public Service Board, in approving the merger between NYNEX
31 Corporation and Bell Atlantic, imposed a condition that the merged company "file a proposed
32 methodology by which the Board may compare the relationship between the services,
33 facilities, infrastructure, and prices offered by the merged company in Vermont and
34

89. Connecticut DPUC docket No. 98-02-20, *Joint Application of SBC Communications Inc., and Southern New England Telecommunications Corporation for Approval of a Change of Control*, September 2, 1998, at 44.

90. *Id.*, at 65.

1 those offered elsewhere within the merged company's service territory." The Board directed
2 Bell Atlantic to make its first annual "Merger Benchmarking Report" by June 1999.⁹¹

3
4 Most recently, in the Stipulation that the Applicants reached in Pennsylvania, the Applicants
5 agree to submit an annual report to the Pennsylvania Public Utilities Commission that details
6 capital expenditures and that:

7 [W]ithin the limits of existing record keeping, such report shall show the
8 amount of capital expenditures by county, the number of broadband and high
9 speed internet access lines per county, the number of residential and business
10 customers by county who have access to broadband and highspeed internet
11 services and the amount and type of other equipment installed by county.⁹²
12
13

14 **The FCC's ongoing investigations of the SBC/Ameritech and Bell Atlantic/GTE mergers**
15 **are relevant to the Washington Commission's investigation of the Bell Atlantic/GTE**
16 **merger.**
17

18 Q. Has the FCC provided any guidance in its SBC/Ameritech merger proceeding that could be
19 germane to this proceeding?

20
21 A. Yes. On April 1, 1999, FCC Chairman William Kennard sent a letter to SBC and Ameritech
22 informing them that he had "asked the Commission's staff to explore with [SBC and
23 Ameritech] and other parties, on a cooperative basis, whether it would be possible to craft
24 conditions that address the public interest concerns."⁹³ Additionally, Thomas Krattenmaker,
25 Director of Research in the FCC's Office of Plans and Policy, stated in a forum held in early

91. Vermont PSB Docket No. 5900, *Joint Petition of New England Telephone & Telegraph Company d/b/a NYNEX, NYNEX Corporation, and Bell Atlantic Corporation for approval of a merger of a wholly owned subsidiary of Bell Atlantic Corporation into NYNEX Corporation*, Order Accepting Compliance Filing, April 5, 1999.

92. Pennsylvania Stipulation, at Section 6.

93. FCC News Release, April 1, 1999 (Report No. CC 99-11), *Letter Regarding SBC Ameritech Merger Sent Today*.

1 May 1999 that the merger proposal, “if not ameliorated by sufficient conditions, flunks the
2 public interest test.”⁹⁴

3
4 Q. Have SBC and Ameritech responded to this letter?

5
6 A. Yes. On July 1, 1999, SBC and Ameritech submitted a detailed package of proposed
7 conditions to the FCC⁹⁵ which are intended to address concerns that FCC Chairman William
8 E. Kennard conveyed to the Applicants in the letter dated April 1, 1999. These proposed
9 conditions (developed jointly by FCC Staff and by SBC/Ameritech) are now the subject of an
10 FCC pleading cycle.⁹⁶

11
12 Q. What is the significance of the FCC’s deliberations on the SBC/Ameritech Proposed
13 Conditions to this Commission’s investigation of the proposed Bell Atlantic/GTE merger?

14
15 A. While the Applicants are likely to attempt to differentiate their proposed transaction from that
16 of SBC and Ameritech, the two mergers are sufficiently similar that the FCC’s actions on one
17 is evidence of its probable actions concerning the other. Based upon my review of the
18 SBC/Ameritech Proposed Conditions, I recommend that this Commission be informed by the
19 FCC’s actions on the Bell Atlantic/GTE merger before it completes its review in this
20 proceeding.

21

94. *TR Daily [Online]*, May 6, 1999. (www.tr.com/online/trd)

95. Letter to Magalie Roman Salas, Esq, Secretary, Federal Communications Commission, dated July 1, 1999, from Richard Hetke, Senior Counsel, Ameritech Corporation and Paul K. Mancini, General Attorney and Assistant General Counsel, SBC Communications Inc., “Proposed Conditions for FCC Order Approving SBC/Ameritech Merger” (“SBC/Ameritech Proposed Conditions”).

96. “Pleading Cycle Established for Comments on Conditions Proposed by SBC Communications Inc. and Ameritech Corporation for their Pending Application to Transfer Control,” CC Docket No. 98-141, DA 99-1305, released July 1, 1999 (“Pleading Cycle Established”). Initial comments are due on July 19, 1999, and oppositions or responses to those comments are due on July 26, 1999. *Pleading Cycle Established*.

1 Q. Why do you recommend that the Commission await the FCC's decision?

2

3 A. Should the Commission consider approving the proposed transaction, it should first review
4 the conditions that the FCC ultimately imposes on the Applicants so that any state-specific
5 conditions complement, and as necessary, supplement federally-imposed conditions. While it
6 is highly probable that the FCC will impose conditions in any order approving the
7 SBC/Ameritech merger, the precise nature of the conditions that the FCC will adopt is
8 unknown. Still less is known about the FCC's actions regarding the Bell Atlantic/GTE
9 merger. However, the Washington Commission's review of any FCC-imposed conditions
10 and sanctions is particularly important for the following reasons:

11

12 • A federal mandate (such as penalties for failure to enter out-of-franchise markets within
13 a specified time period) may increase the economic incentive for the Applicants to divert
14 resources from its home region operations to meet FCC requirements, a concern which
15 the Washington Commission may then need to address with counterbalancing incentives
16 and measures.⁹⁷

17

18 • If the FCC-imposed "package" of conditions is not sufficiently comprehensive, the
19 Washington Commission may need to supplement the conditions with state-specific
20 measures.

21

22 • Where the FCC-imposed conditions do not address state-specific concerns, the
23 Washington Commission may need to supplement the FCC conditions.

24

25 • Where the FCC-imposed conditions create incentives for the Applicants to
26 disproportionately focus on the other 41 states (including the District of Columbia) in the

97. One of the proposed SBC/Ameritech conditions includes financial penalties should SBC/Ameritech fail to enter 30 markets within 30 months of the consummation of the merger, SBC/Ameritech Proposed Conditions, at XXI. d. 61. The FCC would presumably consider comparable penalties in its review of the Bell Atlantic/GTE merger.

1 Bell Atlantic/GTE region, the Washington Commission may need to adopt measures that
2 ensure that Washington benefits at a comparable pace and scope from the FCC-imposed
3 measures.

4

5 Q. Please summarize your recommendation regarding this Commission's action regarding the
6 FCC's proceeding.

7

8 A. As a threshold matter, I recommend that the Washington Commission consider the merits of
9 awaiting the outcome of the FCC's proceeding before rendering a decision in this proceeding.

10 The advantage of such an approach is that the Commission could then focus its regulatory
11 resources on supplementing the FCC conditions as necessary to address state-specific
12 concerns. Alternatively, the Commission could examine critically the FCC-proposed
13 conditions for the SBC/Ameritech merger, and, in its order in this proceeding, determine
14 which, if any, should be adopted for the state of Washington, regardless of the outcome of
15 the FCC proceeding.⁹⁸

16

17 Q. Does this conclude your direct testimony at this time?

18

19 A. Yes, it does.

98. Should the Commission adopt this latter approach (i.e., issue a decision before the FCC does), the Commission, in its order in this proceeding, should clearly signal its intent to revisit the impact of the FCC's proceeding for the specific purpose of ensuring that the FCC decision does not undermine the Commission's efforts to achieve state-established telecommunications goals.