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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Joint Application of Bell Atlantic and GTE Corporation for Consent and Approval of a Change in Control.	))))	Case No. 98-1398-TP-AMT

PRELIMINARY INDEPENDENT STAFF PROPOSAL RELATIVE TO THE ISSUES IDENTIFIED BY THE PUBLIC UTILITIES COMMISSION OF OHIO

I. INTRODUCTION

Pursuant to an entry issued by the Public Utilities Commission of Ohio (Commission) on December 22, 1998, as amended by entry issued January 22, 1999, the Staff of the Public Utilities Commission of Ohio (Staff) was directed to analyze and evaluate the application filed in the above captioned case in light of the issues identified by the Commission. Accordingly, the Staff presents this proposal as an independent preliminary analysis of the application, as it now stands before the Commission. This Staff proposal in no way supplants questions or concerns raised by the Commission in its December 22, 1998 entry. The proposal is intended to provide the Commission with assistance in its deliberations of the issues in this case.

The Staff believes the proposed merger of Bell Atlantic Corporation (Bell Atlantic) and GTE Corporation (GTE) (jointly referred to as the Applicants), raises several concerns relative to the issues set forth by the Commission in its entry of December 22, 1998. After a preliminary review of the application and the comments filed in this docket, Staff believes the application, as it currently stands, does not adequately demonstrate how the merger would promote the public convenience. It is important to understand that, for the purposes of this preliminary review, Staff assumed that, in order to promote the public convenience, the merger must do more than hold the public harmless or simply maintain the status quo. Staff believes that, in order to "promote" the public convenience, the public must be better off after the merger than before the merger. Staff believes the application, as it currently stands, does not demonstrate how the public convenience would be better off after the merger. Staff believes that the merger, as announced, creates some potential concerns as to service quality, as well as competition. In order for the merger to promote the public convenience, Staff believes the benefits of the merger must outweigh the potential harms.

Staff has examined the issues set forth by the Commission. Upon our preliminary investigation, Staff believes the concerns raised by the merger can generally be grouped into the issue categories identified by the Commission in its December 22, 1998 entry. Below we have briefly described why Staff believes the proposed merger raises each of the concerns and, generally, what could be done to eliminate or minimize the concerns.

II. PERFORMANCE STANDARDS, MEASUREMENTS, AND REMEDIES FOR OPERATION SUPPORT SYSTEMS AND FACILITIES

The establishment of appropriate performance standards, measurements, and remedies for the provision of operation support systems (OSS) and facilities is crucial to the development of a competitive marketplace. An incumbent local exchange carrier (ILEC) must provision OSS and facilities in an adequate manner, in order to allow for the development of competition.

Staff believes that the provision of OSS and facilities is an area in which an ILEC may very easily engage in anti-competitive behavior. GTE must provide service (*i.e.,* OSS and facilities) at the same level or on parity with the level it provides to itself. Staff is not suggesting that the concerns related to the provision of these services have arisen solely as a result of the proposed merger. However, the provision of OSS and facilities from the ILEC to the new entrant carriers (NECs) are issues that have been and must continue to be addressed appropriately in this proceeding as well as in other forums and proceedings. It is Staff's view that the merger may decrease GTE's incentive to provide OSS and facilities in a non-discriminatory, pro-competitive fashion.

Several NECs have been authorized to provide service in GTE's Ohio service territory; however, it appears that only one such NEC is in operation in GTE's Ohio territory. If the merger is approved, it is reasonable to assume that Bell Atlantic will want to analyze GTE's existing OSS and make changes. Staff is concerned that the merger may result in a corporate decision to standardize the OSS operations. If Bell Atlantic's systems do not operate with the same protocols as the GTE OSS, any carrier currently using GTE's OSS will likely have its service affected as new protocols and standards are put into place and the learning curve is restarted. In addition, depending on the length of time it would take for Bell Atlantic and GTE to review and finalize any potential changes, new NECs starting up operations in GTE's service territory may experience difficulties due to uncertainty with respect to such protocols and standards.

Given the paramount significance of the adequate provision of OSS and facilities, any proposal that might negatively affect the adequacy of such provisioning demands a high level of scrutiny. Staff believes that any approval of the proposed merger must include mandatory OSS and facilities performance standards and measurements that have strict self-actuating remedies for missed standards. The standards, measurements, and remedies must be clearly defined. In order to facilitate the creation of the appropriate and necessary standards, measurements, and remedies, a collaborative effort between the Applicants, NECs, the Staff, and other interested stakeholders should be initiated.

Furthermore, while Staff does not want to create an unnecessary barrier to positive changes in OSS, we believe the Applicants should commit that, in the future, no protocol changes would occur without significant advance notice to and collaboration with the NEC industry. To that end, Staff recommends that the Applicants commit to jointly develop with the NECs a Change Management Process (*e.g.,* the Change Management Process under development in California) which would allow for input from and discussion with interested NECs with respect to changes or enhancements to interfaces. It is imperative that reliable, fully functional, OSS systems be in place for NECs to have a reasonable opportunity to compete.

III. QUALITY OF SERVICE

Staff is concerned that, since a merger would present opportunities to consolidate facilities and resources, it is likely that such consolidation would result in the movement of personnel and resources away from Ohio. Furthermore, Bell Atlantic has not made a commitment to prevent a reduction in GTE employee levels across Ohio. The lack of such a commitment compounds Staff's prior concern that GTE may have had previous reductions in its field technician work force. Staff is also concerned that some employees currently engaged in providing service to GTE's Ohio customers may be redirected to focus on other non-Ohio or non-regulated activities. Staff is concerned about the long-term employee and service levels dedicated to Ohio customers. If the proposed merger were to be approved, Staff believes it is reasonable to assume that the merged companies' operations would become more centralized than they are today. Staff is concerned that the focus on quality of service for GTE's Ohio customers may be further diluted due to the increased breadth of the corporation's business, the increased focus on competitive opportunities over a substantially broader geographic region, and the increased spatial distance between the corporate decision-making and policy organization in another state and the customers in Ohio. Staff is concerned that such a focus may result in a degradation of service quality for GTE's Ohio customers.

Bell Atlantic customers may currently receive a higher quality of service and a broader range of vertical services than do GTE's Ohio customers. The proposed merger presents an opportunity for all Bell Atlantic's service-related policies and practices to have a positive impact on GTE's quality of service in Ohio. However, since Ohio operations would represent such a small portion of the merged company's total operations, the Staff is concerned that the potential for improved service for GTE's Ohio customers may not be actualized. The Applicants should reduce this concern by committing to improve GTE's service quality and range of vertical services in Ohio.

Staff is also concerned that the merged corporation may focus most of its energy on more competitive opportunities to the exclusion of less competitive services. Staff believes that the merger, as it currently stands, may encourage an intensified focus on marketing and competitive business with less of the merged corporation's resources allocated to meeting the service quality needs of those Ohio customers who do not have competitive alternatives.

GTE has a statutory obligation to comply with the Minimum Telephone Service Standards (MTSS) contained in Chapter 4901:1-5 of the Ohio Administrative Code. Accordingly, customers must receive satisfactory service quality and education about their rights under the MTSS. As the application now stands, however, Staff is not convinced that, after the merger, all customers will be guaranteed adequate and equal quality of service. The merged entity may determine that allocating its resources to competitive businesses would result in earnings that, by far, offset any symbolic and/or substantive penalties that might result from not meeting Ohio's MTSS for customers who do not have competitive alternatives.

It is imperative that the Commission continues to protect the captive ratepayers, especially the residential ratepayers, until such time as effective competition can provide protection. For the reasons enumerated above, it is Staff's position that quality of service for GTE's Ohio customers, especially residential customers, and GTE's marketing practices must receive special consideration in any review of the proposed merger. Staff believes that any approval of the proposed merger must include a detailed and thorough long-term plan related to quality of service, including a delineation of unacceptable marketing practices. Specifically, the plan should show how the Applicants would meet and exceed service quality standards for Ohio customers, with special attention to residential customers. Such a plan should also include specific and self-actuating remedies for not meeting service quality benchmark commitments or for engaging in unacceptable marketing practices. If the commitments to service quality and the self-actuating remedies were specific and significant enough, such a plan might serve to minimize service quality concerns raised by the proposed merger.

In addition to the above quality of service issues, Staff is also concerned that the proposed merger still presents a significant potential to harm the development of competition. This, coupled with the likely decline in attention paid to customers who do not have competitive alternatives, outweighs any benefits that the merger, as it is now proposed, might create.

IV. CARRIER-TO-CARRIER

The Staff is concerned that GTE and its affiliates may engage in unequal treatment of these affiliates as compared to non-affiliate carriers. Although this concern exists with or without the merger, the merger significantly increases the concern. Many of the concerns relative to carrier-to-carrier service quality and anti-competitive behavior are similar to the concerns regarding end user quality of service. To diminish the carrier-to-carrier concerns raised by the proposed merger, Staff recommends that the Applicants be required to commit to specific levels of carrier-to-carrier service quality with specific and self-actuating remedies for failures to meet commitments. Carrier-to-carrier service quality levels should meet or exceed the MTSS. This should include immediate compliance with previous Commission orders in Case No. 96-1175-TP-ORD requiring the amendment of interconnection agreements to address all relevant aspects of the carrier-to-carrier relationship, including recourse provisions. Furthermore, to assure that the Applicants provide the same level of service to non-affiliated carriers as the Applicants provide to themselves and their affiliates, Staff believes the Applicants must commit to regular reporting of the service quality levels GTE provides to itself and the NECs. Similarly, Staff believes it is important that the Applicants not provide any interconnection services or UNEs at a level of quality below that which is provided to the Applicants out-of-region.

Staff is concerned that GTE may be reluctant to cooperate in carrier-to-carrier dispute resolutions. This coupled with the knowledge that GTE oftentimes pursues litigation as opposed to more expeditious resolution processes, leads Staff to believe that the merger raises the concern that resolution of disputes after the merger may be difficult. In order to diminish that concern, Staff believes that the Applicants should commit to work with the Staff and the NECs to develop highly specific alternative dispute resolution procedures and the Applicants should commit to pursue the specific alternative dispute resolution processes in good faith and whenever possible. The Applicants should also commit to cooperate fully in informal settlement discussions in order to ensure timely provisioning of services to Ohio consumers.

One way to be more certain that the proposed merger will promote the public convenience is if the merger increases the provision of service by NECs. Increased competition will help balance against any inclination the Applicants would have to concentrate their resources on new competitive business opportunities while allowing captive customers in non-competitive areas to suffer with a lower quality of service. As proposed, Staff believes the merger will enable the Applicants to use the revenues generated from customers who do not have competitive alternatives to advance the Applicants' competitive business ventures without any proportionate benefit to the captive customers. A commitment to immediately provide the current FCC unbundled network elements (UNEs) and combinations of already combined UNEs would be one way to increase the possibility of competition and offset the concerns raised by the proposed merger.

A commitment by the Applicants to provide shared transport, as defined by the Federal Communications Commission (FCC), in a very short time frame may increase the likelihood of near term competition. We also believe that the Applicants could agree to timely provide specific UNE combinations at specific rates, which will increase the likelihood of competition. Providing both shared transport and UNE combinations may help to add significant benefit to the merger.

In Staff's view, if little or competition develops in GTE's Ohio service territory, such a deficiency should be reflected in GTE Ohio's access rates. In its Opinion and Order issued in Case No. 96-336-TP-CSS, the Commission expressed that one of its reasons for continuing the FCC access charge mirroring policy is its belief that the local service market could be a discipline on ILEC access charges. To date, there is no discernable competition in GTE's local service market. In fact, GTE and AT&T only recently received Commission approval for their interconnection agreement. Should competition fail to materialize in GTE's Ohio service territory, GTE should lower certain of its intrastate access charges to an appropriate level.

V. <u>MARKET POWER</u>

Staff believes that an approval of the proposed merger would need to include the appropriate tools to mitigate market power in order to allow the development of effective competition in Ohio and thereby promote the public convenience. This is a merger of the largest Regional Bell Operating Company (RBOC) ILEC with the largest independent

ILEC. Staff is thus concerned that this merger, if approved, would result in an organization that controls over 63 million access lines in the United States.

The GTE Ohio local exchange service area retains most of the characteristics of a monopolistic market. This is certainly true for the residential and small business market. As of the end of November 1998, 99.9925% of the access lines in the GTE's Ohio service area were controlled by GTE North. Staff believes that the merger, as it is currently proposed, will increase GTE North's market power dominance and may present a significant additional barrier to the emerging competitive market. Staff's concern is that GTE and Bell Atlantic are both potential significant participants in each other's markets. Therefore, a merger of Bell Atlantic and GTE would lead to a loss of one potential significant competitive participant in GTE's Ohio service area, and thus, would delay the development of competition in Ohio and increase the variability of benchmarking among the market participants.

Staff takes little comfort in the Applicants' promises of competing for Cleveland and Cincinnati large business customers, particularly when the current market participants attempting to build market share in GTE's Ohio service area appear to be finding market entry difficult even before a proposed merger. A proposed merger would provide GTE North with the additional resources and tools to forestall competition in its service area. Staff is also concerned that the Applicants did not address the steps for developing effective competition in rural Ohio's residential and small business local exchange markets.

Staff is concerned that, post-merger, the NECs will find negotiating with GTE North more difficult than absent the merger due to GTE North's increase in market power. Staff believes that, in order to diminish the serious concerns of increased market power dominance, an approval of the proposed merger must predicate a strategy for developing local exchange service competition to diminish the existing market power. Staff believes that any strategy for diminishing existing market power through elimination of barriers to market entry must address the process, good faith negotiations, customer service to market participants, implementation, compliance, and reporting.

In addition, Staff is of the opinion that any approval of the proposed merger must include a commitment by the Applicants to provide Staff with a test of market power to be applied on a forward-going basis such that the Commission can determine whether GTE North's market power level is maintained, increased, or decreased following the merger, and thereby take any appropriate action in the future. Staff also believes that any approval of the proposed merger should include a clear understanding of what the Applicants would be required to do to address their market power should a post-merger application of the market power test show that GTE North's market power has not decreased or has increased.

Finally, Staff is concerned about the increase in market power that GTE Communications Corporation ("GTECC," formerly known as GTE Card Services, Inc., d/b/a GTE Long Distance) may realize in GTE's Ohio service area as a result of this merger. Specifically, since the GTE affiliates (GTE North and GTECC) will become second tier affiliates of Bell Atlantic, an RBOC under Section 271 of the 1996 Telecommunications Act (Section 271), how do the Applicants intend to address this possible increase in market power that may be realized as a result of this merger.

VI. COST SAVINGS

In the December 22, 1998 entry in this proceeding, the Commission directed all parties to address how the synergies resulting from the merger, combined with the results of GTE's most recent earnings report, will benefit Ohio consumers.

The Staff believes that the proposed merger would provide the Applicants with significant opportunities to achieve economies of scale and scope. The Applicants have forecasted total corporate merger-related synergy benefits of \$2.0 billion in annual operating cost savings, of which \$10.3 million would amass to GTE's Ohio regulated intrastate operations. Additionally, Applicants forecast \$500 million of total corporate capital investment synergies as a result of the merger, of which \$1.1 million approximates the value assigned to GTE Ohio regulated intrastate operations. The Ohio regulated intrastate costs to achieve these synergies is estimated at \$4.8 million of transaction costs incurred in year 1 following the merger, and \$9.1 million of implementation costs incurred over a 3 year period following the merger.

The Staff believes the recent operational results of GTE on an Ohio regulated intrastate basis indicates that, even absent the merger, the financial ability of GTE to undertake annual Ohio regulatory commitments of approximately $69.9 million without adversely impacting GTE's financial condition. Should the merger be approved and the estimated cost savings above be realized, the Staff estimates that the company could support approximately $80 million toward its Ohio regulatory commitments per year.

Given the economies of scale and scope resulting from the merger, the Staff does not believe the Applicants have sufficiently demonstrated in terms of service value added commitments how Ohio consumers would benefit from the merger. GTE's recent strong financial performance, combined with estimated merger savings, demonstrates that the company has resources to provide infrastructure commitments and customer benefits (*e.g.*, price reductions, and service quality and enhancements) while still maintaining its financial viability. Within this document, the Staff identifies numerous opportunities for the Applicants to ensure that Ohio consumers share in the combined savings and earnings benefits anticipated from the proposed merger.

VII. INFRASTRUCTURE

The proposed merger presents some concerns to Staff regarding GTE North's public switched network. Staff's first concern is that the merged entity will begin to allocate resources to infrastructure investments outside of Ohio that might have been invested in Ohio had the merger not taken place. Historically, GTE has been slow in replacing antiquated plant with modernized inside and outside plant and in sufficiently maintaining its outside plant facilities. Staff is concerned that a merger may exacerbate GTE's historical delays of infrastructure investment. The second concern is that the merged entity will begin to focus its resources on its competitive ventures to the detriment of its captive customers, by maintaining a state-of-the-art network for the customers with competitive alternatives while allowing the network and services of the captive customers to fall into a second-class status. Staff is especially concerned given the fact that GTE North serves mostly Ohio's rural communities, which traditionally have been the last to receive network upgrades and competitive alternatives, and, as a result, GTE lacks an incentive for upgrading its network to provide advanced features and services. Underlying both of the above issues is our pre-existing concern that GTE North has not historically provided or maintained a state-of-the-art network for its Ohio customers and has only recently begun to make commitments to do so.

Staff believes that, in order to eliminate our infrastructure investment concerns, the Applicants must commit to modernizing and maintaining their Ohio facilities and plant to a level sufficient to meet the demands of the 21st century. In addition, the Applicants must adequately forecast the facilities needs for their Ohio customers in order to provide a high level of service quality and reliability. Any approval of the proposed merger would have to include requirements that the Applicants maintain GTE's Ohio network and provide services at the same level to their captive customers as they provide to customers with competitive alternatives whether or not those customers are in Ohio. Plant and facility investment and maintenance benchmarks should be established for GTE in Ohio. Any approval of the proposed merger should also establish clear reporting of GTE's performance against such benchmarks. The Applicants should also be required to provide Staff with a periodic report of network enhancements and technological innovations that have been implemented wherever they offer service. Ohio should be guaranteed that these infrastructure investments and innovations will be deployed and delivered to Ohio's customers as they are being deployed and delivered in other states.

VIII. IN-STATE PRESENCE

The Applicants have made no commitments to the Commission regarding the maintenance of GTE North employment levels or the maintaining of their business offices and regulatory affairs headquarters in Ohio. In order to eliminate the concerns raised by the merger relative to the local management issues, Staff believes that the Applicants should commit to maintain or increase the current GTE North employment levels in Ohio, the positions responsible for providing customer service, the number of GTE North business offices, GTE North's regulatory headquarters, and a substantial management force in Ohio with decision-making authority on the local and state level.

Staff assumes that the proposed merger will result in a consolidation of the Applicants' resources, the movement of decision-making, business practices, and regulatory affairs away from Ohio, and intensified refocusing of the Applicants' attention toward new competitive business opportunities. As these factors could result in eroded quality of service for customers, so too, are these factors likely to result in concerns for how and how much the Applicants would invest their resources in Ohio. The issue of tracking dollars would become an even more difficult and complex process than it is today. To minimize these merger-related concerns and ensure that Ohio receives a fair allocation of the Applicants' investment dollars in an environment in which pressures may exist for it not to do so, Staff believes that any approval of the proposed merger must include a requirement for the Applicants to determine their earnings and investments on a per access line and customer class basis in Ohio. This figure should then be compared to the earnings and investments on a per access line and customer class basis in all of the other states being served by the merged corporation. Ohio should be guaranteed that in-state financial investments would be, at a minimum, proportionate to Ohio's contribution to the corporation's earnings based on this formula.

Finally, if the merged corporation were to reallocate its resources to its competitive business opportunities and the focus on Ohio's captive customers became diluted by the broadened scope of corporate interests, it is likely that there would be an erosion of GTE Ohio's concern for non-telephone households in GTE's Ohio service territory. Any approval of the proposed merger should include a requirement for the Applicants to perform a series of studies to determine the various causes of non-telephone households in GTE's Ohio territory. This research should be conducted under the guidance and review of the Staff and the Commission. The studies should offer concrete conclusions as to the causes of non-telephone households in GTE's Ohio territory. The Applicants should also commit to specific short-term and long-term, detailed plans to address these problems. The Applicants should identify practices and policies that they will implement over a specific period of time and under Commission review for decreasing the number of non-telephone households in GTE's Ohio territory.

IX. BOOKS AND RECORDS

The proposed merger, along with an increase in competition in the telecommunications industry, would create additional affiliated entities for GTE under the new holding company. Staff believes these new affiliates would create an increased potential for inappropriate cross-subsidization, as well as potential anti-competitive activities such as sharing of customer information and inside information. In order to verify that this is not occurring, Staff believes that, to receive approval of the proposed merger, the Applicants would need to agree to make available to Staff, all books and records of GTE, the holding company, and all affiliates as determined relevant by the Staff in order to meet its regulatory responsibilities.

In addition, if the books and records can not reasonably be made available in Ohio, the Applicants should agree, upon request of Staff, to reimburse the Commission for any expenses incurred in examining the books and records that would not have been incurred if the books and records were located in Ohio.

X. AFFILIATES

The merged entity's competitive telecommunication service (CTS) provider affiliates should abide by the Commission's separate affiliate requirements, as well as any other restrictions set forth in the Commission's order in the GTECC certification docket Case

No. 96-252-CT-ACE (96-252). These affiliates include GTECC, Bell Atlantic Communications, Inc. (BACI), NYNEX Long Distance Company (NYNEX), and GTE Telecommunications Services Incorporated (GTE TSI).

GTECC's certificate to provide long distance service in Ohio was granted contingent upon GTECC's compliance with the separate affiliate requirements of Case No. 86-563-TP-COI (563) and a joint marketing prohibition with GTE North. In its Finding and Order issued December 3, 1997 in 96-252, the Commission emphasized that GTECC and GTE North, "will continue to be prohibited from jointly marketing their services at least until GTE North provides a minimum level of support to allow new local carriers to provide service in GTE North's territory." To date, none of the restrictions have been lifted by the Commission.

Bell Atlantic's affiliated CTS providers, BACI and NYNEX were not originally required to abide by the Commission's 563 separate affiliate requirements because, at the time of certification, these CTS providers were not affiliated with any ILEC providing service in Ohio. However, if the proposed merger were approved, Staff believes that BACI and NYNEX, as affiliates of the merged entity providing local service in Ohio, should be subject to the same requirements and restrictions as GTECC, until such time as the Commission lifts the restrictions from GTECC.

RESPECTFULLY SUBMITTED,

On Behalf of the Staff of the Public Utilities Commission of Ohio

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing **PRELIMINARY INDEPENDENT STAFF PROPOSAL RELATIVE TO THE ISSUES IDENTIFIED BY THE PUBLIC UTILITIES COMMISSION OF OHIO** was served by regular U.S. mail, postage prepaid on each party of record, this 22nd day of February, 1999.

Steven T. Nourse