Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Kathleen M. Folsom. My business address is 1300 S Evergreen Pk Dr SW, Olympia, Washington, 98504.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Washington Utilities and Transportation Commission ("WUTC" or "Commission") as a Utilities Rate Research Specialist.

Q. PLEASE STATE YOUR QUALIFICATIONS TO PROVIDE TESTIMONY IN THESE PROCEEDINGS.

A. I hold a Bachelor of Arts degree in Business Administration from Washington State University. I also hold an MBA, with a concentration in Finance, from Portland State University. I have testified before the Commission on issues related to the establishment of an authorized rate of return for GTE Northwest Incorporated (GTE-NW) in Docket No. UT-931591 and U S West Communications, Inc. in Docket No. UT-950200. In my capacity as a Utilities Rate Research Specialist, I have presented recommendations to the Commission on security, affiliated interest, and transfer of property applications.

Q. WAS YOUR TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECTION?

A. Yes, with minor assistance from Fred Ottavelli, Senior Policy Strategist, and Maurice Twitchell, Regulatory Consultant.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to present a recommendation to the Commission regarding the proposed merger between GTE Corporation (GTE or Applicant) and Bell Atlantic Corporation (Bell Atlantic or Applicant). I also examined the potential impacts of the proposed merger on GTE's wholly-owned subsidiary, GTE-NW.

Q. WHAT IS STAFF'S RECOMMENDATION?

A. Staff recommends that the Commission not approve the merger of GTE and Bell Atlantic unless it is subject to the following conditions:

1. GTE-NW must file a $9.6 million rate reduction, equal to its projected Washington intrastate expense savings and capital synergies from the merger, becoming effective not later than six months after the closing of the merger;

2. GTE-NW must identify the Washington intrastate portion of revenue synergies from the merger, as projected on page I-25 of the Joint Proxy

Statement for 1999 Annual Meetings of Shareholders and Prospectus (Proxy Statement), Ex. ___ (KMF-1), and incorporate those additional benefits into the rate reduction filing required in Condition No. 1 above;

3. GTE-NW must not include in future rate filings cost increases that may occur as a result of the merger; and

4. GTE-NW must provide to its local exchange competitors pre-ordering, ordering, provisioning, maintenance, repair, and billing functions that are comparable in quality to those provided by Bell Atlantic in other jurisdictions.[1]

Q. DID STAFF EXAMINE THE MERGER APPLICATION AND ACCOMPANYING EXHIBITS PURSUANT TO RCW 80.12.020 AND CHAPTER 480-143 WAC (TRANSFERS OF PROPERTY)?

A. Yes. Staff examined the merger application pursuant to WAC 480-143-170 which provides as follows: "If, upon the examination of any application and accompanying

[1]Glenn Blackmon, Assistant Director for Telecommunications, addresses this recommendation in his prefiled direct testimony in this docket.

exhibits, or upon a hearing concerning the same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application."

Q. IS THE PROPOSED MERGER CONSISTENT WITH THE PUBLIC INTEREST?

A. The merger on its own, without GTE-NW meeting specific conditions, would not be consistent with the public interest. The prefiled direct testimony of Glenn Blackmon addresses the issues of potential harm to competition and consumers which will be ameliorated by the proposed conditions. If the conditions proposed by Staff are satisfied by GTE-NW, then Staff believes that the merger is not inconsistent with the public interest.

MERGER SAVINGS

Q. DID THE APPLICANTS FILE AN ESTIMATE OF THE COSTS, BENEFITS AND SYNERGIES THAT WILL RESULT FROM THE PROPOSED MERGER?

A. Yes, in part. Joint Applicants' response to Staff Data Request No. 18, Ex. ___ (KMF-C-2), identifies estimated Washington intrastate merger savings associated with expense savings and capital synergies as well as merger transaction and merger implementation costs.

Applicants have not provided the Commission with an estimate of the Washington intrastate portion of annual revenue synergies identified in the Proxy

Statement at page I-25, Ex. ___ (KMF-1), which projects that there will be "annual revenue synergies of approximately $2 billion, primarily from improved market penetration for value-added services (e.g., Call Waiting and Caller I.D.) and faster development of our data and long distance businesses which, at an estimated operating margin of 25%, will produce $500 million in incremental operating income." The Proxy Statement goes on to state at page I-25: "We are targeting revenue growth of 8-10% and earnings per share growth of 13-15% (excluding merger-related charges) in each of the first two years following the completion of the merger. By the third year after the completion of the merger, we are targeting revenue growth in excess of 10% and earnings per share growth in excess of 15% (excluding merger-related charges)."

Q. WHAT ARE THE PROJECTED WASHINGTON INTRASTATE EXPENSE SAVINGS AND CAPITAL SYNERGIES THAT WILL RESULT FROM THE PROPOSED MERGER?

A. According to the Applicants, expenses will be reduced by $8.7 million and capital synergies will produce $.9 million in savings for a total of $9.6 million in savings by the end of the third year following the merger.

Q. WILL THE MERGER ALSO RESULT IN INCREASED EXPENSES?

A. Yes. The Applicants project that the merger will result in certain non-recurring charges and transactional expenses at the corporate level.

Q. SHOULD THESE COSTS BE PASSED ON TO THE RATEPAYER?

A. No. Transaction costs are one-time, non-recurring charges which traditionally have not been recovered from ratepayers. Non-recurring merger charges should be borne by shareholders as part of the risk they incur when approving the merger of the companies they own stock in.

Q. WHAT IS THE TIMING OF THE TRANSACTION COSTS?

A. Some of the transaction costs associated with the merger were incurred over the past year when many of the activities associated with the merger occurred. In addition, certain costs will occur at the closing of the merger when employee-directors of GTE and Bell Atlantic will receive additional compensation.

Q. SHOULD THE PROJECTED WASHINGTON INTRASTATE MERGER SAVINGS OF $9.6 MILLION BE NET OF TAXES?

A. No. The $9.6 million decrease in expenses associated with the merger savings will be offset by the Staff's recommended decrease in revenues. The offsetting decrease in revenues and expenses will not effect federal income taxes.

Q. DOES THE $9.6 MILLION IN EXPENSE SAVINGS AND CAPITAL SYNERGIES REPRESENT A CONSERVATIVE ESTIMATE OF THE BENEFITS TO WASHINGTON INTRASTATE RATEPAYERS?

A. Yes. According to Joint Applicants' response to Staff Data Request No. 18, Ex. ___ (KMF-C-2), savings will continue to increase for at least three years following the merger. It appears that savings could continue into the future but applicants did not provide an estimate of any additional savings. The projected merger savings could in fact be greater due to increased synergies or greater operating efficiencies.

Q. SHOULD THE MERGER EXPENSE SAVINGS, CAPITAL SYNERGIES, AND BENEFITS ASSOCIATED WITH REVENUE SYNERGIES BE PASSED ON TO RATEPAYERS WITHIN SIX MONTHS OF THE CLOSING OF THE MERGER?

A. Yes. Staff believes that an up-front rate reduction to flow through the projected merger savings and revenue synergies would eliminate further regulatory oversight and eliminate the need for tracking and reporting of actual merger savings while still flowing through benefits to ratepayers.

Q. IS STAFF RECOMMENDING A SPECIFIC RATE REDUCTION FILING IN ORDER TO PASS ON THE $9.6 MILLION IN MERGER SAVINGS AND REVENUE SYNERGIES TO RATEPAYERS?

A. Not at this time. However, Staff suggests that high local rates in some exchanges, access charges, and privacy listings (non-published and unlisted numbers) rates be considered by GTE-NW for implementing the rate reduction. GTE-NW should, in consultation with Staff and interested parties, make a specific tariff filing for approval by the Commission to become effective not later than six months after the closing of the merger.

Q. IS STAFF PRESENTLY UNDERTAKING AN EARNINGS REVIEW OF GTE-NW?

A. Yes. The review is preliminary in nature. Currently, it appears that GTE-NW is in an overearnings position.

Q. WILL STAFF'S RECOMMENDATION FOR A RATE REDUCTION BE REFLECTED IN THAT EARNINGS REVIEW?

A. Yes. The rate reduction to flow through merger benefits would be treated as an adjustment in the earnings review.

Q. HAS THE COMMISSION HISTORICALLY ORDERED THAT MERGER BENEFITS BE PASSED ON TO RATEPAYERS?

A. Yes. For example, in the PacifiCorp merger, Docket No. U-87-1338-AT, In re PacifiCorp, Second Supplemental Order (July 1988), the Commission required positive benefits to be allocated to Washington ratepayers in the form of rate reductions; these rate reductions could be offset by future cost increases. Further, in the GTE and Contel merger, Docket No. UT-910499, In re GTE Northwest Incorporated and Contel of the Northwest, Inc., Second Supplemental Order (September 1992), the Commission approved a settlement agreement subject to certain conditions including conditions regarding rate reductions and the authorized rate of return for the applicants.

Q. IS STAFF'S RECOMMENDATION IN THIS PROCEEDING CONSISTENT WITH THE THIRD SUPPLEMENTAL ORDER IN DOCKET NO. UE-981627?

A. Yes. In the PacifiCorp merger with Scottish Power, Docket No.UE-981627, In re PacifiCorp and Scottish Power PLC, Third Supplemental Order (April 1999), the Commission recognized that the approach for determining what is in the public interest varies with the form of the transaction and the attending circumstances. It then went on to observe, under the PacifiCorp merger, "there is no merging of utility operating companies which potentially gives rise to operating efficiencies as in prior cases."

By contrast, in the proposed GTE merger, Applicants *have* projected synergies and operating efficiencies resulting from the merger. Staff proposes that these efficiencies be passed on to ratepayers in the form of a rate reduction.

Q. HAVE THE JOINT APPLICANTS AGREED TO FLOW THROUGH MERGER BENEFITS TO RATEPAYERS IN OTHER STATES?

A. Yes. For example, the Joint Applicants filed a proposal in Virginia, Case Number PUA-990100, pledging to extend a Bell Atlantic rate freeze for three years to expand enhanced services to GTE customers, to expand local calling areas which will reduce rates for many customers, and to invest $1.75 billion in infrastructure over the next three years.

In Illinois, in Docket No. 98-0866, Applicants have committed on the record to many specific benefits including the following: (1) GTE will reduce rates by $10.03 million (approximately three percent of intrastate operating revenues) upon merger consummation to account for earnings and merger savings, (2) GTE will file for a general rate case approximately three years after merger closure, (3) the merged entity will aggressively compete to provide local service to Chicago's residential, small, and medium business customers, and (4) the merged entity will spend a minimum of $234 million in infrastructure capital investment in Illinois over the next three years.

Additionally, in Pennsylvania the Attorney General and the Applicants have issued a memorandum of understanding in which the Attorney General's Office would support the merger under certain conditions. These conditions include capping residential rates through the year 2003; that GTE will reduce certain rural residential rates and vertical features by $15 million; that Bell Atlantic will reduce intrastate access charges by an estimated $250 million over the next five years; and that the Applicants agree to invest $2.5 billion in their Pennsylvania phone networks over the next three years.

<u>COST INCREASES</u>

Q. HAS MANAGEMENT OF GTE OR BELL ATLANTIC FORMULATED A PLAN FOR INSULATING RATEPAYERS FROM MERGER COSTS OR COST INCREASES THAT MAY OCCUR AS A RESULT OF THE MERGER?

A. No. Joint Applicants' response to Staff Data Request No. 19 states that Applicants intend to treat costs and cost savings related to the merger according to Generally Accepted Accounting Principles (GAAP). GAAP dictates the accounting treatment and presentation in financial statements of a company's accounting transactions.

Q. DOES THAT PROVIDE ADEQUATE PROTECTION TO RATEPAYERS FROM MERGER RELATED COST INCREASES?

A. No. Taken alone, GAAP will not insulate ratepayers from the effects of merger costs. As an example, when the merger was announced Standard & Poor's rating agency placed its ratings of Bell Atlantic and related entities on Credit Watch with negative implications

(Joint Applicants' response to Staff Data Request No. 16). This action may result in a downgrade of the merged company's bond rating. Under GAAP, any increase in the cost of debt due to a downgrade in the bond ratings of the merged company likely would not be distinguished from other debt cost in its books of account or its financial statements. Thus, additional regulatory scrutiny would be required to ensure that any such increases in debt cost are not reflected in any future cost of capital calculation (and therefore rates) for GTE-NW.

Q. WHAT IS STAFF'S RECOMMENDATION REGARDING COSTS THAT MAY ARISE AS A RESULT OF THE MERGER?

A. Staff recommends that Washington ratepayers be held harmless such that the post-merger costs to Washington customers shall not be higher than they otherwise would have been if the merger had not occurred.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.