MCI WORLDCOM

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ORIGINAL

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February 15, 1999

VIA HAND DELIVERY

Ms. Blanca S. Bayo
Director, Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Undocketed Commission Workshop Regarding the Transaction between GTE Corporation and Bell Atlantic Corporation, whereby GTE will become a wholly-owned subsidiary of Bell Atlantic

Dear Ms. Bayo:

Enclosed are an original and fifteen copies of MCIWorldCom's comments for the workshop in the above-referenced matter.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me.

Sincerely,

Donna L. Canzano

Donna L. Canzano

Enclosures

ACK ____
AFA 1
APP ____
CAF ____
CMU ____
CTR ____
EAG ____
LEG 2
LIN 5
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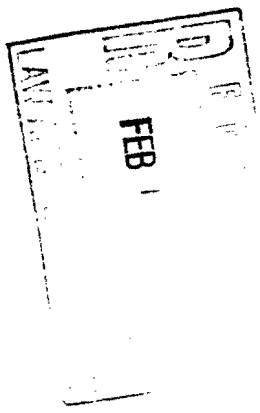
Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of GTE Corporation, Transferor and Bell Atlantic Corporation, Transferee For Consent to Transfer of Control	)))	CC Docket No. 98-184



REPLY COMMENTS OF MCI WORLDCOM, INC.

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Dated: December 23, 1998

MCI WORLDCOM, Inc. ("MCI WorldCom") hereby submits its reply comments opposing the joint application of Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") for approval of their proposed merger.

The overwhelming majority of those commenting on the proposed Bell Atlantic-GTE merger oppose it because they recognize that the merger would produce the worst of both worlds: no more competition out-of-region than would occur without the merger, and substantially less competition in-region. The public interest is not served by enabling Bell Atlantic and GTE to become even more successful in thwarting local exchange competition than they have been over the past several years. Nor is the public interest served by eliminating competition between GTE, with long-standing premerger plans to compete against Bell Atlantic, and Bell Atlantic, which now takes the position that it needs to compete out-of-region in order to survive.

The union of two large monopolists that collectively control over one-third of the nation's access lines is enough in itself to require careful examination in the current environment of no competition. AT&T Petition to Deny 8-12;[1] Sprint Petition to Deny 27-31; Level 3 Comments 2-3; Focal Comments 2-3; Consumer Federation of America and Consumers Union ("CFA/CU") Comments 1. CLECs like MCI WorldCom — with substantial money on the line and facing determined opposition to get into local phone service — all report a deeply disturbing pattern of obstructionism on the part of Bell Atlantic and GTE to prevent local exchange competition from developing. *See* MCI WorldCom Comments 6 -13. Commenters highlight that Bell Atlantic has openly defied the Commission's order imposing conditions to ameliorate the anticompetitive effects of the Bell Atlantic-NYNEX merger, going so far as to deny the Commission's authority

[1]Comments and petitions to deny are cited by the name of the party that filed them.

to enforce the order that Bell Atlantic encouraged it to adopt. AT&T Petition to Deny 52-55; Sprint Petition to Deny 85-91; Level 3 Comments 13; e.spire Comments 7; Hyperion Comments 17; MCI WorldCom Comments 7-11.

Most commenters note that the alleged raison d'être of the merger — that Bell Atlantic needs GTE as an "enabler" and that GTE needs Bell Atlantic's "anchor customers" in order to permit either to compete to provide local phone service out-of-region — is absurd. Many commenters point to GTE's widely publicized plans to compete out-of-region prior to announcement of its merger with Bell Atlantic and its effective positioning to do just that. Level 3 Comments 17; Sprint Petition to Deny 59-68; AT&T Petition to Deny 44-52; Focal Comments 14-16; MCI WorldCom Comments 16-20. GTE's existing national customer base as an Internet service provider ("ISP") and also as a long-distance carrier increases both its ability and its incentive to pursue on its own a national strategy to provide a bundle of local, long distance, and Internet services. MCI WorldCom Comments 18. Commenters explain GTE's actual plans to compete against Bell Atlantic. Sprint Petition to Deny 14-20; e.spire Comments 5; AT&T Petition to Deny 26-29; MCI WorldCom Comments 22-24.

As for Bell Atlantic, commenters recognize that the "enabler" theory is a sham. If Bell Atlantic truly wishes to compete out-of region, it can do so on its own. Bell Atlantic has huge resources that would enable it to implement a strategy that it considers vital to its survival. AT&T Petition to Deny 8-12; Level 3 Comments 10; Focal Comments 10, 14-16; MCI WorldCom Comments 20-21. The fact that Bell Atlantic has not done so to date is not a reason to approve this merger; on the contrary, it raises questions whether Bell Atlantic is indeed serious about competing out-of-region even after the merger. In short, Bell Atlantic's ability and incentive to compete out-of region would not change if the merger were consummated.

All of these factors demonstrate that the Commission must carefully examine whether this merger will eliminate a significant potential competitor in Bell Atlantic's region, as well as eliminate a significant potential competitor in GTE's region. That is the principal reason why it is critical for the Commission and interested parties to have access to Bell Atlantic's and GTE's relevant documents. MCI WorldCom Comments 58-60.

Commenters also note the obvious negative effect this merger will have on the ability of regulators and competitors to benchmark. Sprint Petition to Deny 40-55; AT&T Petition to Deny 20-22; MCI WorldCom Comments 32-37. The purpose of benchmarking is to compare the performance of incumbent local exchange carriers ("ILECs") and make it possible to measure whether ILECs are doing what can be done to open their local markets to competition — and whether they are providing monopoly services including exchange access on reasonable and nondiscriminatory terms. If the SBC-Ameritech merger is allowed to proceed along with the Bell Atlantic-GTE merger, the number of major ILECs available to benchmark will be reduced to four. In the current environment, with no meaningful local exchange competition anywhere, a reduction in the ability to benchmark would be a serious blow to efforts to pry open local phone markets everywhere.

No commenter seriously disputes that GTE will have to immediately cease providing any interLATA telecommunications and information services in all Bell Atlantic states where Bell Atlantic lacks section 271 authority. Commenters agree with MCI WorldCom that the Commission should immediately disabuse Bell Atlantic of any belief that "transitional relief" might be available in lieu of full compliance with the requirements of section 271. AT&T Petition to Deny 36-41; e.spire Comments 6; MCI WorldCom Comments 52-58. To permit Bell Atlantic to believe otherwise would defeat the critical market-opening incentives created by

section 271, and would be directly contrary to the Commission's recent order approving the SBC-SNET merger, requiring SNET to cease originating all interLATA traffic in SBC's region.[2] For every state in which Bell Atlantic does not have section 271 authority, GTE would have to divest all of its interLATA business in that state, including any interLATA information service provided by or through GTE Internetworking.

No commenter disputes MCI WorldCom's showing that the merger would threaten the vibrant competition that exists today in Internet services by giving Bell Atlantic and GTE bottleneck control over access by and to one-third of residential and business customers that use the Internet. MCI WorldCom Comments 39-52. This snowball effect would be triggered if the merged company gains a disproportionate share of Internet traffic by continuing to abuse bottleneck control over high-bandwidth xDSL services to residential and small business Internet users, and by imposing inflated access charges on Internet traffic. *Id.* 41-52. If permitted to become through merger and bottleneck control a dominant ISP, Bell Atlantic-GTE would be able to exert power over Internet content providers and advertisers.[3] For example, Bell Atlantic-GTE would control the first screen that it displays on the "portal" to which it steers its captive customers, and content providers and advertisers that want to be featured on that screen would have to do business with Bell Atlantic-GTE on its terms. In sum, the threat posed by the

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[2] *In re Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor, to SBC Communications, Inc., Transferee*, Memorandum Opinion and Order, ¶ 36, CC Docket No. 98-25, FCC 98-276 (rel. Oct. 23, 1998).

[3] Moreover, MCI WorldCom believes that Bell Atlantic's current provision of Internet services is unlawful, in violation of sections 271 and 272 of the Act. *See* MCI WorldCom Comments 57 (citing MFS Communications Company's Petition for Reconsideration, *In the Matter of Bell Atlantic Telephone Companies Offer of Comparably Efficient Interconnection to Providers of Enhanced Internet Access Services*, CCBPol 96-09 (filed July 3, 1996)).

proposed SBC-Ameritech and Bell Atlantic-GTE mergers, singly and in combination, deserves the Commission's serious attention.

The few commenters that support the merger (mainly a few large business customers of Bell Atlantic, the Communications Workers of America, and the Competitive Enterprise Institute) have not undertaken a complete analysis of the merger's competitive impact and therefore fail to justify Commission approval. This is made all the more clear by the overwhelming opposition to the merger of parties who represent the interests of residential and small business customers. *See generally* CFA/CU Comments; New Jersey Coalition Comments; Consumer Groups Comments (representing 14 consumer groups in 13 states). They oppose the merger because they already realize that this merger offers them nothing — a fact that the few large business customers who now support the merger will come to recognize in time.

The application of Bell Atlantic and GTE should be denied. If the Commission decides to consider granting the application subject to conditions, it should seek public comments on specific potential pre-conditions before reaching any conclusion.

Respectfully submitted,

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Dated: December 23, 1998

CERTIFICATE OF SERVICE

I, R. Dale Dixon, Jr., do hereby certify that on this 23rd day of December, 1998, I served by first-class United States mail, postage paid, a true copy of the forgoing Reply Comments upon the following:

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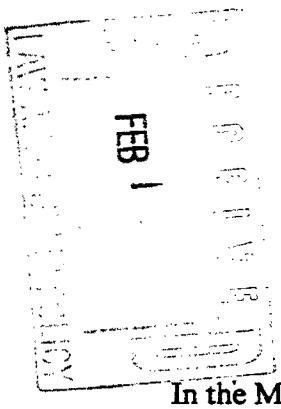

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Dated: November 23, 1998

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EXECUTIVE SUMMARY

As the third anniversary of passage of the Telecommunications Act of 1996 approaches, two more incumbent local exchange carriers ("ILECs") come to the Commission promising to "unleash" and "jumpstart" local competition and "attack other Bell company strongholds" across the country, but if, *and only if*, they are permitted to combine the monopoly regimes that each has spent the last three years doing anything and everything to preserve. Application for Transfer of Control, at 6-7 ("BA-GTE Appl."). In many ways a carbon copy of SBC's and Ameritech's application, Bell Atlantic's and GTE's pitch contradicts their words and actions before they announced their merger.

GTE has stated publicly for over a year that it intends to compete vigorously in out-of-region local markets against the Bell Operating Companies ("BOCs"). When seeking to merge with MCI in October 1997, it emphasized its ongoing "effort to attack and compete with the RBOCs in their service areas." Letter from Charles Lee, GTE, to Bert C. Roberts, Jr., MCI, at 2-3 (Oct. 15, 1997) (attached hereto as Ex. 11). Before announcing the merger with Bell Atlantic, GTE certainly was not telling its shareholders or the public that it lacked the scale or scope to execute these plans, for example, by offering local service to the myriad customers in Bell Atlantic's region to which it provides Internet service over its interLATA network. To the contrary, it offered sworn testimony that it would soon provide local service in competition with Bell Atlantic in West Virginia even though it has no monopoly local franchise in that state.

It comes as more of a surprise that Bell Atlantic now discerns a corporate imperative to compete-out-of-region. Heretofore, Bell Atlantic made no effort to compete out-of-region at all, honoring the apparent non-aggression pact among the BOCs. Just two years ago, Bell Atlantic assured the Commission that it never even seriously considered crossing the Hudson River to

compete in the other parts of the New York metropolitan area. That is in sharp contrast to the "broad-scale attack on the local markets of the other RBOCs across the country" that Bell Atlantic now sees as critical to its future. BA-GTE Appl. 6.

The notion that Bell Atlantic or GTE is by itself each too small, too poor, and too insular to compete as a new entrant in local markets across the country is ludicrous. Bell Atlantic and GTE can do precisely what CLECs like MCI WorldCom are doing without the benefit of monopoly-generated profits — put its money where its mouth is by investing billions of dollars to pry open the local markets dominated by incumbent monopolists. Combining Bell Atlantic and GTE does not enable them to do anything out-of-region that they could not do independently, and the merger is essentially irrelevant to the likelihood that Bell Atlantic and GTE will compete outside their current regions.

Lacking any real upside, the Bell Atlantic-GTE merger presents a huge downside to consumers because it will reduce local competition in their regions. The effect, if not the intent, of the proposed merger would be to raise the barriers to local competition within Bell Atlantic's and GTE's regions by consolidating their monopolies. A Bell Atlantic-GTE monopoly would control over one-third of the nation's local lines. The merger would permit Bell Atlantic and GTE immediately to provide facilities-based local service at a higher percentage of locations of large businesses without any additional investment or reliance on out-of-region ILECs. This would increase GTE's and Bell Atlantic's advantage over CLECs that must undertake the lengthy and expensive process of building out their networks to many of these diverse locations and that depend on the ILEC to reach the rest. Thus, Bell Atlantic and GTE seek to lock up the business of Bell Atlantic's "legion of anchor customers." *See* BA-GTE Appl. 7. Equally important, as

explained above, the merger would eliminate GTE as a significant entrant into local markets in Bell Atlantic's region, and vice versa.

The merger would also significantly reduce the ability of regulators, and competitors, to benchmark the performance of GTE and Bell Atlantic. The elimination of yet another large ILEC through merger would mean that there will be fewer points of comparison among major ILECs. The end result may be the worst of both worlds, with Bell Atlantic-GTE selecting the lowest common denominator in those instances where Bell Atlantic and GTE currently have different policies or practices and one is more competition-friendly than the other.

Of course, another immediate impact of the merger would be that GTE would have to stop offering interLATA telecommunications and information services to customers in each Bell Atlantic state (including, but not limited to, Pennsylvania and Virginia) where Bell Atlantic lacks section 271 authority. The Commission should immediately disabuse Bell Atlantic of the idea that it might obtain "transitional relief" from the requirements of section 271. To allow Bell Atlantic to provide interLATA service through an affiliate without satisfying these requirements would remove Bell Atlantic's incentive under section 271 to open up its local markets to competition. Moreover, because the merged entity would control both ends of a higher percentage of interLATA calls, the merger would exacerbate the anticompetitive effects of Bell Atlantic's provision of in-region interLATA services through an affiliate while it still monopolizes local exchange and exchange access services.

Equally important, the Commission should carefully examine the consequences for competition in Internet services if this merger is allowed to proceed. ILECs have bottleneck control over the initial link between Internet users and the Internet — the local loop. The ILECs are leveraging their monopoly control into the Internet by tying their xDSL and Internet services,

and by attempting to extend to Internet services the current regime of inflated access charges. Even if ILECs do not receive the regulatory concessions that they are seeking in the section 706 proceedings, the limited availability of xDSL-capable loops and collocation on reasonable and nondiscriminatory terms frustrates widespread competition to provide xDSL services, especially to residential and small business customers.

The merger would give Bell Atlantic and GTE control over access to one-third of all Internet customers in the United States — the same as a combined SBC-Ameritech and more than any other company. As xDSL services become a predominant method of providing access to the Internet, Bell Atlantic's and GTE's continuing monopoly control over xDSL services, as well as over other local services used to access the Internet, would enable them to achieve significant power over Internet services. The existing size and scope of GTE Internetworking would bring Bell Atlantic-GTE even closer to a dominant Internet position. Bell Atlantic-GTE's power over a substantial and disproportionate percentage of Internet customers may give it, especially along with a merged SBC-Ameritech, the critical mass that would permit it to tip Internet competition in its favor.

Both independently and collectively, the two pending BOC mega-mergers — Bell Atlantic-GTE and SBC-Ameritech — are not in the public interest. The Commission should deny each application based on individualized review. The Commission should also analyze the relationship between these two mega-mergers and consider the cumulative adverse impact on competition if both were approved. If the SBC-Ameritech merger were permitted to proceed along with the Bell Atlantic-GTE merger, the two resulting companies could together dominate the provision of local telephone service — and possibly bundled local, long-distance, wireless, and Internet service. When it approved the Bell Atlantic-NYNEX merger, the Commission made

clear that at some point it would draw the line against further consolidation of the remaining ILECs. The Commission should draw the line here.

Finally, given the fact that both Bell Atlantic and GTE insist that it is in their corporate interests to compete against other incumbent local monopolists, the facial implausibility of their claim that each is too puny without the merger to compete out-of-region domestically (but not internationally), their existing competition to provide Internet services, and Bell Atlantic's failure in connection with the NYNEX merger to forthrightly present its plans to the Commission, the Commission should investigate the likelihood and scope of actual and potential competition between Bell Atlantic and GTE if they do not merge. As it did in its investigation of the Bell Atlantic-NYNEX merger, the Commission should examine, and make available on a confidential basis to interested parties, the relevant documents that Bell Atlantic and GTE are submitting to the Department of Justice and that relate to the competitive issues at the heart of this merger.

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and Bell Atlantic Corporation, Transferee	)	CC Docket No. 98-184
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COMMENTS OF MCI WORLDCOM, INC.

MCI WORLDCOM, Inc. ("MCI WorldCom") hereby submits its comments opposing the joint application of Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE") for approval of their proposed merger.

I. BELL ATLANTIC AND GTE HAVE THE BURDEN TO PROVE THAT THEIR PROPOSED MERGER WILL ENHANCE COMPETITION IN AFFECTED MARKETS.

Under its now well-established standards for merger reviews, the Commission must determine whether Bell Atlantic and GTE have carried their burden to prove by a preponderance of the evidence that their merger would affirmatively serve the public interest.[1/] The competitive

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1/ *See In re Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor to SBC Communications, Inc., Transferee*, Memorandum Opinion and Order, CC Docket No. 98-25, FCC 98-276, ¶ 13 (rel. Oct.23, 1998) (*"SBC-SNET Order"*); *In re Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, Memorandum Opinion and Order, CC Docket No. 97-211, FCC 98-225, ¶¶ 8, 10 (rel. Sep. 14, 1998) (*"MCI-WorldCom Order"*); *In re Application of Teleport Communications Group Inc., Transferor, and AT&T Corp., Transferee For Consent to Transfer Control of Corporations Holding Point-to-Point Microwave Licenses and Authorizations to Provide International Facilities Based and Resold Communications Services*, Memorandum Opinion and Order, 12 Communications Reg. (P&F) 1095, ¶ 11 (1998); *In re Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation, Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, Memorandum Opinion and Order, 12 F.C.C.R. 19985, ¶¶ 29-36 (1997) (*"BA-NYNEX Order"*).

issues presented by the proposed merger are at the heart of the Commission's analysis. The public interest standard includes "the implementation of Congress' pro-competitive, de-regulatory national policy framework designed to . . . open[] all telecommunications markets to competition." *MCI-WorldCom Order* ¶ 9 (internal quotations omitted). "In order to find that a merger is in the public interest, [the Commission] must, for example, be convinced that it will enhance competition." *BA-NYNEX Order* ¶ 2.

The Commission also "shares jurisdiction with DOJ under sections 7 and 11 of the Clayton Act to disapprove acquisitions of common carriers." *MCI-WorldCom Order* ¶ 8 n.23 (internal quotations omitted). Section 7 of the Clayton Act is a flexible and powerful weapon against anti-competitive mergers in evolving markets. It prohibits mergers whenever there is a reasonable probability that there would be less competition in a given market after a proposed merger than there would be if the merger did not occur. It "requires not merely an appraisal of the immediate impact of the merger upon competition, but a prediction of its impact upon competitive conditions in the future." *United States v. Philadelphia National Bank*, 374 U.S. 321, 362 (1963). Section 7 is intended to prevent not only the last in a series of mergers that results in actual monopoly, but to stop in its incipiency a cumulative process the ultimate result of which may be a significant reduction in the vigor of competition. *Brown Shoe Co. v. United States*, 370 U.S. 294, 317-18 (1962); *United States v. E.I. du Pont de Nemours & Co.*, 353 U.S. 586, 589 (1957).

The Commission's competitive inquiry is primarily concerned not with the status of competition now, but rather with the effect of the merger on competition in the future. With respect to the local market, the question is not whether the proposed merger will make local markets less competitive (after all, they could not be significantly less competitive than they are

now), but whether it will help bring competition to those markets or stand in the way of those markets becoming more competitive.[2/]

Bell Atlantic and GTE do not address the potential effect of the merger on competition for Internet services. With respect to the Internet business, the question is whether, considered in the context of all relevant developments including other proposed and potential mergers among major incumbent local exchange carriers ("ILECs"), the proposed Bell Atlantic-GTE merger will reduce currently robust competition among Internet service providers ("ISPs"). That inquiry must be informed by the size and reach of GTE Internetworking and its established base of customers inside and outside Bell Atlantic's region.

Despite the overwhelming precedent that the Commission has authority to review all salient aspects of their merger, Bell Atlantic and GTE have questioned the jurisdiction of the Commission to review at least certain aspects of the merger. *See* BA-GTE Appl. 25 n.21. Bell Atlantic-GTE's three arguments in a three-sentence footnote are groundless.

First, the limitation of the Commission's jurisdiction in section 2(b) of the Communications Act, 47 U.S.C. § 152(b) with respect to intrastate services does not in any way circumscribe the Commission's review of this merger. The Commission already rejected the contrary contention when it thoroughly examined the impact of the Bell Atlantic-NYNEX merger on local competition. *See BA-NYNEX Order* ¶ 35. Even under the Eighth Circuit's relatively

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2/ Bell Atlantic and GTE attempt to limit the Commission's focus to the effect of the merger on competition in the market for local services exclusively in Pennsylvania and Virginia. *See* BA-GTE Appl. 25-26 & n.22 (arguing that the "only areas warranting separate discussion are those where Bell Atlantic and GTE have nearby service areas"). There is simply no factual or legal basis for such a limitation. GTE has pre-existing, pre-merger plans to vigorously compete against Bell Atlantic, and Bell Atlantic apparently now considers out-of-region competition vital to its survival. The Commission must examine all geographic local markets where GTE and Bell Atlantic would potentially compete against one another.

restrictive view of the Commission's jurisdiction with respect to the local competition provisions of the Telecommunications Act of 1996, the Commission has authority over some aspects of intrastate service, including the interconnection and unbundling requirements of section 252(c), *Iowa Utilities Board v. FCC*, 120 F.3d 753, 794 (8th Cir. 1997), *cert. granted sub nom. AT&T Corp. v. Iowa Utilities. Bd.*, 118 S. Ct. 879 (1998), so the Commission can and should evaluate the likely effect of the merger on these methods of local competition. In any event, it would not be in the public interest to approve a merger that would reduce local competition, and the broad and expansive scope of the Commission's public interest inquiry under sections 214 and 301 is beyond dispute. *See In re Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, To Provide In-Region, InterLATA Services in Michigan*, Memorandum Opinion and Order, 12 F.C.C.R. 20543, ¶ 384 & n.990 (1997) (citing cases holding that public interest standard is expansive). Furthermore, "when local services are inseparable from or substantially affect interstate communications, FCC jurisdiction extends into the intrastate realm." *Alascom, Inc. v. FCC*, 727 F.2d 1212, 1220 n.30 (D.C. Cir. 1984). Less competition to provide local exchange and exchange access services, including switched exchange access services, would undeniably "substantially affect interstate communications," and one of the asserted purposes of this merger is to permit Bell Atlantic-GTE to offer bundled local and long distance service at the locations of its large business customers across the country. *Id.* In addition, competition to provide xDSL services directly affects competition to provide interstate information services. *See* Part III.A below.[3/]

3/ Bell Atlantic and GTE do not dispute the Commission's jurisdiction to consider the effect of their proposed merger on competition to provide Internet services, and in any event, the Commission has already found that it does have jurisdiction to consider this issue. *MCI-WorldCom Order* ¶ 142.

Bell Atlantic and GTE provide no citation or support for their second argument that the Commission's "authority to review a transfer of licenses or certificates is properly limited to assessing the interstate uses of those particular licenses or certificates, and does not extend to other aspects of the merger." BA-GTE Appl. 25 n.21. Nothing in the language of section 214, which deals with certificates of public convenience, limits the Commission to consideration of interstate uses of those licenses, and as explained above, the public interest standard is expansive.

Bell Atlantic and GTE also argue that paragraph four of section 7 of the Clayton Act, 15 U.S.C. § 18, exempts situations where "one common carrier extends its lines by acquiring another common carrier, as long as 'there is no substantial competition between' the two carriers overall." *Id.* (citation omitted). The issue is irrelevant because the Commission has plenary review authority under the Communications Act independent of its Clayton Act authority. *See BA-NYNEX Order* ¶ *35* (noting disagreement with Bell Atlantic's Clayton Act arguments but declining to address them). In any event, whether or not section 7 covers situations of potential as well as actual competition, Bell Atlantic and GTE's reliance on this section of the Clayton Act merely begs the question of whether there is substantial competition between the parties, a determination that is clearly within the jurisdiction of the Commission. *Navajo Terminals, Inc. v. United States*, 620 F.2d 594, 601 (7th Cir. 1979), cited by Bell Atlantic and GTE and the only case discussing the portion of the Clayton Act upon which Bell Atlantic and GTE rely, established this point when it held that the Interstate Commerce Commission must analyze whether competition between two common carriers could be said to be substantial.

II. CREATION OF A MEGA-BOC SERVING ONE-THIRD OF THE NATION'S ACCESS LINES WOULD MAKE COMPETITIVE ENTRY INTO LOCAL MARKETS EVEN MORE DIFFICULT.

By any objective measure, Bell Atlantic and GTE have monopoly control over local exchange access in their respective regions, and have effectively thwarted local exchange competition in their own regions for more than 2½ years. With this merger, they present a plan to the Commission that would allow them to keep that monopoly for years to come. Their plan to use GTE as an "enabler" for Bell Atlantic's out-of-region strategy is primarily a limited plan to serve the peripheral offices of Bell Atlantic's large business customers. Especially when considered in conjunction with the proposed SBC-Ameritech merger, it is clear that this merger will reduce local competition in numerous substantial ways.

A. Bell Atlantic and GTE retain monopoly control over local exchange access and have frustrated the opening of their markets to competition.

That local competition is in its infancy in the regions controlled by Bell Atlantic and GTE is beyond reasonable dispute. *See* Declaration of Kenneth C. Baseman and A. Daniel Kelley ¶¶ 17 - 20 (attached hereto as Ex. 1) ("Baseman-Kelley Decl."). The Commission recently found that "incumbent LECs continue to dominate the market for local exchange and exchange access service to business customers" and that in many places, "the incumbent LEC's market share is or approaches 100 percent." *MCI-WorldCom Order* ¶¶ 172, 168. Bell Atlantic has not been granted section 271 authority to offer in-region long distance service because it cannot come close to demonstrating to the Commission that its local exchange markets are open to competition. GTE has fought tooth and nail to prevent any CLEC from offering competitive local exchange in its monopoly region.

Bell Atlantic's failure to comply with the conditions imposed by the Commission in connection with its merger with NYNEX is clear evidence that it cannot be trusted to permit local competition to take root in its region. The Commission's order in Bell Atlantic-NYNEX set forth multiple conditions to be complied with subsequent to the merger. *See BA-NYNEX Order* ¶¶ 180-191, Appendices C & D. The purpose of the conditions was to counteract the numerous means identified by the Commission through which the proposed merger could impair competition and harm the public interest. *Id.* ¶¶ 37-156. These conditions relate to the provision of performance monitoring reports, Operations Support Systems ("OSS"), establishment of performance standards, and the price of interconnection, unbundled elements, and collocation. *See generally Id.* Appendices C-D. Several of these conditions had been suggested by Bell Atlantic itself in *ex parte* filings with the Commission. *Id.* ¶ 178. The conditions became effective upon release of the Commission's order in August 1997 and were scheduled to sunset in 48 months.

Ever since completion of its merger with NYNEX, Bell Atlantic has openly ignored the conditions imposed on it by the Commission and has been determined to "run out the clock" on the 48-month period of compliance.[4/] One particularly egregious example is with respect to forward-looking, economic cost-based pricing. The Commission's order is unequivocal: Bell Atlantic must offer rates "for interconnection, transport and termination, or unbundled network elements, including both recurring and non-recurring charges" at "the forward-looking, economic cost to provide those items." *BA-NYNEX Order*, Appendix C, Condition 6. The Commission

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4/ The problems described in these comments (and addressed in the complaints now pending before the Commission) are not the only ways in which the Bell Atlantic-NYNEX merger conditions have failed to work as the Commission had hoped. MCI WorldCom also encountered problems in other areas, including with non-recurring charges where Bell Atlantic has inflated the amounts billed under the recurring payment option. Of course, the failure to date of major aspects of the Bell Atlantic merger conditions does *not* mean that the Commission should abandon its efforts to enforce these conditions and make them as effective as possible.

made clear that this meant that Bell Atlantic's rates must correspond to the Total Element Long Run Increment Cost ("TELRIC") costing methodology set out in its local competition and universal service decisions. *Id.* ¶ 185 n.345. And Bell Atlantic was required to "negotiate supplements or amendments to existing interconnection agreements where necessary" in order to ensure that pricing was set at forward-looking, economic cost-based rates. *Id.* Appendix C, Condition 9.

Bell Atlantic has proposed interconnection rates that are emphatically *not* TELRIC in Pennsylvania, New Jersey, Delaware, West Virginia, Maryland, Virginia, and the District of Columbia.[5/] Bell Atlantic's pricing models improperly inflate the costs of network elements, often by including both Bell Atlantic's embedded costs and costs attributable to inefficient network operations and technology. Because Bell Atlantic's defiance of the Commission essentially made local competition within most of its region economically unfeasible, MCI WorldCom was compelled to file a section 208 complaint with the Commission in order to seek compliance with the merger conditions regarding TELRIC pricing. *See* Complaint, MCI Telecommunications Corp. v. Bell Atlantic Corp., File No. E-98-12, at ¶¶ 15-18, File No. E-98-12 (FCC filed Dec. 19, 1997) *("MCI Pricing Complaint")*. AT&T filed a similar complaint about Bell Atlantic. *See* Complaint, *AT&T Corp. v. Bell Atlantic Corp.*, File No. E-98-05 (FCC filed Nov. 5, 1997) *("AT&T Pricing Complaint")*. Both complaints are pending.

For example, in Pennsylvania, recurring rates for unbundled network elements are based largely on Bell Atlantic's methodology which are appallingly high because they are not based on TELRIC. Indeed, the Pennsylvania Public Utilities Commission itself recognized that the Non-

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5/ Rates have also been proposed in a number of states in the former NYNEX region. The rates proposed in those states were based on cost studies that were prepared and presented by NYNEX. They, too, are seriously flawed and are not consistent with TELRIC.

recurring Cost study submitted by Bell Atlantic was not consistent with a forward-looking TELRIC methodology, economic-cost based approach. *See* Interim Order, *Application of MFS Internet of Pennsylvania, Inc. (MFS - Phase III)*, No. A-31023F0002 at 101 (Pa. Pub. Utils. Comm'n. Apr. 10, 1997) ("*PA Order*") adopted in, Final Opinion and Order, *Application of MFS Internet of Pennsylvania, Inc. (MFS - Phase III)*, No. A-31023F0002 (Pa. Pub. Utils. Comm'n. July 10, 1997). In New Jersey, Bell Atlantic submitted the same pricing models as in Pennsylvania for recurring and non-recurring charges, and the Commission adopted the non-recurring charge model without modification, and a 60% weighted version of Bell Atlantic's recurring charge model. Telecommunications Decision and Order, *In re the Investigation Regarding Local Exchange Competition for Telecommunications Services, No. TX95120631*, (N.J. Pub. Utils. Comm'n, Dec. 2, 1997) ("*NJ Order*"). The same study for non-recurring charges which the Pennsylvania commission found was not based on forward-looking TELRIC costs (*PA Order*, 101) is the basis for Bell Atlantic's rates in New Jersey — in direct contravention of this Commission's order that it charge TELRIC prices in all of its states. The 60% weighting of Bell Atlantic's model for recurring charges in New Jersey is also not based on the TELRIC approach, and therefore has the effect of including a substantial portion of Bell Atlantic's overstated, backward-looking cost estimates in prices. The record is clear: Bell Atlantic is openly flouting the pricing commitments it made to the Commission and in the process making it economically unfeasible to compete for local exchange service in its region.[6/]

6/ Even if Bell Atlantic ultimately were required to "true-up" its current excessive rates to a TELRIC-based level, it seriously impedes competition every day that these excessive rates remain in effect. These inflated rates prevent potential competitors from selling as many services as they likely would if Bell Atlantic's rates were TELRIC-based, and uncertainty about the existence, size, and timing of any true-up deters current investment. A true-up, if any, would be based only on actual CLEC use of Bell Atlantic network elements and services, not the use foregone.

Bell Atlantic has also blatantly failed to comply with the condition of the *BA-NYNEX Order* which requires it to "negotiate with requesting carriers to establish in interconnection agreements performance standards for network performance" and specified OSS functions, and "to establish enforcement mechanisms to ensure compliance with each performance standard, including private or self-executing remedies." *BA-NYNEX Order* ¶ 182 & Appendix C, Condition 7. As the Commission noted, "without enforcement mechanisms, reporting requirements are 'meaningless.'" *Id.* ¶ 208. Like all the conditions of the BA-NYNEX order, Bell Atlantic is required to "negotiate supplements and amendments to existing interconnection agreements" in order to comply with the condition. *Id.*, Appendix C, Condition 9.

In September 1997, MCI WorldCom presented a comprehensive proposal to Bell Atlantic setting forth performance reporting, standards, and remedies MCI WorldCom requires in order to have a meaningful opportunity to compete in local markets and obtain services of the same quality Bell Atlantic provides to itself and its own customers. This followed several earlier requests from MCI WorldCom to negotiate appropriate performance requirements that had spanned the prior year. *See* Complaint, *MCI Telecommunications Corp.* v. *Bell Atlantic Corp.* File No. E-98-32 (FCC, Mar. 17, 1998) (*"MCI Performance Requirements Complaint")* with attached Declaration of Mark H. Lugar.

Bell Atlantic's response, which came three months later, was grossly deficient, little different from the position that Bell Atlantic took prior to the BA-NYNEX Order and that the *Order* was intended to change. *MCI Performance Requirements Complaint* ¶ 17. Bell Atlantic's proposal included multiple conditions excusing it from complying with any performance requirements, including a laundry list of "delaying events" that excused its performance. *Id.* ¶ 20. None of these conditions was permitted by the *BA-NYNEX Order,* and they defeated the essential

purpose of having performance standards with self-executing remedies. *Id.* MCI WorldCom brought the matter to the attention of the Commission, first by way of a meeting with the Chief of the Common Carrier Bureau with Bell Atlantic present, and then through a section 208 complaint when all reasonable means of getting Bell Atlantic to negotiate in good faith had failed. *Id.* ¶¶ 22-28. The Complaint is still pending before the Commission, and MCI WorldCom is still unable to this day to obtain the performance standards that are necessary for it to effectively compete in Bell Atlantic's territory.

Perhaps most outrageous, having induced the Commission to approve its merger with NYNEX by agreeing to conditions incorporated in a Commission order, Bell Atlantic now contends that the Commission lacks authority to enforce its own order. Brief of Bell Atlantic, *MCI Telecommunications Corp. v. Bell Atlantic Corp.*, File No. E-98-32, at 19-20 (FCC filed Oct. 2, 1998) (asserting that Commission lacks jurisdiction to enforce certain merger conditions); Response of Bell Atlantic to MCI's Reply Brief, *MCI Telecommunications Corp. et al. v. Bell Atlantic Corp.*, File No. E-98-32 at 9, (FCC filed Nov. 3, 1998) attached to Motion of Bell Atlantic for Leave to Respond to MCI's Reply Brief (filed Nov. 3, 1998) (same). Bell Atlantic would deny the Commission the power to make its own decision about whether Bell Atlantic is honoring the commitments it made to the Commission to obtain its approval. Bell Atlantic's cavalier bait-and-switch tactics are so atrocious that they bear on Bell Atlantic's fitness. *Cf. BA-NYNEX Order* ¶ 239 (Bell Atlantic's candor bears on its fitness as applicant for transfer of control of Commission license). [7/]

7/ Bell Atlantic is still doling out commitments, this time making the commitments contingent upon Bell Atlantic receiving section 271 authority. *See In re* Pre-Filing Statement of Bell Atlantic New York, *Petition of New York Telephone Company for Approval of its Statement of Generally Available Terms and Conditions Pursuant to Section 252 of the Telecommunications Act of 1996 and Draft Filing of Petition for InterLATA Entry Pursuant to Section 271 of the*

GTE's behavior has been no better. GTE has been able to provide interLATA services to its monopoly customers without first complying with the market-opening requirements of section 271. The absence of this incentive to comply has produced predictable results. For example, GTE has maintained that the Act *requires* state commissions to permit GTE to recover its historical costs when pricing unbundled network elements. *See, e.g. MCI v. Pacific Bell,* Case Nos. C97-0670 et al., 1998 U.S. Dist. LEXIS 17556, at *12 (N.D. Cal. Sept. 29, 1998) ("GTE objects to the CPUC's adoption of forward-looking cost models, arguing that the Act requires state commissions to allow for recovery of historical costs.") GTE has even sought to recover its "opportunity costs" in leasing unbundled network elements to CLECs, a position which stands out even in the context of the generally obstructionist tactics that CLECs have been accustomed to from ILECs. *See GTE South Inc. v. Morrison*, 6 F. Supp. 2d 517, 528 (E.D.Va. 1998) ("allowing opportunity costs impedes progress towards greater competition by sustaining GTE's monopoly revenue.").

GTE also intentionally delayed the resolution of interconnection issues between it and CLECs — and thereby delayed local competition in its region and increased the costs of would-be competitors — by filing meritless lawsuits in 16 states challenging state arbitration awards before state commissions reviewed and approved them under section 252(e)(1). Every one of those lawsuits was eventually dismissed on the basis that federal district courts do not have jurisdiction under the Act to hear such cases until a final agreement has been approved by a state commission.

Telecommunications Act of 1996, Case 97-C-021 (N.Y. Pub. Serv. Comm'n, Apr. 6, 1998) (copy available at http://www.dps. state.ny.us).

GTE North Inc. v. McCarty, 978 F. Supp. 827, 836 (N.D. Ind. 1997) (citing 11 of the other cases that were dismissed as premature).[8/]

With local competition in its infancy, the risks from a merger of this size between regional monopolists that, independent of one another, have behaved so poorly in the past cannot be overestimated. The sheer size and reach of a mega-BOC like Bell Atlantic-GTE would give the combined entity enormous power to block competition for local exchange service. Permitting Bell Atlantic and GTE to merge is simply a mandate to raise barriers to the local entry even higher through an entity that would control over one out of every three access lines in this country.

B. The merger does not "enable" Bell Atlantic or GTE to do anything it cannot already do with respect to out-of-region competition, and each will compete out-of-region, including against each other, to the extent it is in its interest to do so.

GTE and Bell Atlantic unabashedly tell the Commission that this extraordinary consolidation of two powerful monopolists is necessary so that these two companies can bring competition to out-of-region local exchange markets and fulfill the promise of the Telecommunications Act of 1996. They have couched the merger in "do or die" terms for the future of the two companies and tell the Commission that the merger "will bring into existence a *fourth* new competitor with the necessary scale and scope" to flourish in an emerging market for bundled services. BA-GTE Appl. 2. All of this will happen only if they are permitted to merge,

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8/ GTE has also sought to convince state commissions in 21 states that it should be classified as a rural telephone company, thereby exempting it from many of the procompetitive interconnection provisions of the Act. In rejecting GTE's request for such a designation, the Ohio Public Utilities Commission observed that the request "causes us to step back and ponder . . . whether the company is positioning itself to act in an anti-competitive fashion going into the emerging local competitive era." *See, In re GTE North Incorporated's Rural Local Exchange Carrier Exemption Under the Telecommunications Act of 1996*, Opinion, No. 96-612-TP-UNC, 1996 Ohio PUC LEXIS 415, at *4-*5 (Pub. Utils. Comm'n of Ohio rel. June 27, 1996).

however, because "GTE is the 'enabler' that will allow Bell Atlantic to attack other Bell company strongholds across the country." *Id.* 1.

The "enabler" theory is a sham. For new local entrants without a monopoly base, every region is out-of-region, and if CLECs can afford to compete in areas where they do not have a monopoly, then so too can Bell Atlantic and GTE. CLECs, which are much smaller in revenues and profits, have invested substantial sums in order to attempt to enter the local exchange market that companies like GTE and Bell Atlantic are preventing them from entering. As the Commission has found, the capital markets provided billions of dollars of capital for CLECs seeking to enter the marketplace.[9/] To the extent that Bell Atlantic or GTE even needs to go to these capital markets, they would be at least as ready a source of financing if they seek to pursue the same strategy as CLECs.

There is simply no plausible evidence that Bell Atlantic or GTE faces an all-or-nothing choice between competing in all major out-of-region markets if the merger is approved versus competing in none without the merger. The chart below sets forth relevant financial data for Bell Atlantic, GTE, other local exchange monopolists, and competitive carriers. By any objective measure, the ability of Bell Atlantic and GTE independently to finance an out-of-region entry strategy cannot be questioned. Each generates from its domestic monopoly profits not available to CLECs. Combined, the merged company would be massive. Indeed, companies with only a

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9/ *See In re Inquiry Concerning the Deployment of Advanced Telecommunications Capability to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996,* Notice of Inquiry, 13 F.C.C.R. 15280, ¶ 29 (rel. Aug. 7, 1998).

fraction of the cash flow of Bell Atlantic or GTE are already financing aggressive strategies to compete for local exchange service:[10/]

	Revenue ($millions)	EBIT ($millions)	Net Income ($millions)
Company	**1997**	**1997**	**1997**
Bell Atlantic	30,193.9	5,341.5	2,454.9
GTE	23,260.0	5,611.0	2,794.0
Merged company:	**53,453.9**	**10,952.5**	**5,248.9**
Ameritech	15,998.0	3,799.0	2,296.0
SBC	24,856.0	3,170.0	1,474.0
Merged company:	40,854.0	6,969.0	3,770.0
Bell South	20,561.0	5,376.0	3,270.0
U S West	10,319.0	2,210.0	1,180.0
AT&T-TCG	51,813.3	6,835.5	4,349.3
MCI WorldCom	27,004.4	1,773.7	592.7
Sprint	14,873.9	2,451.4	952.5
Advanced Radio	1.1	(39.1)	(61.7)
Electric Lightwave	61.1	(34.1)	(33.9)
e.spire (ACSI)	59.0	(82.2)	(115.0)
GST	36.3	(21.8)	(39.6)
ICG	273.4	(180.9)	(327.6)
Intermedia	247.9	(163.5)	(197.3)
McLeod USA	267.9	(69.3)	(79.9)
NextLink	57.6	(102.6)	(129.0)
RCN Corp.	127.3	(60.9)	(49.2)
Teligent	3.3	(135.4)	(138.1)
USN Comm.	47.2	(98.0)	(109.9)
Winstar	79.6	(188.1)	(249.5)

10/ The data in the table is drawn from *QuickSource Fundamental Data & Ratios Reports* (Wall Street Research Net).

Both Bell Atlantic and GTE have the expertise to successfully pursue an out-of-region local strategy independent of the other. These are not neophytes to the local exchange business that must combine their managerial expertise in order to know how to compete in local exchange markets that happen to be out-of-region; these are highly skilled and highly experienced monopolists who have owned local exchange service since the business began. If Bell Atlantic and GTE do not have the expertise to compete out-of-region for local exchange access, no one does.

Bell Atlantic and GTE assert that the merged entity will enter 21 local markets outside its expanded monopoly region. BA-GTE Appl. 6-7. If each really wanted to do so, either GTE or Bell Atlantic individually could finance facilities-based entry into these 21 markets, just as MCI, MFS, and Brooks did individually before their merger to form MCI WorldCom. Even if each company by itself would not enter 21 out-of-region markets, each is likely to enter at least some of the other's monopoly markets. After all, GTE and Bell Atlantic exercise monopoly control over local exchange access in XX of the ten largest local exchange markets in the United States. Thus, even if Bell Atlantic and GTE would not compete in as many out-of region markets on a stand-alone basis (which is far from clear and contrary to GTE's announced intentions pre-merger), GTE would compete in some out-of region markets that would inevitably include at least some Bell Atlantic cities such as New York, Philadelphia, and Washington, D.C. and Bell Atlantic would compete in some out-of-region markets that would inevitably include at least some GTE cities such as Los Angeles, Tampa, and Dallas/Ft. Worth.

Indeed, the Commission — and the shareholders of GTE for that matter — may reasonably ask why GTE suddenly is in need of Bell Atlantic's "anchor customers" (BA-GTE

Appl. 7) to compete out-of-region when the company has stated publicly for over a year that it has firm plans to compete head-to-head out-of-region against the Bell Operating Companies ("BOCs"). *See GTE Annual Report 1997* (Domestic Operations) ("We formed GTE Communications Corporation — which is our competitive local exchange carrier, or CLEC. It will be able to market the full spectrum of GTE services, including local, long-distance, wireless, and data services, without regard to franchise boundaries.").[11/] Indeed, the Chairman of GTE was unequivocal in his message to shareholders in GTE's 1997 Annual Report: "We're confident about GTE's ability to succeed in the competitive marketplace without entering into a major transaction or combination with another company. In other words, we can go it alone and win."[12/] In various statements to its shareholders and the marketplace generally, GTE has made clear that it can afford to compete out-of-region and execute its plans without this merger. See Press Release, *GTE Announces Initiatives to Become a Leading National Provider of Telecommunications Services* (May 6, 1997) ("Simply put, GTE will become a leading national 'one-stop' provider of local, long-distance, Internet and wireless services.");[13/] Indeed, those plans include competing for the business of companies that sound remarkably like Bell Atlantic's "anchor customers." GTE 1997 Annual Report Financial Data ("By packaging products and services, such as traditional wireline, wireless, long-distance and Internet services on one bill,

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11/ A complete copy of GTE's 1997 annual report (Domestic Operations) is available over the Internet at http://www.gte.com/AboutGTE/annual1997/domestic1.html.

12/ A complete copy of GTE's Chairman's message in the 1997 annual report is available over the Internet at http://www.gte.com/AboutGTE/annual1997/message1.html.

13/ A copy of GTE's May 6, 1997 press release is available over the Internet at http://www.gte.com/AboutGTE/news/050697.html.

GTE is positioned to capture high-value, high margin customers, both inside and outside of franchise territories.").[14/]

These statements are confirmed by the size, scope, investments, and profitability of GTE. As of late October 1998, GTE had a market capitalization of nearly $55 billion, and was on track to accumulate nearly $2.8 billion of net income for the year. *See* Prudential Securities, GTE Corp. Company Update (Oct. 27, 1998) (attached hereto as Ex. 3). In the last fiscal quarter, GTE's earnings per share rose 7.6 percent. *Id.* GTE also recently announced that it was planning to sell a small fraction of its local telephone lines as part of its plan to raise $2 billion to $3 billion to invest in faster-growing businesses. See *GTE Plans to Sell 7% Of its Local Phone Lines*, N.Y. Times Nov. 6, 1998 at C5. Contrary to its message to the Commission, GTE is not the undercapitalized "enabler" powerless to execute the same basic strategy that CLECs around the country are pursuing.

Moreover, GTE's national customer base as an Internet provider and also as a long-distance carrier increases both its ability and its incentive to pursue on its own a national strategy to provide a bundle of local, long distance, and Internet services. GTE has over 2.5 million long distance customers — with an addition of over 250,000 in the last fiscal quarter alone — has a 9% market share of the long-distance business in its territories, and long distance customers represent more than 13% of GTE's 19 million domestic switched lines. *See* Merrill Lynch Report, GTE Corporation (Oct. 20, 1998) (Ex. 4). As an Internet provider, GTE Internetworking is the

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14/ A copy of GTE's Annual Report Financial Data is available over the Internet at http://www.gte.com/AboutGTE/annual1997/finreview2.html#Growth. In support of the merger, GTE now tells the Commission that it intended only to target "small to medium business customers out-of-franchise . . . [and] almost all targeted out-of-franchise customers were located in areas near GTE's local or wireless footprint." Declaration of Jeffrey C. Kissell (attached to BA-GTE Appl.) ("Kissell Aff.") ¶ 3. That is flatly inconsistent with the statements it made prior to announcing the merger.

second largest company in the corporate IP services market with a 17% market share. *Bell Atlantic Merges With GTE: Wild Things are Happening!* Consumer Communications at 11 (Vol. 15, Aug. 1998) (Ex. 5). In addition, GTE Internetworking is one of the four largest high-end dedicated web-hosting providers, with roughly 1000 Web-hosting customers. *Id.* at 12. GTE Internetworking has over 200 points of presence ("POPs") in the United States — the majority of which are located in Bell Atlantic's monopoly region. *Id.* at 13.[15/] In short, GTE does not lack for "anchor customers" or a "robust national brand" that only Bell Atlantic can provide. BA-GTE Appl. 7. GTE is well positioned to compete right now and execute its long-standing plans to take on the BOCs.

In addition, because Bell Atlantic and other BOCs are using their control over the loop and advanced local services to favor their own ISPs (*see* Part III.B below), GTE as a major ISP with a lot of Internet business to lose has an additional incentive to compete locally against all of the BOCs. No one recognizes the importance of GTE's Internet presence to its national strategy better than Bell Atlantic. In proceedings before the Illinois Commerce Commission examining the merger, Bell Atlantic argued that GTE was an attractive partner for Bell Atlantic in Illinois because GTE's Internet backbone network in Illinois meant that "GTE knew Illinois." Transcript of Hearing, *In re Telecommunications Policy Open Meeting*, at 103 (Ill. Commerce Comm'n, Oct. 8, 1998) ("*ICC Hearing*") (relevant excerpts attached as Ex. 6). If indeed GTE's extensive Internet backbone in Illinois makes it a knowledgeable and worthy *partner* in Illinois for Bell Atlantic, then surely GTE is a knowledgeable and worthy *adversary* in New York, Massachusetts,

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15/ A visual depiction of GTE Internetworking's dedicated PoPs is available over the Internet at http://www.bbn.com/products/maps/us_pop.htm. In addition, both of GTE's critical Network Operations Centers are located squarely in Bell Atlantic territory. See Dedicated Access PoPs, http://www.bbn.com/products/maps/us_pop.htm.

Pennsylvania, the District of Columbia, and all the other Bell Atlantic region states where GTE Internetworking has a substantial presence. *See* Ex. 7 (map of GTE/BBN Dedicated Access POP Network). What GTE is able to "bring to the table" for Bell Atlantic in Illinois (*ICC Hearing* 103), it can equally use against Bell Atlantic in Bell Atlantic's monopoly region.[16/]

As for Bell Atlantic, its ability and incentive to compete out-of-region does not change if the merger is consummated. Bell Atlantic insists in its comments that it needs to be a global end-to-end telecommunications provider. BA-GTE Appl. 9 ("a principal motivation for the merger is to enable the combined company to become a truly national provider of bundled services."). But the same factors that would cause a merged Bell Atlantic-GTE to go national therefore would apply to Bell Atlantic alone, and whether Bell Atlantic chooses to adopt that strategy (which it has opted against to this point) does not depend on whether it merges with GTE.

Like GTE, Bell Atlantic is a cash-rich monopoly with enormous independent resources that can implement with ease a strategy that it considers vital to its survival. For the first nine months of 1998, Bell Atlantic had net income of $3.2 billion. See *Bell Atlantic Quarterly Results, Third Quarter 1998.*[17/] It has assets of $41 billion and revenues of $27 billion, serves 21 million customers, and monopolizes local service for the headquarters of one-third of the country's

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16/ As with local and Internet service, GTE and Bell Atlantic do not need to merge in order to compete effectively in the long distance market or to bring the benefits, if any, of additional entry by either or both of them. GTE has quickly built a large and successful long distance business with a 9% market share in its territories and over 2.5 million customers. Merrill Lynch Report, GTE Corporation (Oct. 22, 1998). It added 250,000 customers in the last fiscal quarter alone. *Id.* Bell Atlantic can doubtless do the same without the merger, and is already constructing an extensive long distance network. *See* Press Release, *Bell Atlantic Extends Data Network Capabilities Across U.S.*, Sept. 21, 1998, http:/www.ba.com/nr/1998/Sep/ 19980922001.html.

17/ Bell Atlantic's latest quarterly results are available over the Internet at http://www.bell-atl.com/invest/financial/quarterly/3q98_release.htm.

Fortune 500 companies.[18] It describes itself as "among the world's largest investors in high-growth global communications markets, with operations and investments in 23 countries."[19] The premise of the application that Bell Atlantic needs GTE to "enable" it to compete out-of-region is ridiculous.

Even accepting at face value the demonstrably untrue premise of the application that neither GTE nor Bell Atlantic has the resources or ability to enter all 21 out-of-region markets they claim the merged entity will enter, this does not ameliorate the competitive harm the merger will inflict. Entry by an existing ILEC into another's territory, even on a somewhat more limited scale, would have dramatic competitive effects. Baseman-Kelley Decl. ¶10. For example, GTE's entry into only one city in New Jersey or Maryland would benefit local competition throughout that state and, for that matter, throughout the entire Bell Atlantic region. If an experienced local exchange carrier like GTE demonstrated that Bell Atlantic could improve its OSS, local competition everywhere in the Bell Atlantic region would benefit because Bell Atlantic uses the same OSS region-wide. Similarly, if GTE showed an efficient LEC could provide unbundled loops at a lower price than Bell Atlantic claimed, the cost-based rate for unbundled loops would drop not only in Trenton but in all of New Jersey because of state-wide pricing. In sum, new entrants would be better able to rebut obstructionist arguments of the incumbent if their ranks included another incumbent.

Equally important, GTE's activities in Bell Atlantic's region would facilitate local competition in *GTE*'s region, and Bell Atlantic's activities in GTE's region would facilitate local competition in *Bell Atlantic*'s. CLECs would be able to use in GTE's region the arguments that

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18/ See http://www.bellatlantic.com/invest/profile/telecom.htm.

19/ See http://www.bellatlantic.com/about/about.htm?homelnav.

GTE made in the Bell Atlantic region to make UNEs and wholesale services available on better terms, and CLECs would be able to use in Bell Atlantic's region the arguments made by GTE to get better terms from GTE. Thus Bell Atlantic's failure to compete in GTE's region impedes competitive entry in Bell Atlantic's region, and vice versa.[20/]

Indeed, given GTE's long-established plans to compete nationwide, it is simply not credible to suggest that GTE will not also compete in Bell Atlantic's Northeast monopoly region, where over 25% of local service revenues are derived in the United States, 23% of access lines are located, and which Bell Atlantic aptly describes as replete with "anchor customers" that can support the national footprint GTE seeks in local. Baseman-Kelley Decl. ¶¶ 29-31. Moreover, GTE already has a significant presence in Bell Atlantic's region through GTE Internetworking, and GTE can also market local services to this established corporate customer base.

Furthermore, according to Bell Atlantic-GTE's own "enabler" theory, GTE has the ability and incentive to compete against Bell Atlantic in local markets near GTE's territories in Virginia and Pennsylvania. The "enabler" theory, which posits that GTE's existing territories would enable Bell Atlantic to compete against other ILECs with adjacent franchises, applies equally well to establish that GTE is well-situated to compete against Bell Atlantic. That is undoubtedly why the applicants have gone to great extremes to downplay GTE's existing interconnection agreements with Bell Atlantic in Virginia and Pennsylvania, characterizing them as "essentially pro forma interconnection agreements" and arguing that GTE's plans to enter Bell Atlantic's local service markets are "exceedingly limited." BA-GTE Appl. 30.

20/ The fact that out-of-region competition may jeopardize its in-region monopoly may explain Bell Atlantic's decision not to compete out-of-region to date. However, if Bell Atlantic is willing to take this risk collectively with GTE, it would be willing to take the risk individually.

Tellingly, however, the GTE affiant who discusses GTE's pre-merger CLEC strategy, Jeffrey Kissell, is utterly *silent* on the nature of GTE's plans to compete against Bell Atlantic in Virginia and Pennsylvania. *See generally* Kissell Aff. Indeed, no GTE witness offers testimony under oath about GTE's specific plans to compete in Virginia and Pennsylvania anywhere in the application to transfer control, despite the importance of this issue to the Commission's review of the merger. Instead, sworn testimony about competition in Virginia and Pennsylvania comes only from Bell Atlantic's affiants, who exclusively discuss Bell Atlantic's plans to enter GTE's territories in Pennsylvania and Virginia, not vice versa. And one of these witnesses acknowledges that state-wide advertising of Bell Atlantic in Pennsylvania could have a "spill-over" effect in GTE's territories, although this is purported to relate only to long distance service because "there is no consideration of marketing" local or bundled services to these customers. Declaration of Daniel J. Whelan, ¶ 6 (attached to BA-GTE Appl.) ("Whelan Aff").

In proceedings concerning the MCI WorldCom merger less than five months ago, one of GTE's affiants in this proceeding, Debra Covey, testified that with the benefit of its operations in Pennsylvania, GTE intends to offer local telephone service in Bell Atlantic's region in West Virginia. *See* Transcript of Proceedings, *WorldCom, Inc., Petition for Consent and Approval to Acquire All Outstanding Shares of Stock of MCI Communications Corporation*, Case No. 92-0347-SWF-CN, at 119-20 (Publ Serv. Comm'n of W. Va. June 25, 1998) (excerpts attached as Ex. 8) ("GTE Communications Corporation, our C-LEC, which I am employed by, intends to offer local service here [in West Virginia] next year" and "as a C-LE[C] we will offer bundled services, wireless paging, [I]nternet, local"); *id.* at 124 (GTE intends to compete in 100-200 mile radius from existing territories). If GTE intended without the merger to compete to provide local and bundled services in West Virginia with its dispersed population centers, rather modest large

customer base, and lack of immediate proximity to other GTE territories, surely it would compete in New York, Philadelphia, and Washington, D.C. which possess the "large, lucrative business customers" which Bell Atlantic and GTE now maintain are the "opportunity worth considering" in the CLEC business. *See* Whelan Aff. ¶ 5.

If Bell Atlantic is indeed serious about entering local markets out-of-region, it will compete in the major markets that GTE serves as well as those served by other ILECs. If Bell Atlantic were truly interested in breaching the ILECs' current non-aggression pact, it also would likely compete in GTE's monopoly territories in Pennsylvania and Virginia contiguous to Bell Atlantic. As Bell Atlantic itself acknowledges, Bell Atlantic's advertising in Pennsylvania already reaches GTE territory. Whelan Aff. ¶ 6. Thus, Bell Atlantic has name recognition and a cost advantage in competing there. It is therefore the most likely ILEC competitor against GTE. The merger will prevent the significant impact that Bell Atlantic's entry would have in those monopoly regions.

As the Commission has recognized, "[i]n telecommunications markets that are virtual monopolies or that are not yet developed, . . . the loss of even one significant market participant can adversely affect the development of competition and the attendant proposals for deregulation." *BA-NYNEX Order* ¶ 66; Baseman-Kelley Decl ¶¶ 33-36 . The Commission includes as a significant market participant an ILEC that is reasonably likely to enter another ILEC's territory. *BA-NYNEX Order* ¶¶ 72-73. Because of GTE's pre-merger plans to compete out-of region, and because of Bell Atlantic's and GTE's own statements about the imperative to compete out-of-region, the evidence strongly suggests that they will compete head-to-head against one another in at least some markets if they do not merge, and because the competitive pressures on each of them to compete out-of-region are likely to increase as local competition

grows, each of the companies should be treated as a likely potential significant market participant in the other's markets. Baseman-Kelley ¶¶ 33-36 . The loss of a potential significant market participant will harm competition for local exchange access in each of the regions because it will "(1) increase firms' ability to exercise market power unilaterally in the market for local mass market services . . . ; (2) increase firms' ability to exercise market power unilaterally in the market for bundled local and interexchange services . . . ; (3) increase the likelihood that firms will exercise market power through coordinated interaction; and (4) adversely affect the dynamic development of competition in both local and bundled markets . . . ." *BA-NYNEX Order* ¶ 100.

The proposed merger would therefore reduce competition in both regions by eliminating GTE as an independent entrant into Bell Atlantic's region and Bell Atlantic as an independent entrant into GTE's region.

C. The merger will reduce local competition in Bell Atlantic's and GTE's regions.

Bell Atlantic's and GTE's strategy is most assuredly not a plan to bring local competition to out-of-region local markets. Instead, it is a strategy to take advantage of the current *lack* of local competition in in-region markets order to raise even higher barriers to local entry and lock up a critical group of local customers — large business customers that account for a disproportionate share of all local traffic, revenues, and profits and that have multiple locations concentrated in Bell Atlantic's and/or GTE's regions. Bell Atlantic's and GTE's goal is to preempt local competition within their regions, not to promote it outside them.

Bell Atlantic and GTE have made clear to the Commission that the critical goal of their merger is to achieve "the national coverage [which] will allow the combined company to compete more effectively for the business of a host of firms that have offices both in Bell Atlantic's region and near to GTE's franchise areas across the rest of the country." BA-GTE Appl. 13. Indeed,

their main goal is to "utilize Bell Atlantic's existing relationships with these customers to sell through to their subsidiaries or affiliates in *selected out-of-franchise locations*." Kissell Aff. ¶ 7 (emphasis added). Stripped of the rhetoric, Bell Atlantic and GTE's plan to "attack other Bell company strongholds" (BA-GTE Appl. 1) is in fact a strategy to selectively serve the out-of-region locations of its largest in-region customers.

As a result of the merger, Bell Atlantic-GTE would be able to offer business customers facilities-based local service at all of their locations where Bell Atlantic-GTE is the incumbent with a ubiquitous network. Bell Atlantic and GTE correctly recognize that there is a demand for "national local" or "regional local" service: some large businesses that have multiple locations prefer to purchase local and long-distance service from a single source. BA-GTE Appl. 7-8. Equally important, they plan to rely heavily on their own facilities because carriers that are able to meet this demand using their own facilities will have a significant competitive advantage. The applicants also recognize that resale is not a viable strategy, and BA-GTE's "enabler" strategy will work best if it can take advantage of GTE's facilities in its monopoly "islands." Kissell Aff. ¶ 5; see also Baseman-Kelley Aff. at ¶¶ 61-62 . These sophisticated business customers understand that a CLEC that is dependent on a competing ILEC for critical inputs will not be able to assure as high-quality and reliable service as it could if it is exclusively facilities-based. The higher the percentage of locations of a multi-location customer to which a LEC is able to provide local services exclusively over its own facilities, the greater its competitive advantage.

The merger would enable Bell Atlantic and GTE to meet this demand for facilities-based national service not, as CLECs do, by investment alone, but by consolidating their ubiquitous monopoly networks. Bell Atlantic-GTE's advantage would be especially great in marketing to customers with all or most of their locations in the Bell Atlantic-GTE region, and that category is

likely to include companies headquartered in the Bell Atlantic-GTE region, where decisions concerning the telecommunications needs of a particular company are typically made. See BA-GTE Appl. 13 ("the national coverage will allow the combined company to compete more effectively for the business of a host of firms that have offices both in Bell Atlantic's region and near to GTE's franchise areas."). The fact that a third of all the nation's lines are in Bell Atlantic's and GTE's regions virtually guarantees the combined company a disproportionate advantage. To the extent that customers headquartered in its combined region have locations distributed more evenly throughout the United States, Bell Atlantic-GTE still could offer, and Bell Atlantic and GTE individually already do offer, facilities-based service at one-third of their locations. Baseman-Kelley Decl. ¶ 29. Because a smaller portion of the country will be out-of-region after the proposed merger, the amount of investment needed to achieve control over the facilities used to serve any given percentage of locations is smaller for the merged firm than for each firm alone. *Id.* ¶ 64.

Of course, the amount of investment that Bell Atlantic-GTE would need to serve all or most of the out-of-region locations of large businesses headquartered in its region will be substantially less than the investment required by CLECs to provide facilities-based local service to these customers at all of their in-region and out-of-region locations. *Id.* ¶ . Given the limited geographic reach of CLEC networks even in markets where they have facilities, these networks may not serve even all of the locations of these companies in those markets where CLECs have a presence. By combining the monopoly facilities that serve a high percentage of these locations, the merger would reduce Bell Atlantic-GTE's dependence on gaining affordable and nondiscriminatory recourse to access and resale services from out-of-region ILECs. However,

the dependence of CLECs on out-of-region ILECs will be undiminished, and their dependence on Bell Atlantic and GTE in multiple locations would be increased by the merger.

The end result is that the merger would make it harder for CLECs to compete with Bell Atlantic-GTE to provide facilities-based local service at all or most of the locations of businesses headquartered in Bell Atlantic-GTE's region. A CLEC that seeks to compete with Bell Atlantic-GTE for multi-location business must convince a large business customer to change its local provider in 100% of its locations or convince the customer to use multiple providers. On the other hand, in many cases Bell Atlantic-GTE will already be serving all or most of the customer's locations as a result of its geographic reach and monopoly control over one-third of the lines in the country, and therefore little to no change in providers will be required.

Thus, the true impact of the merger to Bell Atlantic and GTE is that it will significantly increase the percentage of locations of national or, more likely, regional businesses that Bell Atlantic and GTE *already* serve using their own monopoly local facilities. Without any out-of-region investment, Bell Atlantic and GTE will make themselves the primary facilities-based provider of these customers' company-wide needs for local telephone service. This includes the one-third of Fortune 500 companies currently headquartered in Bell Atlantic's region alone, as well as the federal government. *See* Bell Atlantic 1997 Annual Report (the Bell Atlantic "region includes 34% of Fortune 500 companies and Federal government.").[21/] Any advantage in serving these customers is important because these "regional local" customers generate a disproportionate share of local exchange and exchange access revenues and profits — which is precisely why Bell Atlantic and GTE are looking to lock them in as customers for the long haul.

21/ A copy of Bell Atlantic's 1997 annual report is available over the Internet at http://www.bell-atl.com/invest/financial.annual97/glance.htm.

By combining their ubiquitous monopoly regions, Bell Atlantic and GTE are seeking to leverage their overwhelming monopoly control of facilities in their own regions to lock up these customers once and for all. Far from promoting competition that purportedly would otherwise not take place in out-of-region markets, Bell Atlantic-GTE's merger stifles competition within their own regions for their most profitable customers. The fuzzy promise of out-of-region competition is the headline, but consolidation of control over customers within its own region is the story of this merger.

By making it harder for CLECs to compete for large business customers, the merger will decrease competition not only for these customers but for *all* local customers. MCI WorldCom's goal, like that of many CLECs, is to compete not only for the local business of large business customers, but also for the business of residential and small business consumers. Many CLEC local facilities support service to both large and small customers, and if CLECs' ability to compete for key business customers is artificially reduced by the proposed merger, the economic justification for investments in facilities that serve all types of customers will be undermined. Shrinking the available market for CLECs by locking up key business customers will increase barriers to entry into the market as a whole and decrease the ability of a CLEC to compete for *any* customer within the combined region. Baseman-Kelley Decl. ¶¶ 77-84. Bell Atlantic-GTE's merger-created competitive advantage will inevitably reduce competition for all types of customers in local markets throughout their regions.[22/]

22/ The problem would be compounded if Bell Atlantic and GTE were allowed to provide in-region long-distance services while they continue to monopolize local exchange and exchange access services. Baseman-Kelley Decl. ¶ 42-56. The profitability of CLEC entry into local exchange service is significantly affected by the ability to compete to provide exchange access. Id. If Bell Atlantic-GTE gains a significant share of in-region long distance traffic by locking up major business customers that constitute a critical portion of the total local customer base, the market available to CLECs would shrink significantly because Bell Atlantic-GTE's long-distance

D. The merger increases the potential for coordinated interaction among the few remaining BOCs in the post-merger market.

As the Commission has found, "[m]arket performance can also be adversely affected if a merger increases the potential for coordinated interaction by firms remaining in the post-merger market." *BA-NYNEX Order* ¶ 121. Coordinated interaction occurs when a group of firms engages in conduct that is profitable to each of them because of the accommodating reactions of all the others. *Id.* The probability of coordinated interaction increases as "the number of most significant market participants decreases" because "the remaining firms are increasingly able to arrive at mutually beneficial market equilibria, to the detriment of consumers." *Id.* Coordinated interaction can be accomplished more easily with fewer firms because the remaining firms will cheat on each other less (because they have less incentive to do so as there are fewer customers to win), are able to detect deviations from coordinated conduct more easily, and can effectively punish deviation through coordinated retaliation. *Id.*

The proposed Bell Atlantic-GTE merger alone would significantly increase the likelihood of coordinated interaction. It will make it much easier and more likely for the few remaining major ILECs to continue the non-aggression pact under which they do not compete in each other's regions.

Although approval of one of the pending BOC mergers does not necessarily mean that the Commission should approve the other, all of these effects would be compounded if the Commission permitted both the Bell Atlantic-GTE and the SBC-Ameritech mergers to proceed. Baseman-Kelley Decl. ¶¶ 29-31. Indeed, approving the pending Bell Atlantic-GTE merger along with the pending SBC-Ameritech merger would be tantamount to carving most of the United

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customers would likely buy access from it, not from CLECs. A contracted market will make it harder for CLECs to justify investment in wide-scale local networks, and that could mean less competition, or delayed competition, for all classes of customers. *Id.*

States into two huge regions each controlled by a single monopolist — "Bell West" consisting of SBC-Ameritech-SNET-PacBell primarily in the Midwest, Southwest, and West, and "Bell East" consisting of Bell Atlantic-GTE-NYNEX primarily in the East. The two combined entities would control almost 70 percent of local exchange revenues in the United States. *Id.* ¶ 29. The mergers would put two-thirds of the country's access lines into the hands of two monopolists who have steadfastly resisted at every turn any progress toward local exchange competition in this country since the Telecommunications Act was passed almost thee years ago. These two monopolists would together dominate the provision of local telephone service in this country, and possibly dominate bundled local and long-distance service as well in their respective regions — which is precisely the purpose of Bell Atlantic's and GTE's strategy. *See* BA-GTE Appl. 9.

If the two pending mega-mergers were allowed to proceed, it would be easier for the few remaining ILECs to reach mutually beneficial understandings to limit competition by serving out-of region locations only of customers predominantly located in their region. For example, Bell Atlantic-GTE would concentrate on the large business customers headquartered in its region, and SBC-Ameritech would concentrate on the large business customers headquartered in its region. The two proposed mega-BOC mergers together threaten to carve up the United States primarily between two local exchange monopolies of relatively equal size, and it is highly unlikely that either of these two mega-BOCs would have an incentive to compete for customers that are primarily located in the other one's region. The mergers would reduce the likelihood that out-of-region competition by one company would cause the other to respond, and by not responding, both companies would be better off than they would otherwise be. A tacit understanding whereby the two mega-BOCs focus only on businesses located primarily in their particular region would be the likely outcome. And even in the unlikely event that the two mega-BOCs chose to compete at

the margins against one another at some indeterminate time in the future, this still would not counterbalance the enormous anti-competitive effects felt in each of their regions now as a result of allowing them to merge in the first instance.

E. The Bell Atlantic-GTE merger, with or without the SBC-Ameritech merger, reduces the ability of regulators and competitors to benchmark.

In the *BA-NYNEX Order*, the Commission carefully analyzed the importance of benchmarking to its ability to combat abuse of market power in the local exchange market, and concluded that mergers of major ILECs seriously threatened the ability to benchmark. *See BA-NYNEX Order* ¶¶ 147-156.[23/] Although the Commission allowed Bell Atlantic to acquire NYNEX notwithstanding this prospect, the Commission should not allow Bell Atlantic to harm benchmarking even further. The Commission should draw the line at the Bell Atlantic-GTE merger (as well as at the pending SBC-Ameritech merger).

The importance of benchmarking is clear. Benchmarking allows the Commission "to ensure just and reasonable rates, constrain market power, [and] establish and enforce the pro-competition rules necessary to achieve competition and deregulation." *BA-NYNEX Order* ¶ 156. The Commission uses benchmarking in a wide variety of contexts.[24/] As the Commission has

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23/ "Benchmarking is the review of performance data from several entities and use of the 'best' performance as the principal criterion for comparing entity performance." *In re Policy and Rules Concerning Rates for Dominant Carriers*, Memorandum Opinion and Order, 12 F.C.C.R. 8115, ¶ 57 (1997) ("Rates for Dominant Carriers").

24/ The Commission, for example, relied on benchmarking to assess the reasonableness of individual LECs' physical collocation tariffs. *See In re Local Exchange Carriers' Rates, Terms, and Conditions for Expanded Interconnection Through Physical Collocation for Special Access and Switched Transport*, Second Report and Order, 12 F.C.C.R. 18730, ¶¶ 143, 146 (1997). Similarly, the Commission has termed benchmarking "not only desirable but indispensable" in price cap regulation. *See In re Policy and Rules Concerning Rates for Dominant Carriers*, Memorandum Opinion and Order, 8 F.C.C.R. 7474, ¶ 8 (1993). As the Commission has noted, benchmarking has been a "primary goal" of certain of the Commission's regulatory efforts.

recognized, the use of benchmarking is broadly recognized and embraced: "Aside from the DOJ and the courts, the Bell Companies themselves have emphasized the importance of benchmarks, and especially seven benchmarks, as an important regulatory tool." *BA-NYNEX Order* ¶ 149 (citing Bell Atlantic support for benchmarking). In allowing the Bell Atlantic-NYNEX merger, the Commission expressly cautioned against further consolidation:

> Further reductions . . . become more and more problematic as the potential for coordinated behavior increases and the impact of individual company actions on our aggregate measures of the industry's performance grows. . . . [A]lthough we do not find the reduction in major incumbent LECs caused by the proposed [Bell Atlantic-NYNEX] merger sufficient to render it against the public interest, further reductions in the number of Bell Companies or comparable incumbent LECs would present serious public interest concerns.

Id. ¶ 156.

In seeking approval of its merger with NYNEX, Bell Atlantic reassured the Commission that after that merger there would still be "5 RBOCs, GTE, SNET" (in addition to smaller companies). *Id.* ¶ 155. Of those seven, however, only four would remain if this round of consolidation is allowed to proceed.[25/] Of the nine largest ILECs when the 1996 Act was passed, fewer than half would remain. This is exactly the "further reduction" that the Commission indicated would "present serious public interest concerns." *Id.* ¶ 156.

Even without the proposed SBC-Ameritech merger, the Bell Atlantic-GTE merger would reduce the Commission's ability to meaningfully benchmark the performance of the ILECs. Simply put, there would be too few incumbent LECs left to provide meaningful comparisons. As with SBC-Ameritech, moreover, the sheer size of a Bell Atlantic-NYNEX-GTE conglomerate

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25/ Having eliminated NYNEX, Bell Atlantic seeks to eliminate GTE as an independent ILEC. After consuming Pacific and SNET, SBC is proposing to consume Ameritech.

alone would reduce the value of certain of the Commission's benchmarking calculations. *See BA-NYNEX* ¶ 150 (discussing impact of size of ILEC on "X Factor" calculation).[26/]

Beyond the need for benchmarking by the Commission and state regulators, customers and competitors of the ILECs also heavily rely on the ability to compare and benchmark the offers and actions of the LECs. *See* Joint Declaration of Marcel Henry and John Trofimuk, ¶¶ 5-7 (attached as Ex. 2) ("Henry-Trofimuk Decl."). If in business negotiations an ILEC asserts that a particular service is not feasible or must be structured or priced in a particular manner, a customer (or competitor) can point to the contrary position of a different ILEC to demonstrate that a more reasonable approach is possible. *Id.* As the number of major ILECs is reduced from 9, 8, or 7 down to 4, 3, or even 2, the ability to compare and contrast service offerings will be greatly diminished. *Id.* ¶ 7. This day-to-day benchmarking occurs all the time, and is gravely threatened by the merger proposals now pending before the Commission.

Benchmarking — by regulators, customers, and competitors — is at least as important in the area of local competition as in other contexts. Today, ILECs engage in a wide variety of abusive practices intended to preclude local competition, but different ILECs use different anticompetitive tactics. The current number of remaining ILECs gives the Commission and state commissions at least some reasonable opportunity to assess differing positions on issues both large and small — and to select the approach that best advances the goals of competition.

26/ The size of the merged entity would also increase its ability to dominate the standards-setting process and to establish *de facto* standards that advantage itself and disadvantage potential competitors. *See* Baseman-Kelley Decl.¶ 40. Both incumbent and competitive LECs need standards in order to be able to interconnect their networks reliably and efficiently. An ILEC like Bell Atlantic-GTE — controlling one-third of the access lines in the country — would have even greater influence in the standards-setting process and, by virtue of its size, would be able to dictate standards that were in its interest. This distortion of the standards setting process would, in turn, further compromise the Commission's ability to benchmark the actions and offerings of the different ILECs.

An important example of policy differences between Bell Atlantic and GTE involves compensation for exchange of local traffic between ILECs and CLECs. GTE agreed to the approach advocated by MCI – a "bill and keep" system under which both sides receive and complete local calls intended for their subscribers, without any exchange of money. In contrast, Bell Atlantic rejected a bill and keep approach in favor of a system of reciprocal compensation. *See* Henry-Trofimuk Decl. ¶¶ 8-10. At a minimum, the different approaches of GTE and Bell Atlantic provide information about the practical effects of the two approaches so that competitors and regulators can evaluate which system is best.[27/]

An example of benchmarking on the operational side involves systems to receive, track and process "trouble tickets" reporting problems in an ILEC's provision of local interconnection and access to CLECs like MCI WorldCom. Bell Atlantic performs this function electronically, but GTE does not. By forcing CLECs to use the telephone to reach GTE's operations department to report and seek a resolution of a problem, GTE's manual system leads to delays and inefficiencies. *See id.* ¶¶ 11-12.

In addition, Bell Atlantic provides a significantly lower level of account team support to MCI WorldCom than does GTE. Henry-Trofimuk Decl. ¶¶ 16-17.[28/] The account team is involved in most aspects of the relationship between the two carriers, and fewer account team members generally means lower levels of service. *Id.* Nevertheless, although MCI WorldCom's

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27/ Notwithstanding Bell Atlantic's preference for reciprocal compensation, however, Bell Atlantic has subsequently refused to pay the required compensation for local traffic that MCI WorldCom terminates to ISPs, and MCI WorldCom has been forced to obtain orders from state commissions requiring Bell Atlantic to comply with its obligations. *See id.* ¶ 9.

28/ Moreover, Bell Atlantic refuses to allow MCI WorldCom to interact with one account team on all issues, but insists that MCI contact different support staff on different types of issues. On issues relating to MCI WorldCom's efforts to compete as a CLEC, Bell Atlantic allocates, for its entire region, a grand total of *three* individuals to work with MCI WorldCom. *See id.* ¶¶ 14-15.

business with a merged Bell Atlantic-GTE would be even greater than its current business with either company separately, Bell Atlantic has indicated to GTE that the merged company would reduce the level of staffing provided to support its business relationship with MCI WorldCom. *Id.* ¶ 17.

This type of "lowest common denominator" approach would likely be used in a wide variety of operational and policy contexts. The merger would necessarily eliminate the existing diversity of approaches to important competitive issues affecting competition. Given the ILECs' interest in preventing effective local competition from emerging, the likely result of the proposed merger is that customers and competitors such as MCI WorldCom would be left with the worst of both companies' policies and practices.

Thus, permitting the proposed merger to proceed would cause the Commission to lose an important tool to nurture local competition and control the abuse of monopoly power. Customers and competitors such as MCI WorldCom would lose the ability to compare the performance of different ILECs. The few remaining major ILECs would be all the more able to exclude competition and abuse their dominant position in the local exchange market. Continued consolidation of ILECs if all pending and likely future proposed mergers are approved would make benchmarking virtually impossible, just as it was with the old Bell System when all of the BOCs were under common ownership and other ILECs followed their lead.

F. The merger would increase Bell Atlantic's and GTE's ability to exercise market power over interLATA telecommunications services if they obtain section 271 authority while their bottleneck remains intact.

Another significant threat to competition posed by this merger involves the long distance market if Bell Atlantic gains authority under section 271 to provide interLATA telecommunications services within its region while it continues to possess bottleneck control

over local exchange and exchange access services.[29] In these circumstances, the merger likely would facilitate Bell Atlantic-GTE's ability to achieve significant market power in the market for long distance telecommunications services. Baseman-Kelley Decl. ¶¶ 42-55 .

The proposed merger would enhance Bell Atlantic's and GTE's ability to engage in anticompetitive price squeezes because it would enable them to engage in price discrimination on both ends of more calls. The Commission has recognized that BOCs have the ability to undermine competition by "squeezing" the differential between the price of interstate exchange access services purchased by competitors and the retail price of long distance service offered by the ILEC to its customers. *See BA-NYNEX Order* ¶¶ 115-117. The price squeeze is accomplished by setting a "high" price for access services and a "low" price for retail long distance services. Baseman-Kelley Decl.¶¶ 42-55. By expanding Bell Atlantic's and GTE's regions, the merger would cause a higher percentage of calls to both originate and terminate in-region.[30] Bell Atlantic-GTE's artificial advantage resulting from inflated access charges is greater for calls that begin and end within its region. By using its own ubiquitous facilities for access within its expanded region, Bell Atlantic-GTE would get access at its economic cost at both the originating and terminating ends (notwithstanding any nominal internal transfer price), but unaffiliated competitors would pay the inflated rate. *Id.* ¶ 43. Through a variety of strategies, Bell

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29/ As discussed in Section IV.B. below, a combined Bell Atlantic-GTE cannot legally provide interLATA long distance service to customers anywhere in the current Bell Atlantic region. Accordingly, following consummation of this merger, GTE will have to cease providing long distance service to customers in Virginia, Pennsylvania, and anywhere else in the current Bell Atlantic region where Bell Atlantic has not received section 271 authority.

30/ Indeed, at an Illinois Commerce Commission hearing reviewing the merger, testimony was offered by Sprint indicating that the merger will result in 42% of interLATA traffic for customers of Bell Atlantic and GTE being in-region after the merger. *ICC Hearing* 118.

Atlantic-GTE could undercut the long distance prices of its competitors even though it is no more efficient. *Id.* ¶¶ 42-55.

The Commission concluded that it could approve a merger that facilitated "price-squeezing" tactics if the tactics were addressed by "adequate safeguards against such conduct," including requiring that "interconnection and unbundled network elements ("UNEs") are available at rates based on the economic costs of providing such services and facilities." *BA-NYNEX Order* ¶ 117. Bell Atlantic has failed to deploy OSS that make UNEs commercially available and has flouted its commitment embodied in the *BA-NYNEX Order* to offer TELRIC rates, and GTE has been no better. *See* Section I.A above. The failure of any nominal "safeguards" is reflected in the general absence of local exchange and exchange access competition that resulted.

The ability to engage in less detectable and more significant non-price discrimination is also significantly enhanced by the merger. Baseman-Kelley Decl. ¶¶ 56-58. Although the Commission did not find that Bell Atlantic's previous merger with NYNEX significantly enhanced the likelihood of anticompetitive effects of non-price discrimination by the merging ILECs, *see BA-NYNEX Order* ¶ 120, here the issue involves a much higher concentration of access lines under common ownership — one-third of all access lines in the entire country — than was at issue in the Bell Atlantic-NYNEX merger. Thus, interexchange carriers will be more dependent on a single entity for access exchange than they would be absent the merger. This would make hard-to-detect methods of non-price discrimination even more crippling to competing long-distance companies. Common ownership facilitates Bell Atlantic's and GTE's ability to focus their non-price discrimination efforts across the two regions.[31/]

31/ The Bell Atlantic-GTE merger increases the risk of harm to long distance competition from another potential anticompetitive practice — "grooming" international traffic inbound to the United States. The Commission recently requested comments on whether grooming arrangements between foreign carriers with market power in their home market and ILECs

III. BY SIGNIFICANTLY INCREASING THE PERCENTAGE OF INTERNET USERS AND TRAFFIC OVER WHICH BELL ATLANTIC AND GTE WOULD HAVE BOTTLENECK POWER, THE PROPOSED MERGER THREATENS COMPETITION IN INTERNET SERVICES.

As with the proposed SBC-Ameritech merger, the application of Bell Atlantic and GTE to merge raises serious concerns about the ability of the merged company to exploit its bottleneck monopoly to endanger competition among ISPs and threaten higher prices for Internet users and content providers. Both mergers raise similar threats to competition on the Internet, and for both the Commission must carefully weigh the ability of an ILEC to steer customers to the ILEC's affiliated ISP and the resulting impact of the merger on Internet competition. The risk of bottleneck exploitation and market dominance is even greater with the Bell Atlantic-GTE proposal, because GTE's ISP (formerly BBN Planet) already holds a leading position in the Internet marketplace. After merger, Bell Atlantic-GTE would be well on its way to market power enhanced by anticompetitive means.

An ISP with a large and disproportionate share of Internet traffic from customers that are effectively locked into its service may be able to exercise market power. Internet users, including consumers and content providers, demand that their ISPs provide universal connectivity — the ability to exchange Internet traffic with any other Internet user. When one ISP controls access to

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present a potential for anticompetitive effects and on how that risk could be reduced. *See In re 1998 Biennial Regulatory Review - - Review of the International Settlements Policy and Associated Filing Requirements*, Notice of Proposed Rulemaking, 13 F.C.C.R. 15320, ¶ 43 (rel. Aug. 6, 1998). The Commission should indeed be concerned about grooming arrangements between a dominant foreign carrier and an ILEC. An ILEC's monopoly control over the local access and exchange markets enables it to negotiate more favorable arrangements to terminate U.S. inbound traffic with dominant foreign carriers that increase the cost of competing U.S. carriers. For example, an ILEC may seek to groom inbound traffic geographically to increase the proportion of low-cost traffic it receives from a foreign correspondent, and the result is to shift high-cost traffic to competitors and thereby undermine their ability to compete. The combination of Bell Atlantic and GTE increases the risks and anticompetitive effects because extending their combined monopoly power over an even greater portion of the United States makes the merged entity an even more attractive grooming partner than the two ILECs standing alone.

a greater percentage of Internet customers than other ISPs, loss of connectivity to the larger ISP may hurt the smaller ISPs more than loss of connectivity to any of the smaller ISPs would hurt the larger ISP. Any resulting inequality in bargaining power may enable the larger ISP to impose a deal in which smaller ISPs pay it more (on a per-unit basis) to terminate their traffic than the larger ISP pays them to terminate its traffic.[32/] As a result, the larger ISP may be able to increase the costs of rivals that are no less efficient or innovative, and the consequence for consumers would be higher prices for Internet services. If the larger ISP becomes big enough and reaches a critical mass, a tipping effect may occur that enables it to wield spiraling power over Internet services. Baseman-Kelley Decl. ¶¶ 90-104.

Both Bell Atlantic and GTE operate ISPs,[33/] and the combination of GTE Internetworking with Bell Atlantic.net would make the Internet business a major element of the merged company that they would want to grow even faster.[34/] Not content to compete strictly on the merits of the ISP services, Bell Atlantic in particular is already pursuing two anticompetitive strategies to leverage its local bottleneck power in order to increase their Internet business. *First*, Bell Atlantic is taking advantage of the popularity of advanced high-speed local services like xDSL to tie its Internet services to its local services. If the promise of these services is realized and they become the predominant form of access to the Internet, these tying arrangements will enable a merged Bell Atlantic-GTE to capture a predominant share of Internet business within their regions.

32/ Whether in the form of peering arrangements or contracts for purchase of dedicated or dial-up access, agreements between ISPS for the exchange of Internet traffic are unregulated.

33/ As explained below, Bell Atlantic is today violating section 271 by providing Internet services, which are prohibited interLATA information services. *See* Part IV.C below.

34/ Certainly the merger does not *enhance* competition in Internet service markets (which, except at the local bottleneck, are already very competitive).

Second, Bell Atlantic and GTE are trying to increase the costs of competing ISPs by making them pay exorbitant prices for the calls that they receive from their customers. Even though the cost of completing a call to an ISP is no greater than the cost of any local call, ILECs want ISPs to pay them inflated access charges applicable to interstate calls. Because an ILEC's ISP (whether integrated with the ILEC or a nominally separate affiliate) will pay only the economic cost of access, it will have an artificial advantage that enables it to capture Internet business even if it is less efficient and less innovative than its competitors.

The combined company's ISPs may have the critical mass of Internet traffic that permits it to skew Internet competition in its favor. The anticompetitive strategies that Bell Atlantic is currently pursuing to exploit bottleneck control over the "last mile" will give the merged company more Internet business than it would earn through fair competition. The merger could therefore enable Bell Atlantic-GTE to increase its Internet business to the point that, either individually or with other mega-BOCs, it could achieve market power, for example, by forcing other ISPs to accept asymmetric interconnection agreements. Because Bell Atlantic and GTE would (like SBC and Ameritech) have bottleneck control over one-third of the access lines in the country, these "mega-BOCs" could gain significant market power over the development of the Internet.

A. BA-GTE could leverage its bottleneck control over local services, especially advanced high-bandwidth services, to acquire enough Internet traffic to exercise market power through coordinated interaction with other mega-BOCs.

Virtually all traffic between end users and ISPs in their regions must go through the networks of Bell Atlantic and GTE, whether through analog modem dial-up, ISDN, or dedicated access such as T-1s and fractional T-1s. Internet users and content providers are almost wholly dependent on reaching the Internet through Bell Atlantic's and GTE's monopoly local networks. Although ISPs that provide Internet connectivity between local networks lack any bottleneck

power and compete intensely,[35] the ILECs exercise bottleneck control of the local Internet connections of end users and content providers. The current lack of local competition leaves Internet users with no choice but to use the ILEC's local network to reach the ISP of the user's choice.

That is true for advanced services like xDSL as well as more traditional methods of access to the Internet. With the advent of advanced high-bandwidth data services such as xDSL that are particularly attractive to Internet users, an ILEC's ability to affect Internet traffic to and from captive customers within its region will become even greater. The Commission has focused on xDSL services because of their potential to make high-speed access to Internet services more broadly and cost-effectively available.[36] Digital Subscriber Line ("DSL") technology runs over existing copper telephone wires, and provides transmission speeds dramatically higher than other commonly available options.[37] Although there has long been the promise of high speed digital

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35/ No interLATA backbone provider has bottleneck control over any customer. Even a company with 50% of that business would not have anything approaching the kind of control over its customers that any ILEC has over its customers. ISPs and end users can choose among several operators of national backbone networks — including GTE — and no ISP or end user is locked into obtaining backbone service from its current provider because all retail and wholesale backbone customers can switch Internet backbone providers with relative ease. *See* Joint Reply of WorldCom, Inc. and MCI Communications Corporation to Petitions to Deny and Comments, *In re Applications of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc.*, CC Docket No. 97-211 at 74, 78-80 (FCC filed Jan. 26, 1998). The dynamic and flexible nature of the Internet means that any ISP or retail customer of which a provider of long-haul backbone services attempted to take advantage would be able to respond easily and quickly and to find an alternative supplier (if it were not already multi-homed).

36/ *See In re Inquiry Concerning the Deployment of Advanced Telecommunications Capabilities to All Americans in a Reasonable and Timely Fashion, and Possible Steps to Accelerate Such Deployment Pursuant to Section 706 of the Telecommunications Act of 1996*, Notice of Inquiry, 13 F.C.C.R. ¶¶ 18-22 (Aug. 7, 1998).

37/ Background and details concerning xDSL service can be found in *In Re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, Memorandum Opinion and Order, and Notice of Proposed Rulemaking, CC Dockets Nos. 98-147 *et al.*, FCC 98-188

access, xDSL services have the potential for widespread deployment at affordable prices that has eluded ISDN and other offerings. In particular, it promises to become a leading option for small and medium businesses and residential consumers that want high-speed Internet access but that would not purchase more expensive high bandwidth services like T-1 service. An independent study released in early November confirmed the growing importance of high-bandwidth delivery of Internet services when it found that 84 percent of residential Internet users want high-bandwidth Internet access, and the consumers most willing to pay for high-bandwidth service vastly prefer xDSL service over current competing cable modem options.[38/]

Thus, although few consumers are able to utilize xDSL services today (because ILECs, including Bell Atlantic and GTE have effectively prevented competition to provide them from getting started), these services may become the predominant form of Internet access in the future. The ILECs' current and future bottleneck control over a principal method of Internet access could enable them to reduce overall Internet competition.

Both Bell Atlantic and GTE currently provide xDSL services to customers, and GTE claims to be the "industry leader" in the introduction of xDSL service.[39/] GTE first conducted extensive tests of ADSL in 1996, providing high-bandwidth services to Microsoft employees in Washington state.[40/] GTE now offers xDSL service in 16 states across the country. Similarly,

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(rel. Aug. 7, 1998).

38/ *See* Press Release, *Yankee Group Finds Consumer Demand for High-Speed Internet Services Growing, but Availability is Limited*, (Nov. 6, 1998) http://www.yankeegroup.com/yg.nsf.

39/ *See* "DSL is Now a Reality for GTE Internet Users," http://www.gte.net/announcements/dsl.html.

40/ Bob Woods, *GTE Adds 1,000 Microsoft Employees & 2 Universities to ADSL Trial*, Newsbytes, May 7, 1997.

Bell Atlantic is actively deploying xDSL in its region,[41/] and has geared its long term data strategy to coordinate with its ADSL service.[42/]

Now and for some time to come, Bell Atlantic and GTE, like other ILECs, will have a virtually complete monopoly over these services, especially for residential and small business customers. Their control will remain regardless of whether the Commission grants the ILECs any relief from the requirements of section 251 (for example, with respect to access to xDSL-equipped loops and resale of advanced services), although such relief would further cement their monopoly choke hold over high-speed digital loop-based services. Neither Bell Atlantic nor GTE has met its most basic obligations under section 251(c) to provide unbundled access to xDSL-capable loops and collocation on reasonable and nondiscriminatory terms, including cost-based rates:

- Neither has deployed efficient, nondiscriminatory systems to give competing providers of advanced services access to xDSL-capable loops on the same terms and conditions as the ILEC or any ILEC data services affiliate.
- Neither conditions loops for competing providers on the same basis as it conditions loops for its own local services.
- Neither permits CLECs to place equipment on efficient and nondiscriminatory terms in ILEC end offices DSLAMs and other equipment necessary to provide xDSL services.
- Neither permits CLECs to place equipment in remote terminals so that CLECs can provide xDSL service to customers served by Integrated Digital Loop Carrier systems.

41/ Press Release, *New Bell Atlantic High-Speed ADSL Service to Shift Internet Surfers into HyperDrive*, (June 3, 1998) http://www.ba.com/nr/1998/Jun/19980603002.html.

42/ Press Release, *Bell Atlantic Launches Next-Generation Long Distance Data Network to Address $80 Billion Market for 21st Century*, (June 8, 1998) http://www.ba.com/nr/1998/Jun/19980608001.html.

Bell Atlantic's and GTE's failure to comply with section 251 effectively precludes competitors from competing to provide advanced local services.

It will likely take Bell Atlantic, GTE, and other ILECs at least several years to make xDSL-capable loops, collocation in central offices and remote terminals, and other xDSL-related elements and services available on reasonable and nondiscriminatory terms, so it will likely take effective competition in xDSL services at least several years to develop. Regardless of whether the ILECs obtain forbearance from current requirements under section 251(c), their monopoly over xDSL services is likely to continue because it will take time to bring them into compliance with the requirements with which even they admit they must comply. Developing the systems related to providing xDSL-capable loops is at least as complicated as providing unbundled voice-grade loops on reasonable and nondiscriminatory terms, and regular voice-grade loops are not available as an unbundled network consistent with the requirements of section 251(c) more than two years after the 1996 Act was passed. It may well take at least as long to work out all the operational and pricing issues relating to xDSL elements and services. Of course, if the Commission rejects (as it should) ILEC demands that they be relieved of the requirements of section 251(c) with respect to this category of local services, Bell Atlantic, GTE, and the other ILECs will have even more work to do to bring themselves into compliance, and in the meantime, their ISP business will continue to benefit from favorable treatment from their local telephone business.

Bell Atlantic's and GTE's continuing monopoly over advanced high-bandwidth services gives them, like other ILECs, a major advantage particularly in serving residential consumers and small business customers for whom T-1 and other traditional high-bandwidth services are not cost-effective. Not surprisingly, they are using this advantage to increase their Internet business.

Both Bell Atlantic and GTE are already bundling residential xDSL service with Internet access service by the ILEC's data affiliates,[43] and at least Bell Atlantic is blatantly steering consumers to its own ISP. A consumer seeking to obtain ADSL service from Bell Atlantic receives a discount of over three hundred dollars on equipment and installation fees *if and only if* the consumer also signs up for one year of service from Bell Atlantic.net.[44]

The Commission has already received extensive confirmation of the risk that ILECs will abuse their monopoly power over xDSL service to enhance their ISP business. In its comments in the Commission's section 706 proceedings, the Minnesota Department of Public Service detailed the monopoly abuses that are the subject of the formal complaint that it and the Minnesota Office of the Attorney General filed with the Minnesota Public Utilities Commission against U S West:

- U S West activated USWEST.NET's ADSL connection before any other ISP, and even in advance of the effective date of the tariff permitting the service;
- U S West provisioned its own ISP with necessary facilities "much sooner than it did for independent ISPs;"
- U S West timed a "free modem" promotion (similar to Bell Atlantic's modem discount promotion) in a way that customers of ISPs other than USWEST.NET were almost entirely excluded, the result of which was that "the overwhelming majority of end user customers who participated in U S WEST's promotion went to USWEST.NET as their ISP;" and

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43/ *See* http://www.bell-atl.com/adsl/more_info/pricing.html; Press Release, *GTE to Offer Ultra-Fast Internet Access* (Apr. 13, 1998) http://www.bbn.com/ aboutbbn/presskit/980413.htm. SBC and Ameritech also bundle ADSL service with their own ISPs' Internet access service. *See* http://www.ameritech.net/visitors/adsl/adsl_faq.htm; http://public.pacbel.net/faq/dsl_faq.html. These World Wide Web pages are attached hereto as part of Exhibit 9.

44/ *See* http://www.bell-atl.com/adsl/more_info/pricing.html. Both SBC and Ameritech also grossly favor their own ISP in the provision of ADSL service. *See* http://www.ameritech.com/ products/data/adsl/index.html (listing only Ameritech.net as a provider of ADSL Internet service). *Compare* http://public.pacbell.net/dedicated/dsl/dsl_solutions.html ($299 for installation and all necessary hardware if the user signs a one year contract with Pacific Bell Internet) *with* http://www.pacbell.com/products/business/fastrak/adsl/pricing.html ($660 for installation and all necessary hardware to choose a different ISP). These World Wide Web pages are attached hereto as part of Exhibit 9.

- U S West's marketing of xDSL service heavily favored its own ISP.[45/]

The Public Utility Commission of Texas explained other ways in which an ILEC could abuse its monopoly power over xDSL service to favor its own ISP:

> For example, to offer xDSL-based information services it is important to be aware of loop characteristics like the presence of bridge taps, load coils, etc. Depending upon the presence of such loop characteristics, the loop may need to be conditioned to make it suitable for offering xDSL-based information services. The ILEC may condition the loop and the advance services affiliate may deploy xDSL network elements (*e.g.*, digital subscriber line access multiplexers or DSLAMs) primarily in an area of interest to the affiliated information services provider. This action gives the ILEC's affiliates a strategic advantage over their competitors.[46/]

Similarly, the Indiana Utility Regulatory Commission voiced significant concerns about favoritism among an ILEC's affiliates in the provision of xDSL services.[47/]

As xDSL services become a predominant method of access to Internet services, BA-GTE could achieve market power over Internet services by leveraging its monopoly over these services to capture a large and disproportionate share of the Internet business. By increasing Internet traffic from customers locked into Bell Atlantic-GTE's Internet service through bottleneck abuse, the merger may give Bell Atlantic-GTE the ability to exploit a lopsided share of Internet traffic in its dealings with other ISPs that need to exchange Internet traffic with it.

45/ *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket 98-147, Comments of the Minnesota Department of Public Services at 7-11 and Appendix a (FCC submitted Sept. 25, 1998).

46/ *In re Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Comments of the Public Utility Commission of Texas at 2-3 (FCC submitted Sept. 24, 1998).

47/ *See In re Deployment of Wireline Services Offering Advanced Telecommunications Capability* CC Docket No. 98-147, Comments of Indiana Utility Regulatory Commission and the Technical Staff of the Public Service Commission of Wisconsin at 6-9 (FCC submitted Sept. 24, 1998).

The merger will significantly increase the percentage of Internet customers to which Bell Atlantic-GTE controls access, and that percentage is certain to grow as xDSL technology is more widely deployed. With xDSL services as the preferred form of Internet access for a substantial group of users, the merger could begin a process that results in increasing numbers of Internet users moving to Bell Atlantic-GTE not because it offers better prices or superior service, but because Bell Atlantic-GTE has successfully raised the costs of rival ISPs, particularly those not part of other mega-BOCs. Increasing the costs of other ISPs that lack bottleneck control could in turn force those ISPs to raise their retail prices for Internet access and thereby cause a general increase in the retail prices. Or, alternatively, Bell Atlantic-GTE could use its anticompetitive price advantage to capture Internet business both inside and outside its region and then raise retail Internet prices to the extent it acquires market power. In either event, consumers would be the losers.

The risk of harm is not limited to Internet end users. If permitted to become through merger and bottleneck control a dominant ISP, BA-GTE would be able to exert power over Internet content providers and advertisers, including providers that do not use BA-GTE as their ISP. If BA-GTE provide Internet service to a significant percentage of end users, it could also create a new Internet "portal" and steer users to that site, thereby giving BA-GTE great influence over the providers seeking access to those users. BA-GTE would control the first screen that it displays to its customers, and content providers and advertisers that want to be featured on that screen would have to do business with BA-GTE on its terms. Indeed, GTE itself emphasized the importance of controlling the first screen displayed to Internet users in its antitrust case against all of the BOCs, including Bell Atlantic, for creating a cartel to monopolize the Internet Yellow

pages market.[48] GTE alleged that the cartel uses its clout with devastating effect to force operators of the World Wide Web "portals" that many users see as their first screen on the Internet to steer users to the BOCs' Yellow Pages site.

The risk that Bell Atlantic-GTE could achieve dominance over the Internet is heightened by the fact that GTE is *already* a market leader in Internet services. In 1997, GTE acquired the BBN Corporation, which was one of the creators of the Internet and one of the leading brand names in the Internet business.[49] With GTE/BBN's broad presence and high name recognition,[50] Bell Atlantic would have both a significant head start toward dominating the Internet and easier market penetration.

If both Bell Atlantic-GTE and SBC-Ameritech are allowed to proceed with their mergers, the risk to Internet competition would increase substantially because the greater the consolidation of the remaining major ILECs, the greater the risk of coordinated interaction. Even if Bell Atlantic-GTE by itself would not achieve national market power over Internet services, Bell Atlantic-GTE and SBC-Ameritech together would control access to 70 percent of all Internet users. The shrinking number of ILECs that exercise bottleneck control over Internet access could facilitate coordinated interaction among the remaining mega-BOCs. In particular, Bell Atlantic-GTE and SBC-Ameritech could agree to exchange Internet traffic with each other on more favorable terms than they exchange traffic with non-bottleneck ISPs. The result could be an

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48/ *See GTE New Media Services Inc. v. Ameritech Corp.*, No. 97-CV-2314 (RMCC), 1998 U.S. Dist. LEXIS 15413 (D.D.C. Sept. 28, 1998) (decision denying motion to dismiss).

49/ *See GTE Takes Action Toward Being a National Full-Service Provider*, Communications Daily, May 7, 1997.

50/ GTE has a nationwide Internet business, with a heavy presence in Bell Atlantic's existing territory. *See* Dedicated Access PoPs, http://www.bbn.com/products/maps/us_pop.htm; Dial-Up Access, http://www.bbn.com/products/maps/dl_us.htm.

effective Internet duopoly with Bell Atlantic-GTE and SBC-Ameritech impeding the ability of other ISPs to compete for the business of end users and content providers. *See* Baseman-Kelley Decl. ¶¶ 90-104.

B. Applying inflated access charges to local Internet access would increase the risk that mega-BOCs would achieve market power over Internet services.

The ability of ILECs to leverage their monopoly control over local services into market power over Internet services will be increased if they succeed in their current efforts to extend the current system of excessive access charges to calls from Internet users to their ISPs. By inflating the costs of competing ISPs, BOCs that provide Internet service along with local service would gain the same ability to impede Internet competition that BOCs have to impede competition in the long-distance market by unaffiliated long-distance carriers. The merger would mean that monopoly leveraging by Bell Atlantic-GTE would give it an even greater undeserved share of the Internet business and further threaten the ability of equally efficient and innovative ISPs to compete against the merged company.

By squeezing competing ISPs that must pay excessive access charges, and by tying its ISP service to advanced methods of Internet access, the combined Bell Atlantic-GTE threatens to appropriate enough Internet traffic to give it power in the national market for Internet services — if not unilaterally, then through coordinated interaction with other mega-BOCs. The increase in Internet traffic resulting from merger could give Bell Atlantic-GTE power (a) to extract more favorable terms from Internet content providers, outside as well as inside Bell Atlantic-GTE region, because users in the expanded region can get access to their content only through Bell Atlantic-GTE's expanded bottleneck, or (b) to capture the business of content providers from equally or more efficient ISPs because Bell Atlantic-GTE hinders their ability to provide

competitively-priced connectivity to a large number of Internet customers held captive by Bell Atlantic-GTE. By using its artificial merger-enhanced advantage to capture more business from content providers, Bell Atlantic-GTE will increase its importance to other ISPs and to Internet end users and thereby gain additional power to increase the costs of other ISPs and raise retail prices.

This process could result in tipping the market more and more toward Bell Atlantic-GTE until it acquires monopoly power.[51/] Simply as a result of the merger, Bell Atlantic-GTE would have a significantly greater share than either company would have without the merger. At a minimum, Bell Atlantic and GTE have not shown that the combined company's share of the Internet business would be so small as to eliminate the tipping concern. It is also clear that the risk of anticompetitive effects would be greatly increased if the Commission permits the SBC-Ameritech merger, because the risk of coordinated interaction would increase, as explained above.

Consistent with the public interest standard in section 310(d), the Commission has a duty under section 706(a) of the Telecommunications Act of 1996 to use its regulatory authority to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans." The proposed Bell Atlantic-GTE merger threatens to create a substantial barrier to infrastructure investment. Consistent with the congressional directive in

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51/ Opponents of the MCI-WorldCom merger claimed that combining MCI's and WorldCom's Internet business would produce a similar network tipping effect. *See MCI-WorldCom Order* ¶¶ 147-150. Here, however, customers and ISPs would have no choice but to deal with Bell Atlantic-GTE for the first or last mile of Internet connections. In contrast, customers and ISPs did have alternatives to MCI and WorldCom for Internet backbone services. Thus Bell Atlantic-GTE's control over local access to its customers would be far more complete than that of any large interLATA backbone provider, and the resulting threat to competition far more substantial. Nevertheless, even in the context of an interLATA backbone provider facing intense competition, the Commission required complete divestiture of any Internet overlap as a condition of the MCI WorldCom merger.

section 706(a), the Commission should use its authority over the requested transfer of control to prevent the formation of this barrier.

IV. THE MERGED COMPANY MAY NOT PROVIDE ANY INTERLATA TELECOMMUNICATIONS OR INFORMATION SERVICE IN ANY IN-REGION STATE WHERE BELL ATLANTIC LACKS 271 AUTHORITY.

Bell Atlantic and GTE drop a bomb into one footnote in their application. The footnote reads in full:

> Bell Atlantic hopes to have needed Section 271 approvals by the time this merger closes. If that process is not complete, applicants will request any necessary transitional relief from the Commission.

BA-GTE Appl. 19 n.14. But section 271 of the Act does not allow for any "transitional relief." The Commission should make that clear to Bell Atlantic and GTE sooner rather than later, so that Bell Atlantic does not proceed under the illusion that it will be permitted by merger to circumvent the critical market-opening incentives created by section 271. As it did in its *SBC-SNET Order*, the Commission should make clear that if this merger is permitted to go forward, it will require a complete divestiture of GTE's interLATA business in all Bell Atlantic states for which Bell Atlantic has not obtained section 271 authority prior to closing of the transaction. This divestiture would necessarily include all interLATA information services currently provided by GTE in Bell Atlantic's region, including Internet services, because, as the Commission has held, the section 271 prohibition against a BOC or its affiliates from providing any interLATA service applies to interLATA information services as well as interLATA telecommunications services. Finally, the acquisition of GTE by Bell Atlantic means that all of the merged entity's operations in Pennsylvania and Virginia, including in current GTE territories, must be found to comply with section 271 before Bell Atlantic-GTE can offer interLATA service anywhere in those states, and

that all present GTE territories must comply with the conditions imposed in the *BA-NYNEX Order* (as ineffective as those conditions have been so far).

A. Section 271 does not allow for transitional relief.

Either Bell Atlantic fully implements the competitive checklist and meets the public interest test before the merger, or section 271 flatly prohibits Bell Atlantic, directly or through an affiliate, from providing in-region interLATA services. Section 271 makes no provision for "transitional relief," and section 10(d), 47 U.S.C. § 160(d), prohibits forbearance from applying the requirements of section 271 until they have been fully implemented, because failure to enforce section 271 would defeat its very purpose — to "use[] the promise of long distance entry as an incentive to prompt the BOCs to open their local markets to competition." *In re Application of BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc., for Provision of In-Region, InterLATA Services in Louisiana*, Memorandum Opinion and Order, CC Docket No. 98-121 FCC 98-271 ¶ 3, (rel. Oct. 13, 1998) ("*FCC Louisiana II Order*").

If Bell Atlantic-GTE provides interLATA telecommunications or information services in-region directly or through GTE affiliates before its bottleneck is broken and it meets all section 271 requirements, "there is an unacceptable danger that they will use their market power to compete unfairly in the long distance market." *FCC Louisiana II Order* ¶ 3. Indeed, the whole statutory scheme of the Telecommunications Act of 1996 is premised on the reality that Bell Atlantic would have the ability and incentive to exercise local market power to impede competition in long distance and Internet services if it is able to offer those services before its local markets become competitive. *Id.* ¶ 3n.6 (citing 141 Cong. Rec. S8057 (1995) (statement of Sen. Dorgan) ("It is not fair for the Bell operating companies to have a monopoly in local service, retain that monopoly and get involved in competitive circumstances in long distance service.")).

It is critical for the Commission to make clear sooner rather than later that section 271 does not permit the "transitional relief" that Bell Atlantic-GTE muse about in their application. *See* BA-GTE Appl. 19 n.14. Otherwise, the prospect that Bell Atlantic will be able to avoid section 271 restrictions by providing interLATA services through GTE will immediately diminish Bell Atlantic's incentive to fully implement the 271 competitive checklist and to satisfy the section 271 public interest test. The longer that Bell Atlantic thinks that transitional relief may be possible, the slower it will be to come into full compliance with section 271. Bell Atlantic should not operate on any false impressions that "transitional relief" is possible.

B. Without section 271 authority, the merged company cannot provide interLATA telecommunications services to customers anywhere in the current Bell Atlantic region.

The immediate consequence of consummation of the merger would be that GTE would have to cease providing originating long distance service to customers in Virginia, Pennsylvania, and anywhere else in the current Bell Atlantic region where Bell Atlantic has not received section 271 authority. That is because the same section 271 prohibitions that apply to the current Bell Atlantic automatically would apply to the merged entity in Bell Atlantic's existing region. *See SBC-SNET Order* ¶ 36 ("in order to comply with Section 271, SNET and its subsidiaries must cease originating long distance traffic in SBC's current seven-state region"). As discussed below, this includes all interLATA services provided by GTE, including GTE Internetworking, in Bell Atlantic's region, whether interLATA telecommunications services or interLATA information services, including Internet services. *See* Part IV.C below. Requiring divestiture of GTE's long distance and Internet operations (including its interLATA network) in areas where Bell Atlantic has not yet received section 271 authority is the most straightforward type of condition, with the least impact on consumers, that would ensure compliance with section 271. Alternatively, GTE

could be required simply to terminate service to all of its existing long-distance and Internet customers in Bell Atlantic's region, although that option would cause unnecessary disruption for customers.

As the Commission has recognized, there is vigorous competition in the long distance market and barriers to entry are low. *MCI-WorldCom Order* ¶¶ 36-77. Accordingly, the loss of GTE as a competitor in Bell Atlantic's region because of section 271 restrictions will not harm overall competition. And Bell Atlantic and GTE, if permitted to merge by the Commission, would have the same opportunity as every other BOC to get into the long distance business in-region — by fully implementing the section 271 competitive checklist and satisfying the public interest test.

C. A merged Bell Atlantic-GTE could not lawfully continue to provide Internet service to GTE Internetworking customers because Internet services are prohibited interLATA information services.

Not only will GTE have to cease providing interLATA telecommunications service to customers in Virginia, Pennsylvania, and elsewhere in the Bell Atlantic region where Bell Atlantic has not received section 271 authority, but GTE Internetworking would also have to cease providing Internet services supported by its interLATA backbone network or that of any other provider of Internet backbone services. *See In re Implementation of the Non-Accounting Safeguards*, First Report & Order and Further Notice of Proposed Rulemaking, 11 F.C.C.R. 21905 ¶ 115, CC Docket 96-149 (rel. Dec. 24, 1996); *cf. SBC-SNET Order* ¶ 36. Even Bell Atlantic and the other BOCs concede that they must have section 271 authority to provide services over interLATA data networks in their regions.[52/]

52/ *See* Press Release, *Bell Atlantic Moves Forward to Meet Data Demand*, (Oct. 21, 1998), http://www.ba.com/nr/1998/Oct/19981021001.html (acknowledging that activation of data network depends on regulatory approval); Press Release, *Bell Atlantic Extends Data Network Capabilities Across U.S.*, (Sept. 21, 1998), http://www.ba.com/nr/1998/Sep/19980922001.html

As the Commission is aware, over two years ago MFS Communications Company (now a wholly owned subsidiary of MCI WorldCom) filed a still-unresolved challenge to Bell Atlantic's provision of Internet services.[53/] MFS demonstrated that Bell Atlantic's provision of Internet services violates the requirement that interLATA information services only be offered after compliance with section 271 and through a separate affiliate under section 272. The unlawfulness of Bell Atlantic's Internet service would be even more clear and indisputable if Bell Atlantic provides Internet service through GTE Internetworking.[54/] GTE provides telecommunications and information services over an interLATA network within Bell Atlantic's region. The continued provision of interLATA services over this network by the merged entity would be plainly illegal, and the Commission cannot permit the merger to proceed if it would create, or exacerbate, a violation of section 271.

To comply with section 271, the merged entity must stop providing interLATA telecommunications and information services, including Internet services, within the current Bell Atlantic region. Bell Atlantic-GTE should divest GTE's interLATA business, including its

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(same).

53/ *See* Petition for Reconsideration, *In the Matter of Bell Atlantic Telephone Companies Offer of Comparably Efficient Interconnection to Providers of Enhanced Internet Access Services*, CCBPol 96-09 (filed July 3, 1996) ("BA CEI Challenge"); Ex Parte Filing, BA CEI Challenge (filed Nov. 13, 1998); *see also* Ex Parte Filing of WorldCom, Inc., *In the Matter of Southwestern Bell Offer of Comparably Efficient Interconnection*, CCB-Pol 97-05 (filed July 7, 1997).

54/ Bell Atlantic attempts to avoid the clear prohibition of section 271 by claiming that its customers obtain interLATA Internet connections from a "Global Service Provider" ("GSP"). However, Bell Atlantic's pretense that its customers select a GSP is a farce, and cannot save Bell Atlantic's ISP offerings. *See* Ex Parte Letter from David N. Porter to William F. Caton, BA CEI Challenge (filed Aug. 21, 1997). But, for purposes of this merger review, the Commission need not resolve the GSP issue, because there is no similar pretense for GTE Internetworking's ISP business. There is no question that GTE Internetworking itself provides the interLATA component of the Internet services, and thus the merged entity may not provide these services absent authority under section 271.

interLATA network, to another company that may lawfully provide these services within these states. Before the Commission may approve the merger, Bell Atlantic and GTE should submit a plan (identifying critical components such as the identity of a purchaser and the terms and conditions of the transaction) to bring themselves into compliance to the extent that Bell Atlantic has not obtained section 271 authority at the time the merger closes.

D. In GTE territories acquired by Bell Atlantic, Bell Atlantic-GTE must fully comply with both section 271 and the Bell Atlantic-NYNEX merger conditions.

Section 271 does not currently apply to GTE, but it most certainly does apply to Bell Atlantic. For Bell Atlantic to get section 271 authority, *all* of its operations within a state, whether provided directly or by an affiliate *including any former GTE operations,* must fully comply with section 271, including the competitive checklist that incorporates the requirements of sections 251 and 252. GTE's right before the merger to offer interLATA service does not in any way alter Bell Atlantic's statutory obligations if Bell Atlantic is permitted to acquire GTE. The fact that Bell Atlantic would be reaching new homes and businesses in Virginia and Pennsylvania through merger rather than through routine growth does not alter Bell Atlantic's obligations to permit vigorous competition from CLECs to provide service to those homes and businesses.[55/]

Similarly, the Bell Atlantic-NYNEX merger conditions expressly apply to "any affiliated companies" of Bell Atlantic, *BA-NYNEX Order* ¶ 249, and therefore would apply to a newly-acquired GTE.[56/] Thus, GTE must comply with those conditions imposed by the Commission

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55/ *See SBC-SNET Order* ¶ 37 (requiring SBC to ensure that SNET complies with all statutes and past and future Commission orders).

56/ The *BA-NYNEX Order* recognizes that Bell Atlantic provides its services "through network operations subsidiaries," *id.* ¶ 18, and GTE would simply be one additional such subsidiary. Indeed, if the merger is permitted, GTE will have exactly the same legal status as NYNEX after the merger with Bell Atlantic. *Compare id.* ¶ 23 ("NYNEX will survive as a wholly-owned subsidiary of Bell Atlantic") *with* Application for Transfer of Control at 2 ("GTE

when it approved Bell Atlantic's acquisition of NYNEX. Moreover, especially in light of Bell Atlantic's recent arguments that the Commission lacks authority to enforce conditions, the Commission should require Bell Atlantic's and GTE's compliance with the Bell Atlantic-NYNEX conditions *prior* to permitting any additional mergers and should extend the term of those conditions because of Bell Atlantic's prolonged and inexcusable non-compliance.

V. THE COMMISSION SHOULD REQUIRE THE PARTIES TO SUBMIT ADDITIONAL INFORMATION AND DOCUMENTATION TO TEST THEIR CLAIMS THAT THEY WOULD NOT COMPETE AGAINST EACH OTHER IF THE MERGER DOES NOT OCCUR.

The Commission should closely scrutinize the assertions made by Bell Atlantic and GTE in light of the past history of Bell Atlantic's prior dealings with the Commission. As the Commission knows, there were serious questions about Bell Atlantic's candor about its plans to compete against NYNEX in the Commission's proceeding examining Bell Atlantic's merger with NYNEX. *See BA-NYNEX Order* ¶ 75 (comparing Bell Atlantic's statements in its FCC application to merge with NYNEX that it had no plans to compete against NYNEX with planning done at Bell Atlantic to compete against NYNEX and noting that the facts and circumstances of plans to enter out-of-region markets "should be forthrightly presented to the Commission"). The Commission should carefully examine such statements in Bell Atlantic's and GTE's current application such as there is "no basis for any conclusion that Bell Atlantic, on its own, would be an entrant" in GTE's territory and no "colorable basis for suggesting that GTE might be an economically significant entrant" in Bell Atlantic's territory. *See* BA-GTE Appl. 25-26 n.22. Careful scrutiny is required by Bell Atlantic's history of minimizing its out-of-region plans, by Bell Atlantic's and GTE's current insistence that competing out-of-region is critical to its future

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will become a wholly-owned subsidiary of Bell Atlantic"). What applies to Bell Atlantic's NYNEX subsidiary would equally apply to Bell Atlantic's GTE subsidiary.

viability, by the facial implausibility of Bell Atlantic's and GTE's claims that they lack the resources to compete out-of-region unless they merge, and by significant evidence that GTE and Bell Atlantic would compete against one another. *See* Section II.B above (discussing testimony of GTE representative that GTE intends to compete against Bell Atlantic in West Virginia). In essence, the Commission must conduct an inquiry into whether Bell Atlantic's and GTE's primary justification for the merger — that they need to merge in order to compete out-of-region — is true.[57/]

The only effective way for the Commission to conduct such an inquiry is to require Bell Atlantic and GTE to make available to Commission, and to interested parties under a protective order, all of the relevant documents relating to at least the following subjects:

- GTE Communications Corporation, the business unit created to compete against the BOCs
- GTE Internetworking's customer base and expansion plans in Bell Atlantic's region
- GTE's out-of-territory long distance customers in Pennsylvania and Virginia
- GTE's plans to provide wireline service with wireless switches (Kissell Aff. ¶ 13)
- Bell Atlantic's plans to extend its in-region long distance network out-of-region

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57/ The Commission should also examine material that Bell Atlantic submitted under seal in GTE's antitrust lawsuit against Bell Atlantic and the other BOCs for monopolizing Internet Yellow Pages. *See* note 48 above. In particular, Bell Atlantic asserted counterclaims against GTE, including allegations that GTE had sought to "dominate its competitors." *See* Answer, Affirmative Defenses, and Counterclaims of Defendants Bell Atlantic Corporation and Bell Atlantic Electronic Commerce Services, Inc. *GTE New Media Services, Inc. v. Ameritech Corp.*, Civ No. 97CV02314 at 28, ¶ 6 (D.D.C. filed Nov. 14, 1997) (excerpts attached as Ex. 10). However, Bell Atlantic redacted from its public filing the support for this counterclaim. *See id.* In exploring the Internet competition issues raised by this merger, the Commission and interested parties should have access to factual claims made by one of the applicants about the other's anticompetitive acts.

- Bell Atlantic's plans to compete out-of region for local service, including its allegedly "highly targeted" plans to compete in GTE's Pennsylvania and Virginia territories (BA-GTE Appl. ¶ 31)

- Bell Atlantic's plans to compete against GTE Internetworking and other ISPs to capture additional Internet business in-region

- GTE's and Bell Atlantic's plans to provide bundles of local, long distance, and Internet services

Bell Atlantic and GTE are doubtless already collecting and providing these materials to the Antitrust Division of the Department of Justice as part of the Hart-Scott-Rodino process. Accordingly, as it did with the Bell Atlantic-NYNEX merger, the Commission should require Bell Atlantic and GTE to make part of the record in this proceeding the relevant Hart-Scott-Rodino materials submitted to the Department of Justice in connection with its investigation of the merger. *BA-NYNEX Order* ¶ 28.

VI. THE COMMISSION SHOULD DISAPPROVE THE BELL ATLANTIC-GTE MERGER.

As explained above, the proposed merger between Bell Atlantic and GTE raises a variety of serious threats to competition in local, Internet and long-distance markets. The most straightforward way to eliminate these threats, and to do so without regulatory conditions whose enforcement would consume substantial Commission resources, would be for the Commission simply to disapprove the merger.

To the extent the Commission considers approving the merger with conditions, the Commission should seriously consider structural conditions that would affirmatively boost competition. An alternative to structural conditions would be behavioral conditions that require Bell Atlantic-GTE to take specified procompetitive actions or prohibit it from taking specified anticompetitive actions. It is difficult to imagine any reasonably enforceable behavioral conditions that, individually or in combination, would be sufficient to make the merger affirmatively pro-

competitive. Unlike structural conditions, behavioral conditions require on-going regulatory oversight and enforcement because their goal is to make monopolists act contrary to their basic economic interests. Of course, Bell Atlantic has not complied with the behavioral conditions imposed in connection with its merger with NYNEX and has even contended that it may flout them with impunity because the Commission lacks the jurisdiction to enforce them. *See* Section II.A above .

Although it is not clear that all the problems inherent in a behavioral approach can be corrected, experience with Bell Atlantic and the Bell Atlantic-NYNEX merger conditions makes clear that at least two changes are necessary. First, any behavioral conditions on ILEC mergers would have to be very specific. For example, it was not enough to require in general terms that Bell Atlantic set rates for unbundled network elements based on unspecified forward-looking costs, or that Bell Atlantic negotiate in good faith about meaningful performance measurements, standards, and remedies. Second, any conditions must be implemented *before* the merger closes. Once two major ILECs merge, they lose all incentive to comply with the conditions, and the merged company would come up with one reason after another why compliance is infeasible or should be delayed. As a practical matter, the Commission can most effectively enforce any behavioral conditions before the ILECs complete a proposed merger.

CONCLUSION

The proposed merger of Bell Atlantic and GTE would harm the public interest because it would reduce local competition and threaten Internet and long distance competition. The application of Bell Atlantic and GTE should be denied. If the Commission decides to consider granting the application subject to conditions, it should seek public comments on specific potential conditions before reaching any conclusion.

Respectfully submitted,

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Dated: November 23, 1998

CERTIFICATE OF SERVICE

I, Stuart M. Rennert, do hereby certify that I have on this 23rd day of November, 1998, served by first-class United States mail, postage paid, a true copy of the foregoing Comments Of MCI WorldCom upon the following:

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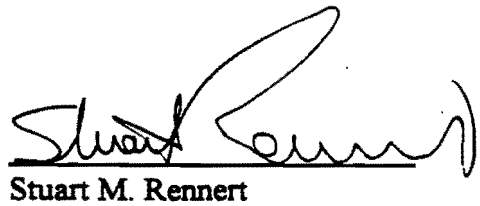

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Before the
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In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from GTE Corporation, Transferor, to Bell Atlantic Corporation Communications Inc., Transferee	)))))	CC Docket No. 98-184

DECLARATION OF KENNETH C. BASEMAN AND A. DANIEL KELLEY

I. INTRODUCTION

1. MCI WORLDCOM, Inc. ("MCI WorldCom") has asked us to prepare this economic analysis of issues raised by the proposed merger between GTE Corporation ("GTE") and Bell Atlantic Corporation ("Bell Atlantic").

2. Kenneth Baseman is a Principal with MiCRA, an economic consulting firm in Washington, D.C. He received his graduate training in economics at Stanford University. He served as a senior economist in the Economic Policy Office of the Antitrust Division of the Department of Justice where, for over two years, he was a member of the Division's trial staff in U.S. v. AT&T. He has been an economic consultant for thirteen years. His consulting assignments have focused primarily on competitive issues, both in antitrust and regulatory proceedings. His earlier professional papers dealt with entry and competition in a regulated

industry with natural monopoly characteristics and were published in the *American Economic Review,* and by the National Bureau of Economic Research and the MIT Press. His more recent publications have focused on the use of non-linear pricing and technical incompatibility by dominant firms to preserve market power in the face of developing competition. He has consulted on telecommunications issues with the Department of Justice, MCI, AT&T, the National Cable Television Association, and WebCel Communications, and he has testified on competitive issues relating to telephony before state commissions in Ohio, Wisconsin, Texas, Georgia and Kansas. A copy of his vita is attached to this Declaration.

3. Daniel Kelley is Senior Vice President of HAI Consulting, Inc. ("HAI"), of Boulder Colorado. He received a Bachelor of Arts degree in Economics from the University of Colorado in 1969, a Master of Arts degree in Economics from the University of Oregon in 1971 and a Ph.D. in Economics from the University of Oregon in 1976. His professional experience began in 1972 at the Antitrust Division of the U.S. Department of Justice where he analyzed mergers, acquisitions and business practices in a number of industries, including telecommunications. While at the Department of Justice, he was a member of the U.S. v. AT&T economics staff. In 1979, he moved to the Federal Communications Commission ("FCC") where he held positions as Senior Economist in the Common Carrier Bureau and the Office of Plans and Policy, and also served as Special Assistant to the Chairman. After leaving the FCC, he was a Project Manager and Senior Economist at ICF, Incorporated, a public policy consulting firm. From September 1984 through July of 1990, he was employed by MCI Communications Corporation as its Director of Regulatory Policy. He conducts economic and policy studies on a wide variety of

telecommunications issues, including local exchange competition, dominant firm regulation, and the cost of local service. He has advised foreign government officials on telecommunications policy matters and has taught seminars in regulatory economics in a number of countries. He has testified on telecommunications issues before this Commission, the California, Colorado, Connecticut, Florida, Georgia, Hawaii, Maryland, Massachusetts, Michigan, New York, Oregon, Pennsylvania and Utah Commissions, as well as the Federal-State Joint Board investigating universal service reform. His resume is attached.

4. We recently prepared a Declaration for MCI WorldCom analyzing the anti-competitive effects of the SBC-Ameritech merger.[1/] The Bell Atlantic-GTE merger obviously raises similar issues. Therefore, we relied heavily upon our previous work in connection with the earlier Affidavit in preparation of this analysis. An important difference between the analysis of the SBC-Ameritech merger and this one is that GTE currently provides interLATA telecommunications services in Bell Atlantic's region that Bell Atlantic cannot provide directly or through an affiliate under the terms of Section 271.[2/] Also of importance is the fact that GTE is a major player in the Internet and has a major presence in Bell Atlantic's territory through GTE Internetworking. Finally, both GTE and Bell Atlantic own operating telephone companies

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1/ Affidavit of Kenneth Baseman and A. Daniel Kelley, *In the Matter of Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Ameritech, Corporation, Transferor, to SBC Communications Inc., Transferee*, CC Docket No. 98-141, submitted October 15, 1998.

2/ Section 271 was added to the Communications Act by the Telecommunications Act of 1996, Pub.L. No. 104-104, 110 Stat. 56 ("1996 Act").

in Pennsylvania and Virginia. Bell Atlantic and GTE argue that GTE's service "islands" can be used as launching pads for out-of-region entry.

5. As was the case with the SBC-Ameritech merger, we conclude that the consolidation of GTE and Bell Atlantic raises substantial competitive risks without countervailing public interest benefits. We note that this merger raises substantial competitive risks even if the SBC-Ameritech merger is not approved.

6. In approving the acquisition of NYNEX by Bell Atlantic, the Commission found that there were substantial anticompetitive effects flowing from the merger.[3/] The Commission concluded that the merger could be approved only if Bell Atlantic took a number of steps to open its local markets to competition.[4/] We understand that Bell Atlantic has not honored the commitments that it made during the BA-NYNEX proceeding.[5/] Now, like SBC and Ameritech before them, GTE and Bell Atlantic attempt to justify their merger with a plan to enter local

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3/ *In the Matter of the Application of NYNEX Corporation and Bell Atlantic Corporation for Consent to Transfer Control of NYNEX Corporation and its Subsidiaries*, File No. NSD-L-96-10, released August 14, 1997. ("BA-NYNEX Order")

4/ The merger conditions agreed to by Bell Atlantic include agreeing to accept TELRIC as the mechanism for pricing unbundled network elements, preparation of service monitoring reports, uniform interfaces to Operations Support Systems ("OSS"), operational testing of interfaces, options for payment of non-recurring charges, a shared transport unbundled network element, as well as performance standards and enforcement mechanisms. See BA-NYNEX Order, Appendix C.

5/ See Complaint of MCI Telecommunications Corporation and MCIMetro Access Transmission Services, Inc., File No. E-98-12 (filed December 19, 1997) and Complaint of MCI Telecommunications Corporation and MCIMetro Access Transmission Services, Inc., File No. E-98-32 (filed March 17, 1998) for descriptions of how Bell Atlantic has failed to comply with the pricing and performance standards conditions it agreed to.

markets outside their regions. From an economic perspective, there is no reason to believe that Bell Atlantic-GTE will have any more incentive to enter markets outside their territories than they would have as separate entities.

7. By claiming that a merger between two of the largest telephone companies in the world is required to enable entry into local markets not already served by them, Bell Atlantic and GTE concede that entry into local markets is extremely difficult. GTE has had longstanding plans to enter into adjacent markets,[6/] but now implicitly admits that its fellow incumbent local exchange carriers ("ILECs") have failed to open their markets sufficiently to allow such entry when it argues that "economical local entry requires truly proximate facilities."[7/]

8. This market environment leads to the following major conclusions. First, as the Commission found in the BA-NYNEX Order, there are only a limited number of firms capable of challenging ILECs for mass market customers. Experience in the past year shows that the prospects for widespread entry in the short term by competitive local exchange carriers ("CLECs") are actually lower now than they were perceived to be a year ago. Both AT&T and MCI WorldCom have virtually abandoned resale as an entry vehicle because the discount levels set in state arbitrations are too small, ILEC Operations Support Systems for provisioning resold lines do not work, and resale limits the ability of firms to differentiate their services.

6/ See Bell Atlantic-GTE, Public Interest Statement, p. 7.

7/ *Id.*

9. CLECs continue to be frustrated by the high price of, and difficulty in procuring, unbundled network elements ("UNEs"). AT&T appears to have embarked in a new direction with the proposed acquisition of TCI. Whether cable assets can be used as a basis for entry into mass market telephony remains to be seen, and the result will not be known until at least several years and many billions of dollars are spent. Wireless alternatives are unlikely to fare much better. As a result, *de novo* out of territory entry by an existing ILEC willing to break from the cartel remains a key competitive entry mechanism.

10. ILECs have provided local telephone service for over a century, they own and know how to operate necessary support systems, they are extremely profitable, and judging by their international investments, they have the capital and the ability to invest outside their traditional geographic markets. Moreover, ILECs are uniquely situated to challenge the discriminatory interconnection and pricing policies that are slowing entry by other carriers. State Commissions ruling in arbitration proceedings face a significant information asymmetry problem. An out-of-region ILEC would be an extremely credible participant in an arbitration proceeding. Thus far, no ILEC has entered local markets out-of-region on any significant scale. However, the more ILECs there are, the more likely it is that one of them will break from the cartel.

11. The merger will cause direct competitive harm in several significant ways. First, the merger will eliminate GTE as an independent entrant into local markets in Bell Atlantic's region, and vice versa. Second, benchmarking ILECs is an important regulatory tool, and one that Bell Operating Companies ("BOCs") relied upon to justify their requests for eliminating MFJ line of

business restrictions.[8/] This merger will eliminate a significant benchmark. Third, if BOCs such as Bell Atlantic receive Section 271 authority prematurely, their ability to harm competition is enhanced to the extent their territories are larger. This is because more calls will originate and terminate in their territory, thus increasing the return to discrimination. Finally, the merger places at risk the continued evolution of the Internet on a competitive basis.

12. The potential negative impact on Internet competition is particularly significant. The Internet has developed under a competitive environment, with no single firm dominating its evolution. If this merger is approved, then an even smaller group of firms will dominate the last mile between Internet providers and their customers. If this control over the last mile is leveraged into control over access to and from Internet service providers ("ISPs"), the most technologically vibrant and fastest growing segment of the economy could be damaged.

13. The out-of-region entry proposed by Bell Atlantic-GTE does not compensate for these anticompetitive effects. First, there is no real assurance that this "commitment" is any more credible than the BA-NYNEX "commitment" to open their markets.[9/] Second, the primary Bell

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8/ Benchmarking is the process by which direct comparison of firms is used to evaluate conduct and performance. Both regulators and customers can use benchmarking to their advantage.

9/ We would note that Bell Atlantic is still doling out commitments in hoped for exchange of regulatory favors. See *In the matter of Petition of New York Telephone Company for Approval of its Statement of Generally Available Terms and Conditions Pursuant to Section 252 of the Telecommunications Act of 1996 and Draft Filing of Petition for InterLATA Entry Pursuant to Section 271 of the Telecommunications Act of 1996,* Pre-filing Statement of Bell Atlantic New York, Case 97-C-021 (New York Public Service Commission, April 6, 1998) (A copy of Bell Atlantic's filing is available at http://www.dps.state.ny.us). Instead of actually

Atlantic-GTE strategy is to provide facilities based competition in competition with the existing CLECS. Competition for the business of major corporate customers in central business districts is further advanced than mass market competition, at least as measured by installed capacity, but is still very limited.[10/] There is no reason to believe that a combined Bell Atlantic-GTE would be any more able to serve mass markets outside their territories than existing CLECS, including AT&T and MCI WorldCom.

14. GTE and Bell Atlantic argue that there are other public interest benefits that will flow from the merger, including realization of economies of scale and greater competition in the long distance market. GTE and Bell Atlantic are already very large carriers and have likely exhausted all available scale economies.[11/]

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opening local markets to competition, the 1996 Act merely opened up an extending bargaining session between CLECs and ILECs, with ILECs still holding most of the chips and the CLECs relying on regulatory intervention to enforce the Act.

10/ See, e.g., Jonathan Kraushauer, Fiber Deployment Update, End of Year 1997, Common Carrier Bureau, FCC. pp. 34-35 for a description of CLEC fiber investments. In the Order approving the SBC-SNET merger, the Commission found that " . . . incumbent LECs are facing increasing competition in these business markets, and numerous new entrants are rapidly entering this market, especially in central business districts in urban areas." *In the Matter of Application for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor to SBC Communications, Inc., Transferee*, CC Docket No. 98-25, released October 23, 1998, para. 20 ("SBC-SNET Merger Order").

11/ Cost data collected by the Commission fail to support the view that there are significant scale economies in providing local telecommunications services — at least for firms as large as the BOCs. In 1997, Southwestern Bell and Bell Atlantic showed higher overall expenses per line than Ameritech, US West and BellSouth. (Based on data in Common Carrier Statistics, 1997.)

15. Section II below discusses the evolving structure of the local exchange business. Section III discusses the loss of benchmark and likely competitive harms in the long distance market that will be caused by the merger. Section IV addresses the supposed major public interest benefit of the merger — out of region entry by the combined Bell Atlantic-GTE. With this background, the effect of the merger on local markets is also discussed in Section IV. Section V addresses the impact of merger on broadband competition and the Internet. Section VI shows that Dr. Thomas Hazlitt's stock market event analysis, purporting to show that the merger will be procompetitive, is flawed. A more sophisticated event analysis produces the opposite conclusion. The summary and conclusions are in Section VII.

II. POST MERGER INDUSTRY STRUCTURE

16. This Section discusses developments in local competition and the nationwide structure of the local service business. Section A shows that competition for the business of large customers is beginning, but mass market competition has yet to get off the ground. Section B describes the evolving structure of the local exchange business, demonstrating that if all planned mergers are allowed, the nationwide structure of the local exchange industry will be heavily concentrated.

A. Local Markets Are Not Competitive

17. Although the ILECs have been predicting that local competition is "just around the corner" for more than a decade, the reality is quite different. The high expectations for the development of competition at the time of the passage of the 1996 Act have not been realized.

Demonstrating that the local exchange is still a monopoly, and is likely to remain so for the foreseeable future, does not require an extensive *de novo* antitrust market analysis. The Commission concluded such an analysis just over a year ago when it approved the Bell Atlantic-NYNEX merger with conditions. In the Bell Atlantic-NYNEX Order, the Commission concluded that in New York City LATA 132, arguably the market where local competition is the most developed:

> neither the firms remaining in the market nor other telecommunications firms not currently in the market appear able to quickly and effectively increase their presence in response to any exercise of market power in the relevant market.[12/]

Unfortunately, the commitments made by Bell Atlantic in exchange for approval of the merger have not changed this conclusion.

18. The extensive documentation in the ALTS 706 Petition[13/] and MCI's May 1998 Access Charge Report[14/] show that CLECs are still having difficulty procuring essential network elements at reasonable prices. The SBC-Ameritech and Bell Atlantic-GTE merger applications

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12/ BA-NYNEX Order, para. 143. Also see *In the Matter of Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications to WorldCom, Inc.*, Memorandum Opinion and Order, CC Docket No. 97-211, para. 168, where the Commission found that Bell Atlantic has lost only six percent of the New York Metropolitan area business market to competitors and that "in many other places, the incumbent LEC's market share is or approaches 100 percent."

13/ See, *Petition of the Association for Local Telecommunications Services (ALTS) for a Declaratory Ruling Establishing Conditions Necessary to Promote Deployment of Advanced Telecommunications Capability Under Section 706 of the Telecommunications Act of 1996*, CC Docket No. 98-78 (filed May 27, 1998) ("ALTS Petition")

14/ See, *ex parte* Letter from Mary L. Brown, MCI, to Richard Metzger, FCC, *In the Matter of Access Charge Reform*, CC Docket No. 96-262, RM 9210, May 7, 1998, p. 27, fn. 59. ("MCI Access Report").

are themselves concessions that entry by means of resale or use of unbundled network elements is extremely difficult. As a result, the ILECs retain substantial market share and monopoly control over the local exchange.

19. The conclusion that ILECs retain monopoly control over the local exchange is also consistent with empirical analysis by HAI. In The Enduring Local Bottleneck II ("ELB II"), HAI analyzed the business case for competition for residential and small business customers from cable and wireless operators.[15/] ELB II concluded that widespread deployment of the competitive technologies is not likely in the near term.[16/] ELB II analyzed the business case for providing cable telephony over hybrid fiber coax ("HFC") networks. There have been no changes in technology or costs sufficiently dramatic to change the results of that analysis. Cable companies have been attempting since the beginning of the 1990s to provide telephony over the HFC with virtually no penetration of the residential and small business marketplace.

20. ELB II noted the potential development of cable modem service as an entry point for cable provision of cable telephony services. Developments with Internet voice technology and the recent announcement of the acquisition of TCI by AT&T provide some hope that this technology will help break the bottleneck. However, even assuming that Internet voice will be a reasonably priced and high quality substitute for ILEC circuit switched services, billions of

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15/ "The Enduring Local Bottleneck II," Hatfield Associates, Inc., April 30.

16/ *Id.* p. 73.

dollars in investment and a substantial amount of time are required to implement this strategy.[17/] Internet telephony quality problems are likely to be solved in time, but cable companies must upgrade their networks, install the necessary electronics, and market the service (together with a substantial investment in premises hardware) to consumers. As a result, it will likely be some time before that service is widely available. Even if the service becomes widely available, the result will not be a competitive market structure. The structure will be a duopoly with substantial barriers to additional entry.

21. Wireless competition presents similar problems. Fixed wireless solutions may well provide competition for local exchange service in rural areas. However, ELB II concluded that the traffic loads imposed by fixed service make wireless technology impractical as a substitute for local exchange service in more densely populated areas. Broadband wireless also faces significant hurdles before it can become a serious contender for fixed wireline service in the foreseeable future. Although the technology exists, it suffers from coverage problems due to signal attenuation and the need to provide a line of sight connection to customers. It is certainly far from clear now that broadband wireless will overcome these problems.

22. It is also useful to assess local exchange competitiveness with the traditional industrial organization tool of structure, conduct and performance analysis.[18/] The CLECs are growing

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17/ See Mike Mills, "AT&T: No Changes in TCI Deal," Washington Post, July 8, 1998, p. C11.

18/ F.M. Scherer and David Ross, *Industrial Market Structure and Economic Performance* (1990). The U.S. Department of Justice *Merger Guidelines* are based on this paradigm.

rapidly. However, today, CLECs primarily provide services for large businesses and IXCs in mostly business sections of large cities. As a result, they often report their progress in terms of markets or cities served. CLEC market penetration gains are also usefully measured on a building-by-building basis. In 1997, CLECs had only 15,667 buildings located on their networks, representing less than 0.31 percent of commercial buildings, and less than 0.012 percent of households and commercial buildings.[19/] In terms of total national market penetration, the CLECs are today approximately where the competitive long distance providers were twenty years ago when they received authority to provide switched services. They are providing some dedicated services, and are only in the early stages of providing switched services. The percentage of residential and small business customers served by competitors is, of course, even smaller. That number likely rounds to zero percent.

23. MCI WorldCom recently provided the Commission with data on the extent to which it is able to use competitive alternatives to avoid excessive ILEC access charges. An Affidavit filed by MCI WorldCom's Vice President of Network Financial Operations reported that "during the first six months of 1998, an average of only 3 percent of MCI's total billed access charges, and far less than one percent of MCI's switched access minutes, are with competitive access providers ("CAPs") or CLECs."[20/] This is despite the fact that MCI WorldCom is highly

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19/ See, MCI Access Report, p. 27, fn. 59.

20/ Affidavit of Wayne Rehberger, filed with Comments of MCI WorldCom, *In the Matter of Access Charge Reform*, CC Docket No. 96-262, October 26, 1998. ("MCI Access Charge Reform Comments")

motivated to avoid excessive ILEC access charges and has invested billions of dollars in the means to do it.

24. Viewing the market from the perspective of conduct and performance confirms that the monopoly structure leads to monopoly results. Unlike customers and suppliers in competitive markets, access providers and their long distance customers frequently find themselves in adversarial relationships. For example, ILECs seldom cooperate with their CLEC or IXC customers when requests are made for new or more efficient forms of interconnection.[21/] If the ILECs were facing imminent widespread facilities-based competition, they would be more than willing to make unbundled network elements available to firms that would otherwise construct competing facilities.

25. The ILECs do not voluntarily reduce prices when their costs fall. Regulators must order reductions. This is demonstrated by the fact that access charges are typically set at the maximums allowed by price cap plans. Productivity adjustments under price cap regimes have been insufficient to prevent the inexorable climb of profits towards full unconstrained monopoly levels.[22/]

21/ The failure of ILECs to cooperate on interconnection issues is detailed in the ALTS Petition and the MCI Access Report.

22/ See MCI WorldCom Access Reform Comments for empirical data showing that productivity factors have been inadequate to constrain ILEC prices to competitive levels.

26. ILEC profits dramatically exceed any reasonable estimate of a competitive cost of capital. The most recently prescribed interstate rate of return was 11.25 percent. Reports filed with the Commission show that the price cap carriers are earning 15.52 percent.[23/] A recent study completed for MCI finds that the ILEC cost of capital is only 9.1 percent.[24/]

27. The ILECs might argue that this profit performance is due to the fact that price caps provide incentives for cost reductions. It is true that price caps are a contributing factor to the enormous returns. But other factors that may be just as significant as, or more significant than, price caps contribute to the excessive ILEC returns. For instance, access demand is growing due to the per minute access charge reductions the Commission has imposed in the past, and due to competition in the long distance market.[25/] Costs are falling due to advances in switching and transmission technology that are affecting all high-technology companies.[26/]

28. In a competitive market, there would be pressure to reduce access charges when profits are as high as those being experienced by ILECs. If competitive firms experienced such

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23/ *Id*, p. 31.

24/ See Matthew I. Kahal, Analysis of Rate of Return of Local Telephone Companies, submitted with MCI WorldCom Access Reform Comments.

25/ Recent per minute access charge reductions ordered by the Commission have been largely offset by increases in per line charges and explicit universal fund assessments.

26/ In the BA-NYNEX Order, the Commission noted that "price cap regulation, for example, may not constrain market power . . . ." Among the reasons cited by the Commission is the fact that "if carriers offer bundles that contain both price-capped services and some services not subject to price caps but potentially subject to the exercise of market power, the price of the overall bundle is not price capped and market power may be exercised by increasing the overall price of the bundle." (fn. 201)

decreases in costs and increases in demand, they too might see dramatic increases in profitability, but such levels of profit would be transitory. They would quickly be competed away.

B. From a National Perspective, the Local Exchange Business Is Becoming Heavily Concentrated.

29. Two major ILEC mergers have already been approved by the Commission: SBC-Pacific Telesis and Bell Atlantic-NYNEX. The SBC-SNET merger was also approved recently. As a result, the industry is much more concentrated than it was at the time the 1996 Act was passed. If the remaining announced mergers between SBC and Ameritech and GTE and Bell Atlantic are consummated, concentration will take another dramatic turn upward. Tables I and II compare the concentration among ILECs at the time the 1996 Act was passed and under the hypothetical assumption that all announced mergers are consummated. The change is dramatic. The largest firm will control almost 40 percent of the total revenues and the two largest will control almost 70 percent of the revenues.

Table I Pre and Post Merger ILEC Revenue Shares					
1/1/96			1/1/98		
Companies	**Revenues (000)**	**% of Total Revenues**	**Companies**	**Revenues (000)**	**% of Total Revenues**
Bell South	13,900	14.53%	BA Group	38,303	37.14%
Bell Atlantic	12163	12.72%	SW Bell Group	32,207	31.23%
GTE	12,115	12.67%	Bell South	14,666	14.22%
NYNEX	12,099	12.65%	US West	10,021	9.72%
Ameritech	10,795	11.29%	All Others	7,935	7.69%
US West	9,214	9.63%	**Total**	103,134	100.00%
Southwestern Bell	8,860	9.26%			
Pacific Bell	7,825	8.18%			
SNET	1,472	1.54%			
All Others	7,198	7.53%			
Total	95,646	100.00%			

Source: FCC, Statistics of Common Carriers, Table 2-9

Table II Pre and Post Merger ILEC Line Shares					
1/1/96			1/1/98		
Companies	**Lines (000)**	**% of Total Lines**	**Companies**	**Lines (000)**	**% of Total Lines**
Bell South	22,595	13.61%	BA Group	63,519	32.81%
Ameritech	21,889	13.19%	SW Bell Group	66,878	34.54%
Bell Atlantic	20,705	12.47%	Bell South	25,732	13.29%
Pacific Bell	18,782	11.31%	US West	25,294	13.06%
NYNEX	18,032	10.86%	All Others	12,191	6.30%
US West	17,671	10.64%			
GTE	17,354	10.45%			
Southwestern Bell	16,343	9.84%			
SNET	2,057	1.24%			
All Others	10,580	6.37%			
Total	166,013	100.00%	**Total**	193,614	100.00%

Source: FCC, Statistics of Common Carriers, Table 2.10

30. According to the GTE and Bell Atlantic logic, only very large ILECs are capable of an effective national expansion program; they say that they are too small standing alone. Tables III and IV provide concentration figures using the BOCs and GTE as the universe. At the time the 1996 Act passed, the largest BOC, BellSouth, controlled only 14.54 percent of the lines and 15.72 percent of the revenue for this collection of firms. If the mergers are consummated, the "Bell Atlantic group" of telephone companies will control about 40 percent of the revenues while the "SBC group" will control 36.86 percent of the lines and 33.8 percent of the revenue. Only four major ILEC players will be left. If SBC-Ameritech and Bell Atlantic-GTE claims about the firm size required for out of region local entry are to be believed, Bell South and US West should not even be on this list because they are too small to compete on a national scale.

Table III "Major ILEC" Revenue Shares					
1/1/96			1/1/98		
Companies	Revenues (000)	% of Total	Companies	Revenues (000)	% of Total
Bell South	13,900	15.72%	BA Group	38,303	40.24%
Bell Atlantic	12,163	13.75%	SW Bell Group	32,207	33.83%
GTE	12,115	13.70%	Bell South	14,666	15.41%
NYNEX	12,099	13.68%	US West	10,021	10.52%
Ameritech	10,795	12.21%			
US West	9,214	10.42%			
Southwestern Bell	8,860	10.02%			
Pacific Bell	7,825	8.85%			
SNET	1,472	1.65%			
Total	88,443	100.00%	Total	95,197	100.00%

Source: FCC, Statistics of Common Carriers

Table IV "Major ILEC" Line Shares					
1/1/96			1/1/98		
Companies	Lines (000)	% of Total	Companies	Lines	% of Total
Bell South	22,595	14.54%	BA Group	63,519	35.01%
Ameritech	21,889	14.08%	SW Bell Group	66,878	36.86%
Bell Atlantic	20,705	13.32%	Bell South	25,732	14.18%
Pacific Bell	18,783	12.08%	US West	25,294	13.94%
NYNEX	18,032	11.60%	Total	159,311	100.00%
US West	17,671	11.37%			
GTE	17,354	11.17%			
Southwestern Bell	16,343	10.51%			
SNET	2,057	1.33%			
Total	155,429	100.00%			

Source: FCC, Statistics of Common Carriers

31. This concentration in nation-wide control is significant for several reasons. First, there would be competitive effects in both the local and long distance markets resulting from increases in nation-wide concentration. Second, competitive benchmarks are an important regulatory tool, the value of which is reduced as large ILECs merge. Third, the universe of potential entrants is

being reduced significantly by the mergers. Finally, the merger has potential negative implications for the large corporate customers discussed in the Bell Atlantic-GTE Application. Thus, the Bell Atlantic-GTE merger raises a fundamental question for the FCC: how much consolidation will the Commission allow among the BOCs and/or major ILECs — including GTE? These problems are discussed in Sections III and IV below.

III. THE BELL ATLANTIC-GTE MERGER IS INCONSISTENT WITH THE PUBLIC INTEREST

32. This section discusses three major reasons why this merger will harm the public interest. First, a potentially valuable potential entrant — one of a dwindling set of firms — will be lost. Second, a valuable regulatory benchmark will be lost. Finally, competition for long distance and bundled local and long distance service will be put at risk.

A. The Merger Will Remove a Valuable Potential Entrant

33. Neither GTE nor Bell Atlantic has entered local markets out of their territory to date in any significant way. However, GTE has publicly announced its intention to enter local markets] and has established a subsidiary to undertake the business.[27/] Bell Atlantic does not discuss any entry plans it may have made, other than to deny an interest in entering GTE territory within the Bell Atlantic region. Even if Bell Atlantic does not have *current* plans to enter independently, it,

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27/ *See GTE Annual Report 1997* (Domestic Operations) ("We formed GTE Communications Corporation — which is our competitive local exchange carrier, or CLEC. It will be able to market the full spectrum of GTE services, including local, long-distance, wireless, and data services, without regard to franchise boundaries."). A complete copy of GTE's 1997 annual report (Domestic Operations) is available over the Internet at http://www.gte.com/AboutGTE/annual1997/domestic1.html.

along with GTE, is among a small group of firms with the requisite skills and capital to enter the mass market segments of the local exchange business. And current market conditions and plans can change. Bell Atlantic's plans for out-of-region local entry could change if it felt the need to respond to successful local entry on a significant scale in its region by MCI WorldCom, AT&T, or any of the CLECs.[28/] Therefore, both GTE and Bell Atlantic are valuable potential entrants into markets that would still be highly concentrated even if some initial entry were to take place.

34. One of the reasons that large ILECs such as Bell Atlantic and GTE are important potential entrants to the mass market is that the eventual penetration of the mass market will likely require substantial reliance on resale and unbundled network elements. The prices, terms and conditions for these entry modes are established in contentious arbitration hearings in the states. As noted in the introduction, State Commissions ruling in arbitration proceedings face a significant information asymmetry problem. They are faced with competing claims by ILECs and by competitors of the cost and difficulty of provisioning unbundled network elements. An out-of-region ILEC would be an extremely credible participant in these arbitration proceedings.

35. The market for the business of large corporate customers addressed by Bell Atlantic-GTE is discussed in detail in the next section. We would note here that, if Bell Atlantic and GTE are incorrect about the size and scale required to be viable in that market, the number of significant potential entrants will have been reduced by one.

28/ The issues surrounding defensive entry of this sort are discussed below at paragraphs 71-73 and 120.

36. We would also note that potential entry merger analysis must be calibrated differently for telecommunications than for other markets. Standard potential entry theory focuses on "most likely" potential entrants. However, standard potential entry analysis typically focuses on unregulated markets where there have been no legal entry barriers, and where the market is not almost completely monopolized. Entry has only been allowed in local telephone markets for a relatively few years. As a result, the dynamic entry process is not well developed. Therefore, the second, third and fourth most likely potential entrants are more important in this market than in other industrial markets.[29/] This is especially true if, as SBC and Ameritech argued,[30/] unlikely potential entrants *today* might be transformed into actual entrants in the future as market conditions change. It would be a mistake not to value the potential pro-competitive prospects of significant potential entrants very highly, even if the potential entrants are not planning current entry. The loss of major potential entrants into GTE's and Bell Atlantic's territories (i.e., Bell Atlantic and GTE, respectively) with an admitted strong interest in out-of-region local entry would be substantial.

B. An Important Regulatory Benchmark Will Be Lost

37. Regulators and economists have long understood the importance of benchmarks. This fact has also been recognized by the ILECs, as the Commission noted in the Bell Atlantic-

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29/ The Commission reached this conclusion in the Bell Atlantic-NYNEX Order.

30/ See the "defensive entry" discussion below at paragraphs 71-73 and 120.

NYNEX Order.[31/] While benchmarking has not eliminated discrimination, it has been a useful regulatory tool. As the number of potential benchmarks is reduced, the value of the tool is correspondingly devalued.

38. There are significant differences between the Bell Atlantic and GTE. These differences are potential sources of information for regulators and customers that will be lost if the merger is approved. For example, as the Joint Declaration of Marcel Henry and John Trofimuk submitted with the Comments of MCI WorldCom in this proceeding show, GTE and Bell Atlantic have taken different positions on several critical business issues, including directory assistance data, reciprocal compensation, automated maintenance systems and account team support. Advances in local competition that may otherwise have occurred in the GTE region as a result of using Bell Atlantic as a benchmark are thus placed at risk if GTE is acquired by Bell Atlantic. Similarly, the acquisition will eliminate policy differences between the companies that would place benchmarking pressure on Bell Atlantic from those areas where GTE's policies are more conducive to local entry than Bell Atlantic's. Bell Atlantic's acquisition of GTE will thus reduce the possibility of meaningful benchmark competition.

39. The Rivers Affidavit filed by SBC in the SBC-Ameritech merger proceeding provides an example of the use of benchmarks by ILEC customers. Rivers reports (at page 9)

> . . . that AT&T, our largest wholesale customer, which is familiar with the methods used by all major carriers in providing HiCap lines, preferred Southwestern Bell's HiCap procedures to those used by other companies. . . .

31/ Bell Atlantic-NYNEX Order, para. 149.

> Consequently, because of AT&T's request, many of those procedures that were superior to those we were previously using have become standard with us. Business customers, interexchange customers, CLECs, wireless carriers, and others who use HiCap service have benefitted from our experience.

SBC and Ameritech used this as an example of how they can rely on one another for ways to improve their service to IXCs. This improvement took place without the merger because AT&T had a competitive benchmark to use. A more likely post-merger outcome is that, with loss of the benchmark, service quality will be lower on average. Neither Bell Atlantic-GTE nor SBC-Ameritech have a large economic incentive to voluntarily improve service to IXCs, who they view as actual or potential competitors.

40. The nationwide structure of the industry also plays an important role in the development of industry standards. A dominant ILEC may impose standards on the industry, bypassing standards processes. The development of industry standards has always been problematic, with the local telephone companies able to control the process and adopt standards that disadvantage other players, such as IXCs. With fewer voices in the standards process, the ability of a single large firm to drive the results will increase. This is particularly important given the current evolution of broadband technologies. A more consolidated local telephone industry will have a greater ability to force anticompetitive standards on the industry.

41. The effect of the merger on dynamic efficiency through technological change is related to the benchmarking issue. Rapid technological change may well be more likely in a less concentrated industry where parallel paths of innovation lead to more experimentation and a

larger number of technological approaches are sampled.[32/] GTE and Bell Atlantic argue that the merger will lead to economies in research and development.[33/] While this argument may apply in a situation where a large firm acquires a much smaller rival,[34/] it is less likely to apply in the case of a merger between two very large firms.

C. Competition for Long Distance and Bundled Local and Long Distance Service Will Be Harmed by the Merger

42. It is appropriate to analyze the competitive effects of the merger under the assumption that BOCs obtain near term Section 271 authority to provide interLATA long distance service within their regions. Based on the analysis in Section II, significant local competition is not likely in the near term. An inevitable result of the merger will be that more calls will originate and terminate in the combined territory of Bell Atlantic. This is significant because the artificial access charge advantage enjoyed by ILECs will increase as a result of the merger, as will their incentive to engage in non-price discrimination. The geographic dispersion of GTE territories

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32/ See Declaration of Stanley M. Besen, Padmanabhan Srinagesh, and John R. Woodbury, "An Economic Analysis of the Proposed SBC/Ameritech Merger," October 14, 1998, pp. 25-30, submitted with the Petition to Deny of Sprint Communications Company, CC Docket No. 98-142 and HAI Consulting, "Economics and Technology of Broadband Competition," pp. 26-33, for a more detailed discussion of the relationships among firm size, market structure and dynamic efficiency.

33/ See the Declaration of Thomas W. Hazlitt, p. 8.

34/ The Commission made this finding in the context of approving the acquisition by SBC of the much smaller SNET. See *In the Matter of Applications for Consent to the Transfer of Licenses and Section 214 Authorizations from Southern New England Telecommunications Corporation, Transferor to SBC Communications, Inc., Transferee,* Memorandum Opinion and Order, CC Docket No. 98-25, released October 15, 1998.

does not affect this argument — the ability to discriminate is related to the total size of the customer base.

43. The artificial access advantage stems from the fact that access charges are currently priced well above costs. Excessive access charges result in subsidies from the long distance carriers to ILECs. These subsidies give the ILECs an artificial and anticompetitive advantage in the long distance market. These advantages are not the result of efficiency or innovation by ILECs. They are the result of their position as the incumbent local exchange carrier, with the consequent ability to charge competitors high prices for access. One significant problem is that ILECs can place their long distance competitors in a price squeeze.

44. Under a price squeeze, a firm supplying a monopoly input incurs less cost for the monopoly input than it charges its competitors. As a result, the competitors are unable to earn a profit even though they may be as efficient or more efficient than the monopolist. Modern economic theory recognizes the anticompetitive nature of such price squeezes. Raising the price of an essential monopoly input is a "raising rivals' cost" strategy.[35/]

45. Imputation rules do not solve this problem. Under imputation, the monopolist charges itself or its affiliate toll provider the same rate for the monopoly input, i.e., access, as it charges its competitors. Experience in administering the imputation rules shows that these rules are hard

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35/ See, for example, Salop, S. and D. Scheffman, "Raising Rivals' Costs," *American Economic Review*, 73, May, 1983.

to enforce in the face of incentives for the local monopoly telephone companies to abuse them — and the incumbent telephone companies do indeed have these incentives.

46. At the request of AT&T and MCI WorldCom, HAI reviewed imputation of access charges by New York Telephone ("NYT") for its toll and Regional Calling Plan ("RCP") services. The conclusion reached was that despite the Commission's imputation rules and policies, many NYT intraLATA toll services were priced too low to allow competing, equally efficient interexchange carriers to make a profit. The NYT imputation analysis contained unrealistically low costs of administration and marketing. As a result of this and other problems identified, NYT placed its competitors in a price squeeze. Thus, imputation as a competitive safeguard is flawed in both theory and practice.

47. These competitive problems would not be resolved if the imputation rules were changed. Excessive access charges provide incentives for abuse. It is very difficult for regulation to overcome these incentives. With the introduction of local competition, the resources of regulators are stretched even further. The evidence in the interLATA market is that there will be a variety of pricing plans and frequent service innovations. At best, regulators will be able to perform cursory imputation reviews of ILEC offerings. By the time reviews are completed, plans that fail an imputation test may have already damaged competition. As the experience in New York demonstrates, this problem is exacerbated by the fact that the issues surrounding a proper imputation can be quite complex. The New York Commission recently found that " . . . the incumbent local exchange carrier is advantaged by the difficulties and delays inherent in

policing imputation . . ."[36/] A New York administrative law judge described the problems in more detail.

> . . . as a practical matter the [imputation] rule appears difficult to apply, and with the proliferation of competitive services, New York Telephone's rates may be increasingly difficult to police for imputation failure . . .staff reported in July 1996 that New York Telephone's personalized rate plan failed the imputation standard. Despite filing of tariff revisions, New York Telephone conceded and the Commission found that the service still failed imputation in July 1997.[37/]

The bottom line is that pricing access at economic cost is an essential competitive safeguard. If ILECs are not earning excessive profits on access, they are less able to earn low or negative margins on the non-access portion of toll rates.

48. Incumbent local exchange carriers have argued that they have no incentive to discriminate against long distance competitors because they would lose the profits they are making on access as a result. This "opportunity cost" argument is not correct; under some, empirically relevant, circumstances neither imputation nor the firm's own calculus provides the correct opportunity cost to the ILEC. First, the monopolist will have incentives to offer volume discounts or other types of discount plans that long distance competitors cannot match. On minutes of use stimulated by such plans, the long distance carrier will still pay the ILEC full access charges, but the ILEC will recognize that its marginal cost of access is less than a long distance carrier's marginal cost of access. It will therefore be able to profitably offer consumers

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36/ See *Opinion and Order, Establishing Access Charges for the New York Telephone Company and Instituting a Targeted Accessibility Fund*, Opinion 98-10, June 2, 1998, p. 12, fn. 2.

37/ *Recommended Decision* of Judge Stein in Case no. 94-C-0095, January 23, 1998.

deeper discounts. These discounts are not due to efficiency or innovation, but are due simply to the fact that access charges are priced above cost for competitors.

49. Second, if the monopoly telephone company is subject to an explicit or implicit profit cap from regulators, it will not perceive the same cost of discriminating against competitors as when this is not the case. In other words, pricing its own long distance services without regard to access charges may be profitable. Its access profits will fall, but it may avoid a general rate reduction. In addition, it will gain a competitive advantage against its long distance rivals.

50. Third, above cost access charges distort competition because the ILEC can profitably engage in non-linear pricing strategies (e.g., volume discounts or multi-part declining tariffs) that IXCs cannot profitably match. Under these pricing strategies, usage charges can be reduced all the way to marginal cost. The marginal cost floor for an IXC is the per minute access charge paid to the ILEC while the marginal cost floor of the ILEC is the true marginal cost of access. Because the ILEC's private marginal cost of access is far less than an IXC's private marginal cost of access, it can profitably offer non-linear pricing packages for its long distance service (or bundles that include long-distance and local services) that include deeper discounts for marginal long-distance users than can the IXCs, which cannot internalize (and thus eliminate) the distortion created by above-cost prices for access.[38/]

38/ See Declaration of Kenneth C. Baseman and Frederick R. Warren-Boulton on Behalf of MCI, CC Docket No. 97-208 (*In the Matter of BellSouth's Application for InterLATA Authority in South Carolina*), paragraphs 27 and 28 for a more detailed explanation.

51. Mergers among ILECs exacerbate the problems discussed above because mergers will result in a larger number of ILEC calls both originating and terminating within territory. This increases the total access charge advantage accruing to the ILEC. Access charges have fallen in recent years, reducing the magnitude of the advantage. Nevertheless, access charges remain well above costs and continue to account for a substantial portion of the total costs of IXCs.[39/]

52. The Commission reviewed this argument in the context of the Bell Atlantic-NYNEX merger, concluding that the problem was not sufficient to justify disapproving the merger in light of other regulatory rules concerning price squeezes and its expectation that Bell Atlantic would comply with market-opening conditions imposed by the Commission in connection with the merger.[40/] However, since the Commission review of that merger, it has become even more apparent that competition is unlikely to move access charges towards cost. As discussed above, local exchange competition is not developing rapidly.

53. The fact that GTE has not monopolized long distance within its territories does not invalidate the above argument. GTE has been able to gain a nine percent long distance market share in a short period of time.[41/] This is far greater success than any other pure reseller. Our understanding is that this success has been achieved despite the fact that GTE's long distance

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39/ Usage-based access charges have fallen even faster than total access charges because access charge revenue requirement has been transferred to fixed rate elements such as the PICC or explicit universal service requirements.

40/ Bell Atlantic-NYNEX Order para. 115.

41/ See Merrill Lynch, "GTE Corp.," October 20, 1998, p. 2.

prices are higher than those of its competitors.[42/] A similar phenomenon has occurred in SNET territory. This suggests that three forces are at play. First, some consumers have a preference for one-stop shopping and are willing to pay a premium for it. Second, the ILECs that are integrated into long distance service are able to charge a premium for the service because there is no effective local competition to bid the premium away. Third, GTE has a relationship with every customer and may through discrimination steer them to its long distance service even if they do not have a particular preference for one-stop shopping. The GTE and SNET experience does not show that Congress was wrong when it established safeguards for BOC entry into long distance. In fact, SNET achieved its market position in part on its ability to terminate an AT&T billing contract, which had the effect of reducing AT&T's ability to compete for the customers interested in one-stop shopping.[43/] Finally, because of its geographically splintered structure, only about 12 percent of the calls originating in GTE's territory also terminate there — compared to a 40 to 50 percent figure for the BOCs prior to the current merger wave.[44/] This leaves GTE with less incentive to discriminate than a BOC. If the GTE and Bell Atlantic territories are merged, the percentage of calls originating in current GTE territory and terminating in the joint territory will increase substantially, as will the percentage of calls originating in the old Bell Atlantic territory and terminating in the new combined territory.

42/ Merrill Lynch reports that GTE was able to acquire its market share "without crashing the LD pricing structure." Id.

43/ See Baseman and Warren-Boulton. op. cit., paragraph 25.

44/ See B. Douglas Bernheim and Robert D. Willig, The Scope of Competition in Telecommunications, American Enterprise Institute, 1996, p. 47.

54. The competitive problems associated with premature Bell Atlantic entry would be as great if Bell Atlantic provides interLATA service through a wholly owned affiliate GTE as through another affiliate that complied with the separation requirements of Section 272. GTE's long distance operation would effectively become affiliated with the monopoly local exchange carrier in all of Bell Atlantic's territory. There would be a significant risk that all of the anticompetitive behavior that the Section 271 safeguards are designed to minimize would occur. The Section 271 safeguards must be satisfied before Bell Atlantic can safely be allowed to provide these services, either directly, or through the GTE Trojan Horse.

55. The merger may also reduce the prospects for local competition within the territories of the merged firm. Local and long distance services will likely be offered as a bundle. Customers who choose Bell Atlantic-GTE local and long distance service bundles will be lost to CLECs. The access charge advantages the ILECs enjoy (because they are uniquely able to integrate around the problem that overpriced access charges create for IXCs) will result in a smaller potential market for their local competitors. This, in turn, will make it more difficult for independent entrants to reach a viable size. The effects on local markets are discussed further in the next section.

56. Non-price discrimination will also become more likely with a merger. A merged firm degrading quality will have a greater impact on its long distance rivals than non-merged firms because a higher proportion of the independent rivals' calls will both originate and terminate within region. That is, discrimination will carry a higher pay-off after a merger. This incentive

is exacerbated by the fact that the probability of detection of discrimination will be reduced by the loss of benchmarks.

57. The risk of technical discrimination is actually higher now than it has been in the past. The deployment of new signaling systems, intelligent network architectures, and the growth of broadband applications are all leading to different and more complex forms of network interconnection. This in turn increases the opportunity to discriminate. To take the Advanced Intelligent Network ("AIN") as an example, an ILEC can refuse to interconnect at critical points or to convey essential information messages across the network. Instead of refusing to cooperate, the ILEC can choose to cooperate in a painfully slow way – with the same ultimate result. It can also put competitors at a substantial disadvantage by slow-rolling their requests for interconnection based on unjustified claims of technical infeasibility or lack of capacity. Regulators have a difficult time refereeing technical disputes of the sort that would be created. The implication is that competitors will not be able to design customized applications for customers that the ILEC would be able to provide – not because the ILEC is more efficient but only because the ILEC controls the last mile.

58. Of course, another problem is that simply by having to ask for new or special forms of interconnection to meet special customer needs or develop new products, IXCs are put at a disadvantage. The ILEC can delay provision of the necessary interconnection until it is ready to market the same service.

IV. THE ADVERSE EFFECTS FOR LOCAL COMPETITION FROM BELL ATLANTIC'S ACQUISITION OF GTE

59. Bell Atlantic and GTE argue that their merger is in the public interest because the new Bell Atlantic will jumpstart local exchange competition by investing aggressively in out-of-region facilities that will be the catalyst for competion against other ILECs.[45/] In section A, we discuss the companies' out-of-franchise activities and plans for local competition. It section B, we explain why the merger is unlikely to result in out-of-franchise entry that would not soon have occurred anyway, but is likely to eliminate an incentive for GTE to use its proximity to BOC urban centers to sell local inputs to competing entities trying to satisfy one-stop preferences of major corporate customers. In section C, we explain why the merger will likely reduce local service competition within the Bell Atlantic and GTE service territories.

A. Bell Atlantic's and GTE's Plans for Out-of-Franchise Local Entry.

60. Bell Atlantic acknowledges the merger will reduce local competition in Virginia Beach, where it will not pursue a plan to compete (in a venture with Cox Communications) against

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45/ Bell Atlantic and GTE clearly possess technical and financial resources for entry better than, or at the very least as good as, any other entrant. Nevertheless, they each indicate that independent out of region local entry on any significant scale will not generate returns sufficient to justify the investment. Thus, in the Application they recognize that enormous entry barriers remain in local service. This position completely undermines claims that the IXCs and stand-alone local entrants have been timing and scaling their entry so as either to prevent BOC entry into long distance service under the 271 process or to "game" the regulator into requiring lower rates or better terms for BOC services or UNEs. If GTE (who has no 271-based strategic motive to avoid out-of-region local entry) finds such entry unprofitable, one need not look for subtle, strategic reasons why MCI WorldCom, AT&T and others have not entered as quickly as they initially hoped. There are substantial barriers to local entry for them as well. It is ironic that Bell Atlantic castigated other local entrants for not entering sooner or on a broader scale, when its own out-of-region investments in local service were minuscule.

GTE.[46] Bell Atlantic also notes that it has competed against GTE to provide service at Dulles airport, in the Virginia suburbs of the District of Columbia. It argues that any loss of competition in Virginia is inconsequential. Bell Atlantic notes that at one point it was studying entry into GTE exchanges adjacent to its existing service territories in Virginia and Pennsylvania. It says it has abandoned any consideration of such entry, and no one has been authorized to even study the economics of such entry the NYNEX acquisition.[47] Bell Atlantic provides no information about any pre-merger plans it may have had to enter local markets in states outside its service territory.

61. GTE indicates that it has attempted entry as a reseller in a few local markets adjacent to its existing LEC operations. However, it says that discounts available to resellers are too small to support a profitable operation. It has therefore found that profitable entry must be at least partially facilities-based. However, at the small scales it has achieved, it cannot justify investing in facilities.[48] Its entry thus far has focused on mid-sized businesses. It has not attempted to

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46/ Declaration of Hugh Stallard (attached to BA-GTE Appl.) ("Stallard Aff.") at p. 5.

47/ Stallard Aff. at p.2.

48/ GTE's observation here is particularly poignant. It has argued in Section 252 proceedings that host ILECs will voluntarily share their economies of scale and scope with new entrants by selling them inputs at prices determined according a "market-based" variant of the efficient component pricing rule (M-ECPR). It, and the BOCs, have generally been required by state regulators to sell UNEs at prices lower than M-ECPR levels (but higher than true TSLRIC levels). Yet in its role as an out-of-franchise entrant, GTE finds that it still suffers from diseconomies of scale. Apparently it cannot find ILECs to share voluntarily with it their economies of scale and scope.

market to residential consumers because the "cost of acquiring and serving consumer customers was prohibitive".[49/]

62. The companies say that the merger, by combining GTE's locations next to BOC urban franchises outside the Bell Atlantic territory with Bell Atlantic's existing relations with large businesses in the Northeast, will enable it to begin providing facilities-based local competition in 21 cities. Bell Atlantic, which under this theory is providing the important increments in traffic, would have had incentives for out-of-region local entry even without the GTE merger. But the application is silent on the issue of how many of these 21 cities Bell Atlantic might have entered anyway. The application is also silent on whether Bell Atlantic might have entered any GTE franchise areas outside the Northeast.

B. The Merger Is More Likely to Reduce than to Enhance Local Competition and Competition for Bundles of Local, Long Distance, and Other Services.

63. Bell Atlantic-GTE's public interest argument rests on several assumptions. First, they claim GTE's franchises are themselves not particularly attractive locations for out-of-franchise entry by other BOCs or CLECs, because they are largely suburban and rural and therefore lack the necessary concentrations of large businesses. Thus, they argue that Bell Atlantic could not

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49/ Kissell affidavit at p. 2. GTE, like other CLECs, says it has not served residential customers because the poor profit potential does not warrant the necessary investment. The BOCs have generally claimed that the IXCs are strategically avoiding residential local competition in order to avoid triggering 271 authority for the BOCs. GTE's experience lends credence to the IXCs' denial of the charges, since GTE is allowed to provide interLATA service now, without going through the 271 process.

be interested in entering GTE's territories. Interestingly, the Bell Atlantic affidavits address only its studies of entry plans.

64. Second, they argue that, because of the proximity of GTE's facilities to important urban areas where the BOCs provide service, the sharing of facilities in GTE's franchise areas can be used to reduce the costs of local entry in these attractive, adjacent, urban areas. Third, they argue that Bell Atlantic's relations with large businesses headquartered in the Northeast allow it to provide the concentrations of traffic volume that make feasible investment in facilities near GTE's local exchanges whose average costs depend on volume. Apparently, the potential for cost-effectively entering adjacent local markets from neighboring GTE exchanges exists only outside of Bell Atlantic states because the parties tell the Commission that GTE would not enter any of Bell Atlantic's states on its own.[50/] Therefore, the parties suggest that, their merger will enhance competition for local and bundled services. The GTE franchises "enable" Bell Atlantic to enter local service out of region that it otherwise could not afford to undertake. Fourth, the parties assume demand will be strong for bundled local and long distance services, and they

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50/ We note that less than five months ago one of the GTE affiants supporting this application, Debra Covey, told the West Virginia Public Service Commission that GTE was in fact going to compete against Bell Atlantic for local exchange service in West Virginia. *See* Transcript of Proceedings, at 119-20, *WorldCom, Inc., Petition for Consent and Approval to Acquire All Outstanding Shares of Stock of MCI Communications Corporation*, Case No. 92-0347-SWF-CN (June 25, 1998) (excerpts attached as Ex. _ to MCI WorldCom's Comments) ("GTE Communications Corporation, our C-LEC, which I am employed by, intends to offer local service here [in West Virginia] next year" and "as a C-LEC we will offer bundled services, wireless paging, Internet, local"); *id.* at 124 (GTE intends to compete in 100-200 mile radius from existing territories).

assert, without specifying how, that the merger will enhance competition for these bundled services.

65. The first assumption — that the GTE franchise areas are not attractive targets for out-of-region entry by the BOCs or CLECs so Bell Atlantic is not likely to ever enter there — is clearly overstated. The premise is that GTE's franchises are mostly in suburban and rural areas, therefore are not likely candidates for local competition. It is true that in the early years of the Bell system's monopoly, it consciously tried to achieve and maintain monopolies in major cities, and it sometimes left to other companies the higher cost, less urbanized areas. Since GTE was not part of the Bell system, it was not part of the Bell system monopoly over most urban areas. However, GTE did manage to end up with operations in several important urban areas, such as Dallas, Tampa and Los Angeles. These cities hardly seem less attractive prospects for entry than the twenty-one cities the parties identify as attractive candidates for entry after they merge. Given the logic of the urban/rural categorization, GTE should offer to divest operations in these cities so as to preserve Bell Atlantic's incentives to enter there.

66. Moreover, if it is true that most GTE's franchises are unlikely targets for entry by other local carriers, the logical implication is that it is especially important that GTE remain independent of the BOCS. One explanation for why the BOCs have not attempted to provide local service in one another's region is that each fears that such entry will lead to retaliatory entry within its own region by the BOC whose territory it entered. The threat to enter GTE's franchises on a retaliatory basis is less credible if there are no profits to be earned. On this basis, if GTE is right that its regions are less desirable entry targets, then GTE is an especially credible

potential entrant because it is less likely that any ILEC against whom it enters can retaliate effectively.

67. The second assumption — that many of GTE's facilities are close enough to major population centers to meaningfully reduce the costs (by sharing facilities) of local entry in adjacent areas — does not justify this merger. Recall that GTE's position is its own territories are not attractive for entry, and that standing alone it cannot earn a sufficient return to warrant entering adjacent urban areas where entry is inherently more attractive, even with the leg up of being able to leverage off geographically proximate facilities, because it sees insufficient demand to justify the investment. There are two major problems with this formulation. First, GTE has in fact been attempting to enter local markets out of its franchise areas, and has announced plans to invest substantially more in the future.[51/] And it has established non-LEC businesses in Bell Atlantic's territories (a substantial presence in GTE Internetworking and long distance activities) from which it would make sense to base a local entry strategy there. Thus the premise that GTE has the ability to enter local markets only adjacent to its LEC franchises is

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51/ *GTE Announces Initiatives to Become a Leading National Provider of Telecommunications Services* (May 6, 1997) ("Simply put, GTE will become a leading national 'one-stop' provider of local, long-distance, Internet and wireless services."); *GTE 1997 Annual Report Financial Data* ("By packaging products and services, such as traditional wireline, wireless, long-distance and Internet services on one bill, GTE is positioned to capture high-value, high margin customers, both inside and outside of franchise territories."). A copy of GTE's May 6, 1997 press release is available over the internet at http://www.gte.com/AboutGTE/news/ 050697. html. A copy of GTE's Annual Report Financial Data is available over the internet at http://www.gte.com/AboutGTE/annual1997/finreview2.html#Growth.

inconsistent with GTE's actions prior to announcement of its merger with Bell Atlantic and contrary to its established presence in Bell Atlantic's region.

68. In addition, the parties' argument that GTE needs Bell Atlantic's concentrated long distance traffic to enter local markets adjacent to its LEC franchises is highly suspect. If GTE does not have to fear local entry by others into its suburban franchises (because, as GTE argues, they are not attractive targets for entry by anyone), why wouldn't it attempt to solve its volume problem by investing in adjacent, out-of-franchise facilities and leasing or renting capacity to other firms, such as the IXCs, who it says now have the demand volumes to support construction of new facilities?[52/]

69. One possible explanation is that Bell Atlantic-GTE do not see the cost synergies as being all that significant, which implies that controlling GTE's facilities will not affect materially the costs for out-of-franchise entry. A second explanation is that the market for bundled local/long distance service is still nascent, so it would not pay GTE to construct the facilities yet because demand from IXCs and out-of-region BOCs will not soon be sufficient to fill the facilities. In that case, however, the relevant forward-looking question is why, as demand develops, the public interest wouldn't better be served by keeping GTE independent. It would have

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52/ This questions is especially relevant to GTE's national fiber network. The parties' merger application repeatedly refers to these facilities near Phoenix and Denver as being an "enabler" for Bell Atlantic's out-of-region entry. The parties never explain why GTE can't simply sell capacity on those facilities to Bell Atlantic, if and when Bell Atlantic gets around to entering out of region. GTE has no incentive to resist that capacity sale, since, as it points out, it does not have local exchanges near Denver or Phoenix against which Bell Atlantic would be competing.

commercial incentives to lease capacity to several customers (e.g., MCI WorldCom, BellSouth and Bell Atlantic), whereas when Bell Atlantic owns GTE, it would have the incentive to use the facilities to support only its own entry. This is because, under GTE's logic, Bell Atlantic has something that GTE does not possess: established business relationships with the largest corporations. Thus, GTE could not compete for the end-to-end business, so it would have incentives to lease facilities to all contestants for that business.[53/]

70. We turn now to the third step in the logic – that Bell Atlantic brings to the BA-GTE merger table established business relationships with large business customers that GTE does not possess. This premise is clearly overstated, at the very least. For example, GTE Internetworking already has existing relationships with large corporate customers, including many who are located in Bell Atlantic's region. And GTE operates its Internet/long distance network in the Northeast.

71. Moreover, even accepting the counterfactual premise that GTE is powerless to enter local service in the Northeast, it does not follow, as the parties suggest, that Bell Atlantic needs GTE in order to "enable" it to enter local service out of region in the near future.[54/] Bell Atlantic's

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53/ An independent GTE investing in out-of-franchise local entry would provide both actual competition to the incumbent ILEC and useful benchmarks.

54/ The parties also apply the "enabling" argument to brand names, claiming that the merger is needed to enable them to invest in a brand name to challenge other major brands in telephony. This argument is a red herring. Brand names matter little to major business customers. Bell Atlantic and GTE say their merger is most likely to "enable" them to reach Fortune 500 accounts who are contemplating some sort of sole-source arrangement with a single vendor. For smaller business customers and residential customers, brand names are useful to the extent they provide accurate summary information about the firms' reputations and qualities. However, Fortune 500 accounts will directly investigate and extensively test the services of any

relationship with large business customers gives it an incentive, with or without the merger, to enter local markets out of region if those customers show an interest in end-to-end service. The incentive for out-of-region entry is especially strong if Bell Atlantic begins losing high margin local telephone business with major corporations to rivals offering end-to-end service.

72. The economics of such defensive entry are far different than the economics of offensive entry. The returns from offensive entry (entering out-of-region local service before there is meaningful in-region local competition) are simply the (relatively low) profits from competing as a small player against the host ILEC. The returns from defensive out-of-region entry include both the out-of-region profits from local service plus the larger monopoly profits from local service within region that the ILEC retains if it keeps local business, rather than losing it to CLECs who have established a nationwide footprint.

73. Thus the notion that ILECs may enter the local telephone business out of region for defensive, but not offensive, purposes has logical appeal. However, if this argument is correct, then this merger is not needed to induce Bell Atlantic to enter local service out of region. As ILECs begin to lose multilocational business to facilities-based local entrants in their regions (such as MCI WorldCom), they will begin investing out of region to protect their customer base. A logical implication is that Bell Atlantic's current business plans for out-of-region local entry are largely irrelevant to its likely future actions. It may have no current plans for out-of-region

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vendor before committing to them on a sole source basis. In addition, it is hard to imagine that any Fortune 500 telecommunications manager is not intimately familiar with the names GTE or Bell Atlantic given how long they have monopolized local telephone service.

local entry because it has not yet seen a significant enough loss of high margin, in-region local business. In that case, the returns from facilities-based local entry out of region are not particularly attractive, as today's CLEC's, including GTE, have found.[55/]

74. The factual premise for the fourth assumption — that demand for end-to-end service (which may, but need not necessarily, entail bundled local and long distance services) will turn out to be strong — may or may not turn out be valid, but certainly many firms, including MCI WorldCom, have invested heavily in facilities that would satisfy any such demand. Local markets are not competitive, but the major facilities of large Fortune 500 firms are sometimes served by multiple suppliers. MCIWorldCom, TCG, and a number of smaller CLECs have facilities in major cities throughout the country. The competitive benefits of an additional entrant into this segment of the market are correspondingly reduced.[56/]

55/ GTE's experience confirms that entry into local telephony is time-consuming and costly. Very large barriers to entry remain in local markets. And the UNE procedures in place have done little to change that fact. The UNE provisioning process is not working. Moreover, the prices are too high. The practical reality is that, to the extent local entry is occurring, it is predominantly with facilities constructed by the entrant. MCI WorldCom has argued that local entry cannot be viable if it depends substantially on UNEs purchased under the terms and conditions that now prevail from an entity, the ILEC, with no incentive to make the transaction work. Bell Atlantic and GTE have reached the same judgment. They have decided that out-of-region local entry must be predominantly facilities-based and they cannot rely substantially on UNEs purchased from the out-of-regions ILECs on the terms and conditions at which they are currently available (at least during the early stages of entry).

56/ The benefits of competition could, of course, be extended to more customers if ILECs were to make available unbundled network elements and wholesale services on non-discriminatory terms.

75. Indeed, in our opinion this merger will affect adversely the development of competition for bundled services because it will strengthen each partner's bottleneck control over local facilities within region. There is already ample competition in the long distance portion of the bundle, but not for the local portion of the bundle. Permitting this merger to occur, as discussed below, will make even more remote the possibility that such local competition will ever occur in Bell Atlantic's and GTE's monopoly regions. To that topic we now turn.

C. This Merger Will Reduce Local Service Competition in the Bell Atlantic and GTE Territories, and Thereby Harm Consumers.

76. Disapproving the merger provides the best chance for local competition to develop in Bell Atlantic's and GTE's territories. Bell Atlantic's and GTE's defense of their merger proposal explicitly recognizes that entry into local service is extraordinarily difficult. The proposal also recognizes that the market opening measures for local service that thus far have been implemented under the 1996 Act have not opened local markets very much.

77. GTE and Bell Atlantic are in effect conceding that out-of-region local markets are not yet "open to competition," which the 1996 Act makes a prerequisite for BOC interLATA authority. GTE and Bell Atlantic are as well positioned as anyone in terms of the technical and financial capabilities for local entry. If entry is unprofitable for them, the market is not "open to competition" in any meaningful economic sense.

78. If the local inputs needed to compete with ILECs for the business of major business customers could be procured in a competitive environment, then out of region local entry by Bell

Atlantic-GTE would not be needed to satisfy these customers. However, ILECs who do not yet face established, facilities-based local competition can be expected to discriminate against anyone (including operations of out-of-region ILECs) trying to take away local service revenues.

79. ILECs have an incentive to provide UNEs on a non-discriminatory basis to entities that are both capable of entering with their own local facilities and in a position to offer sole-source or one-stop shopping to large corporate accounts. In this case the ILEC has an incentive to provide good UNE service in order to avoid losing all local revenues flowing from the business of those customers. This incentive is eliminated by the merger if Section 271 authority has also been granted prematurely (e. g. before local competition has taken root and forced access charges far closer to economic cost). The merged company will move to provide its own one-stop shop immediately, and therefore will be able to compete for the patronage of its own Fortune 500 customers on an end-to-end basis. It will not have to consider whether to make UNEs available on a more reasonable, competitive basis in order to keep a portion of the business of these large customers. Thus, a Bell Atlantic-GTE merger coupled with Section 271 authority raises serious risks to the possibility of effective local competition by reducing the chances Bell Atlantic or GTE otherwise might have moved, as local competition developed, to provide UNEs on more reasonable terms.

80. If Bell Atlantic does not provide in-region interLATA service, the merger still creates a serious risk that it will be able to seriously disadvantage smaller competitors for national/local accounts. The smaller competitors would include CLECs and other ILECs who might consider

out-of-region entry. By definition, these carriers have less extensive local facilities in place. Bell Atlantic-GTE could install out-of-region switches and fiber rings so as to provide national customers with the same telecommunications interface in all areas where it had its own facilities. Without interLATA authority, Bell Atlantic would have incentives to set up its service so that customers could use it with any long distance service. But because there is no serious disagreement that long distance service for large corporate amounts is quite competitive, Bell Atlantic need not fear that long distance carriers will purposely design their service so as not to work well with its multilocational service. Customers who prefer Bell Atlantic's multilocational local service features will search out long distance services that interconnect well with Bell Atlantic.

81. But with respect to the local facilities used in these product bundles, asymmetrically large ILECs, such as the proposed Bell Atlantic-GTE and SBC-Ameritech, will be better able to win a discrimination game against other competitors for multilocational accounts. The mergers are contrary to the public interest because larger ILECs can discriminate more effectively than smaller ones. Consider a customer for whom 80 percent of its traffic originates and terminates in Bell Atlantic's territory, and 20 percent of which flows between points in Bell Atlantic's territory and the territory of another ILEC. In competing for the multilocational business of that customer, Bell Atlantic has a substantial advantage. If the smaller ILEC wants to compete for that customer, it will need to build its own facilities or procure UNE's from Bell Atlantic for 80 percent of the customer's business. CLECs would have to build facilities or buy UNEs for 100 percent of the locations. Bell Atlantic will need to build facilities or buy UNEs to serve only 20

percent of the customers requirements. For UNE-based entry, Bell Atlantic can discriminate against rivals for a far greater volume of business. And Bell Atlantic's investment to build around such discrimination is far smaller than the other ILEC, because it already provides facilities-based service for four times as many calls. This gives Bell Atlantic both the incentive and ability, without fear of effective retaliation, to discriminate against other firms attempting to meet the demand for multilocational service.

82. It then may make (private) sense for GTE-Bell Atlantic to build their own out-of-region local facilities. It will then control both local ends for far more major clients than any other ILEC or non-ILEC competitor with fewer local facilities in place near the larger business customers' locations. Because it will be far larger than other competitors, it can inflict far more discrimination on others than it will have to incur itself. In these circumstances, the post-merger Bell Atlantic — like the post-merger SBC — will find itself uniquely well-positioned to win the business of Fortune 500 clients, since it can offer service far less prone to discrimination than IXCs and other ILECs.

83. To see how this works, consider the following simple example. Suppose that if an ILEC provides "good" UNE services, other local carriers can profitably serve corporate customers using a UNE-based strategy. However, currently the ILECs' incentives are to offer "bad" UNE services, which prevents UNE-based local competition. Offering UNEs on this basis allows the ILEC to keep all local revenues from those corporate accounts. The ILEC would obtain lower

revenues and profits from selling UNEs.[57] So, while the ILEC could provide good UNE service to its competitors, it chooses not to do so. Rather, it provides them with bad UNEs so as to forestall local competition. It provides good service to itself (but these are not called UNEs).

84. This situation can be understood using the theory of network externalities. In a competitively structured market, firms have an incentive to interconnect on mutually beneficial terms. In this context, this means that firms have an incentive to open their networks to other competitors through provisioning UNEs and terminating network interconnection on reasonable physical and financial terms and conditions. To not do so means the loss of business to other firms. However, if Bell Atlantic gets too large, it loses any private incentives to maintain compatibility. It will have more to lose than to gain by opening its networks. When it gets large enough, it has incentives to "tip" the system to incompatibility.[58]

85. Premature interLATA relief exacerbates the problem. Bell Atlantic can still provide good service to itself, yet continue to provide bad UNE service to others. It is not backsliding on the performance of UNEs it sells to others, it just never offers UNEs of any serious commercial

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57/ As we noted above, if (as) local competition develops (without interLATA authority) at some point the ILECs incentives change. It will have incentives to provide good service to other carriers because they have competitive alternatives of getting good quality service from other local facilities-based competitors. At that point, the ILEC finds it profitable to stop discriminating (or to begin providing more compatibility), for it is better for the ILEC to get the UNE revenues than nothing at all.

58/ Jean-Jacques Laffonte, Patrick Rey, and Jean Tirole, "Network Competition: 1. Overview and Nondiscriminatory Pricing," The Rand Journal of Economics, Spring '98, pp. 1-37.

value. In these circumstances, the Bell Atlantic-GTE merger creates additional incentives for discrimination (for less compatibility offered to customer/competitors). The merged firm now finds it profitable to be the only provider of high quality one-stop (local plus interLATA) service, and it now has stronger incentives to resist local competition (because it now captures all one-stop revenues that previously were captured by no one).

V. MERGERS BETWEEN MAJOR ILECS (SUCH AS BELL ATLANTIC-GTE AND SBC-AMERITECH) THREATEN COMPETITION FOR ADVANCED SERVICES AND INTERNET SERVICE

86. The Commission is currently concerned about competition for the advanced services that will bring broadband Internet access to residential and small business customers.[59/] A key fact in the development of the Internet is that there have been no dominant firms involved in its evolution. Due to the Line of Business Restrictions in the MFJ,[60/] BOCs were originally restricted from providing information services. After this restriction was eliminated, the BOCs claimed that the interLATA restriction limited their ability to provide information services. Despite constant claims by the BOCs that these services would not reach the mass market without their involvement,[61/] the Internet flourished. Both large and small entrepreneurs were able to innovate and invest in Internet technology. As explained below, the mergers between

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59/ *In the Matters of Deployment of Wireline Services Offering Advanced Telecommunications Capability*, CC Docket No. 98-147, Memorandum Opinion and Order and Notice of Proposed Rulemaking, released August 7, 1998. ("Broadband NPRM")

60/ *U.S. v. A.T.&T.*, 552 F.Supp. 131 (D.D.C. 1982).

61/ See *Memorandum of the Bell Companies in Support of Their Motion for a Waiver of the Interexchange Restriction to Permit Them to Provide Information Services Across LATA Boundaries* (D.D.C. filed April 24, 1995).

Bell Atlantic and GTE and Bell Atlantic and GTE will have negative consequences for development of both broadband and Internet competition.

A. Broadband Competition

87. There are many ways in which an ILEC can discriminate against competitors that are dependent on access to the ILEC networks to reach customers. Discrimination is a particular problem when technologies are changing.[62/] Discrimination can be built into new network architectures and new technologies can be deployed to favor the advanced services provided by the ILEC.[63/] For example, the ILECs generally have been trying to limit competition for new DSL technologies by refusing to allow customer/competitors to purchase essential facilities needed to provide broadband services. Rather, the ILECs insist that would-be competitors to its broadband offerings must purchase an unbundled loop and collocate their own equipment to provide DSL service to their customers. The problem is exacerbated by the fact that ILECs in general are refusing to allow efficient collocation, and imposing a variety of other restrictions that have the effect of limiting the ability of competitors to offer competitive versions of xDSL.

88. The problem will only become worse as broadband technology evolves. xDSL technology provided over copper loops has been available for almost a decade and is fairly well understood. The ILECs are deploying digital loop carrier ("DLC") systems to more and more of their customers. With DLC systems, competitors may require access to electronics located at the

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62/ See Baseman and Warren-Boulton, op. cit., at paragraphs 20-24.

63/ See Economics and Technology of Broadband Deployment.

fiber-feeder interfaces in the loop. So far, no ILEC has allowed the subloop unbundling required to provide this access. With evolving technology, it may be possible for ILECs to select for strategic reasons a broadband/DLC architecture that does not allow efficient unbundling at ether the subloop or the wire center.

89. The merger will have negative effects on the evolution of broadband competition primarily because it will eliminate important benchmark competition. It is during a period of rapid technological change that competitive benchmarks can be particularly revealing. Broadband technology is relatively new and has not evolved to the extent that traditional circuit switched technology has evolved. In these circumstances, different firms will be experimenting with different technologies and approaches to providing the service. To the extent that major ILECs make independent broadband technology choices, adopt independent collocation polices, or make independent unbundling decisions, the Commission is provided with invaluable information. The loss of a benchmark is particularly significant with this merger because, as an established nation-wide Internet player, GTE has an interest in using its considerable expertise as a local exchange carrier to induce other ILECs to open their networks to allow broadband competition to develop rapidly. This will be less likely once it is affiliated with Bell Atlantic.

B. Internet Issues

90. There is also a substantial risk to Internet service providers. Some parties opposed the MCI WorldCom merger, arguing it created the potential for MCI WorldCom to monopolize the Internet backbone. MCI WorldCom's Internet operations were divested before the merger was

approved. The Internet concerns struck us as theoretically valid, but empirically suspect, since it was not at all clear that (given the extensive building of backbone and other routing facilities by many other players) there was any danger that there was in fact a backbone bottleneck or that MCI WorldCom could gain control of it.

91. On the other hand, there is clearly a local bottleneck. As discussed above, the ILECs thus far have been able to restrict competition for that bottleneck by refusing to provide competitor/customers with the essential elements they need and are entitled to under the 1996 Act in order to be able to compete. The bottleneck and the many ways the ILECs can discriminate do not go away simply because the network is evolving to incorporate local broadband technologies such as xDSL. Indeed, local broadband technologies provided over ILEC monopoly networks may become the preferred method of access to the Internet. As such there is great risk that the bottleneck will simply evolve to encompass the new technologies. ILEC mega-mergers exacerbate that problem. The potential problems are discussed below.

92. There is a great risk that ILECs will be able to favor their own ISPs.[64/] This, of course, is a risk any time a vertically integrated monopolist competes in regulated monopoly and competitive markets. The problem will be exacerbated to the extent that xDSL access becomes a significant means of accessing the Internet. It is in fact likely that xDSL, or other forms of

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64/ See *Complaint of the Department of Public Service and the Office of Attorney General, Before the Minnesota Public Utilities Commission, In the Matter of an Investigation Into U S West Communications Provision of MegaBit Services*, Docket No. P421/EM-98-471, September 10, 1998.

broadband access, will become increasingly significant as the consumer demand for high bandwidth Internet applications grows.[65/]

93. Current Internet access for most end users is through dial-up local connections. Discrimination against ISPs to date has been limited due to the fact that ILECs have been late in entering the market and the fact that the pricing, technology and provisioning of these connections is standardized. By contrast, xDSL connections will be subject to pricing, technological, and provisioning uncertainty. This will open up the opportunity for discrimination against CLECs and ISPs.[66/]

94. The problems discussed above, of course, are likely to occur with or without the merger. However, the negative consequences for the development of the Internet are exacerbated by the merger. As described in Table II, after the merger, Bell Atlantic-GTE and Bell Atlantic-GTE will control almost 70 percent of the lines between them. These lines are the true bottlenecks to the Internet. If SBC-PacTel-SNET-GTE and Bell Atlantic-NYNEX-GTE leverage their advantages in the provision of broadband access into a significant position in the ISP business, the problems will only be worse. Perhaps separately, and certainly in "gentlemen's agreement"

65/ See Economics and Technology of Broadband Deployment, Section II.

66/ We are not suggesting that discrimination over dial-up connections can not or has not occurred. But the ILECs were not among the first movers in the ISP business. The absence of discrimination to date could merely reflect the fact that the ILECs were not in a position to benefit from discrimination, not that existing regulation is sufficient to prevent discrimination in dial-up access. Our main point, however, is that incentives for discrimination are far harder for regulators to control when technology is changing.

duopoly, these parties would have the ability to refuse to peer with other ISPs, or to discriminate in other terms in favor of their own ISPs, in precisely the ways that concerned regulators in the MCI WorldCom merger.[67/]

95. In short, with two major suppliers of Internet bottleneck connections to end-users, there is a risk that they will act in concert to disadvantage all other suppliers. For example, by imposing discriminatory terms of interconnection on other providers, they can raise their rivals' cost of doing business.[68/] With several smaller firms, this is less likely. Even though, prior to the mergers, individual ILECs may disadvantage ISPs in their own regions and therefore gain control over a disproportionate share of the ISP business, there would still likely be a sufficient number of large players to ensure that interconnection in the Internet business generally is on reasonable terms. There would be incentives to exchange traffic on reasonable terms since no one supplier controls a disproportionate share of the business. Recent economic analysis shows

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67/ The problem is ameliorated if other technologies emerge to provide broadband access for ISPs. For the cable industry, at least, the prospects for effective competition from the cable industry for the last mile of Internet access are uncertain. See Barbara Esbin, "Internet Over Cable: Defining the Future in Terms of the Past," FCC, OPP Working Paper no. 30, August 1998 for a discussion of Internet over cable.

68/ Critics of a merger of MCI's and WorldCom's Internet businesses argued that it would be easy to customize discrimination so as to pick off one competitor at a time, as part of a divide and conquer strategy. (See "Internet Reply Affidavit of Robert G. Harris on behalf of GTE Corporation," June 8, 1998, paragraph 46, and "The Strategy of Targeted Degradation," pp. 10-13 of "The degradation of quality and the domination of the Internet" by Jacques Cremer, Patrick Rey and Jean Tirole submitted by GTE to the European Competition authorities and to the FCC in June 1998.

The Commission took those complaints seriously. If discrimination can be customized, it would clearly be feasible for the Bell Atlantic and the Bell Atlantic groups of ILECs to treat one another quite differently than they treated other Internet companies.

that in network industries, there is an incentive to cooperate as long as no single player or small set of players dominates. However, once the industry moves to an asymmetric structure (e.g., where the merged Bell Atlantic-NYNEX and Bell Atlantic-GTE substantially control more choke points on the Internet than other players), the dominant firm or firms have incentives to not cooperate with smaller firms.[69/]

96. The negative consequences of two large firms essentially controlling the financial and physical terms of entry into the Internet business are substantial. For example, ISPs are not merely gateways to information services. They are becoming important content providers and Internet service innovators. ISPs increasingly are in the content business and the business of assisting other firms with Internet commerce through designing, hosting and managing web sites. By imposing costs on independent firms and thereby making it more difficult to enter and expand in the Internet business, social welfare could be dramatically affected.

97. The underlying public policy rationale behind the required spin-off of MCI's Internet backbone business prior to the WorldCom merger must have been that this market is capable of being monopolized by players with asymmetrically large positions. The Bell Atlantic and Bell Atlantic groups will control the majority of bottleneck local facilities necessary for Internet service. Their potential for effective discrimination far exceeds anything MCI WorldCom would have possessed, because the "last mile" bottleneck is far more secure than any temporary choke

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69/ See Laffont, Rey and Tirole, op. cit.

points MCI WorldCom might have possessed if no divestiture of Internet assets had been required for regulatory approval of that merger.

98. We recognize that (unlike MCI WorldCom) the Bell Atlantic-GTE merger does not consolidate existing strong positions among two former competitors. Bell Atlantic and GTE are not now competing with one another for local customers in each others' territories, and Bell Atlantic is a minor ISP player. But they each now have a local monopoly in their home region. And the merged company will have a greater incentive and/or ability than the individual companies to distort inefficiently competition in adjacent markets, such as ISP or backbone service out of region.

99. Exactly how the incentives play out depends on other decisions the Commission and state regulators must make. If the ILECs are required by the Commission to sell xDSL UNEs at regulated rates based on forward-looking cost, then they will have strong incentives to evade the profit constraint by entering adjacent markets and discriminating against competitors. If the Commission does not require the ILECs to sell xDSL UNEs on a regulated, carrier-to-carrier basis, the xDSL consumer prices will likely still be constrained directly or indirectly by regulation. Competitors may buy conventional unbundled loops at regulated rates and attempt to assemble their own xDSL service as best they can in face of noncooperation from the ILEC concerning issues such as collocation.[70/] Alternatively, competitors to the ILECs may attempt to

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70/ We recognize that the Commission is addressing these issues in its Broadband Rulemaking. Separate affiliates and enhanced unbundling and collocation requirements are under consideration. To the extent that the Commission adopts suggestions made in HAI's

compete reselling xDSL service purchased at state-regulated retail rates. In each of these cases, because its xDSL profits are constrained by some form of regulation; the ILEC will want to integrate into adjacent markets, discriminate against rivals, and take profits in those markets that regulation denies it by limiting xDSL prices to less than the monopoly level.[71/]

100. These incentives for discrimination will exist with or without the merger. However, a merged Bell Atlantic-GTE (and a merged SBC-Ameritech) will have greater ability than the companies standing alone to discriminate effectively because of their greater combined control of Internet bottleneck facilities.

101. Indeed, the Public Interest Statement filed by Bell Atlantic and GTE seems to contemplate substantial steering by Bell Atlantic of in-region Internet business to GTE's backbone. GTE's Curran argues that GTE's backbone business will obtain "access for Bell Atlantic's concentrated Northeast customer base,"[72/] allowing it to provide these customers with

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"Economics and Technology of Broadband Deployment" and in the Comments of parties in the Broadband proceeding, the problems discussed here might be ameliorated. However, as long as the bottleneck is in place and vertical integration is allowed, there will be competitive concerns. Regulation is simply not adequate to eliminate all problems when there are strong incentives for evasion.

71/ Of course, this is not to say that regulators ought to deregulate the ILECs' xDSL service, or that there is little to choose from among the various possible regulatory alternatives for xDSL. Based on a judgment that multiple methods of entry are necessary for local competition to develop, the 1996 Act is that ILECs should unbundle their services, offer inputs to rivals at forward-looking, cost-based rates, and offer rivals the option of purchasing ILEC services at wholesale discounts for resale to their own customers. Competitors to the ILECs should have all these options for the xDSL business for the same reasons they should have them for conventional local telephony.

72/ Curran affidavit at p. 2.

an unspecified array of new services. But today GTE has the same "access" to customers as the other backbone companies. None of the major national backbone companies is now a BOC, so in each BOC's territory, each backbone provider can compete on a level playing field to attract patronage of ISPs. Bell Atlantic and GTE apparently plan to use control over "access to Bell Atlantic's concentrated Northeast customer base" to tilt this competition in favor of GTE. They argue that the merger benefit to GTE is access to Bell Atlantic's extensive Northeast marketing and distribution networks. But this seems merely a silly euphemism for discriminating against other backbone providers. As the parties note, Bell Atlantic is but a tiny ISP, and it does not currently provide interLATA backbone services. Thus its marketing network has no relevant experience. Preferential access to Bell Atlantic's distribution network (the bottleneck to the end user!) is discrimination.

102. The merged super BOCs will also have incentives for monopolization of out-of-region Internet activity. That is, even if they earned the entire profit available from monopolizing in-region advanced and Internet services and if no further profit could be extracted from monopolizing adjacent or related in-region services, they still have incentives to leverage their control of the lion's share of local Internet access into additional profits in out-of-region ISP services. For example, after entry into out-of-region Internet services (and in-region Internet services if the Commission's interpretation of Section 271 allows it), the merged BOCs could discriminate against competing ISPs at either backbone to backbone connections, or at backbone to local interconnections. Since the BOCs will control more local Internet access after merger than before, merger will increase their ability to discriminate effectively.

103. In summary, there is a danger that Internet service will "tip" to Bell Atlantic and SBC if they are allowed to consummate their pending mergers. Competition among ISPs or backbone service providers could be seriously distorted due to these mergers. The result would be higher prices for consumers of Internet services and reduced opportunity for innovation by independent firms. This magnitude of the social risk depends on a number of factors, about which we now offer no empirical assessment. First, the risk is greater the more completely and quickly the Internet moves away from dial-up access to xDSL connections, where the potential for successful discrimination is far greater. Second, the risk is greater the lower the ultimate competitive significance of alternatives provided by CLECs or the cable industry.[73/] Third, the risk is greater the lower the entry barriers for BOCs into the adjacent markets, since merger-related Internet problems occur only when the merged company enters (or expands from a fringe position) in a market in which it was either not present previously, or in which it was small.

104. Even if the probability that all three factors will be present in the near future is small, the Commission should still view the risks to Internet competition as serious, especially since, as we noted, GTE's Internet business apparently plans to benefit from ISPs and end-users in the Northeast being steered to use GTE's services. As discussed above, the Bell Atlantic-GTE merger carries very little potential for public benefits, so additional risks, such as the risk to Internet competition, add to the public interest case against the merger.

73/ This is not to say that the market will exhibit competitive performance if, say, the cable industry becomes a significant local player in high speed Internet access. Duopoly is not competition as we know, for example, from the cellular business. There the addition of more sources of competition, such as PCS, has benefitted consumers.

VI. A PROPERLY CONSTRUCTED STOCK MARKET EVENT ANALYSIS SHOWS THE MERGER IS ANTICOMPETITIVE

105. Bell Atlantic and GTE offer an "event study" by Thomas Hazlitt as evidence to support their application. In general, event studies are used in antitrust to assess the perception of investors in financial markets concerning the likely effects of a merger. The intuition behind the event study methodology is straightforward. Investors are betting real dollars trying to anticipate the effect of important events, such as merger-related changes in market structure, on firms' stock market values. Various investment institutions expend considerable resources to follow events that can be expected to influence the values of widely held stocks, such as Bell Atlantic, GTE, AT&T and MCI WorldCom. Thus, the stock market's reactions to a merger are said to be largely influenced by well-informed predictions of the actual effects of the merger. For example, if the "market" expects that a merger will generate significant efficiencies or synergies, then the combined value of the two partners' stock should increase. [74/]

106. There is at least some controversy within the literature over the value of event studies in assessing the effects of mergers, or other events. First, the method assumes that investors are fairly well informed, and in a good position to judge quickly the effects of a merger. Critics of

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74/ It is the change in so-called abnormal returns to the stocks of the merging companies that is of issue. That is, the analyst is interested not in the changes in the merging firms' stock prices, but the changes in those prices after netting out the aggregate effects on stock-market wide changes occurring at the same time. Hazlitt computes abnormal returns by netting out from the changes in individual company stock prices the change in the S&P 500 on the same day.

To keep the discussion in the text as simple as possible, we will sometimes refer to changes in stock prices in the merger window. But in each case we are referring to the abnormal returns to the stock prices.

event studies point out that many mergers to which investors reacted favorably turned out later to be disasters for the shareholders. Promises of synergies or efficiencies sometimes are not met, and the costs of merging and running two organizations are sometimes far higher than expected. Second, the predicted effects of a merger may sometimes depend on the size of the "event window," and there is not yet a well-recognized basis for deciding which window is most appropriate. The event window is the period over which the abnormal changes in the merging firms' stock prices are analyzed. For example, Hazlitt reports the stock price changes over a one day and a three day window. The one day window looks only at the stock prices the day of the merger announcement. The three day window looks at stock price changes from the day before the announcement to the day after the announcement. The longer the window, the greater the chance that other, non-merger, events might be influencing stock prices, thereby undermining the value of any inference about the predicted effects of the merger. The shorter the window, the more compelling becomes the objection that the "market" has had not sufficient time to fully analyze the merger's effects. Practitioners of the methodology recognize that the conclusions are strongest when similar effects are found using different, reasonable windows.

107. There is an economic literature, some of which is cited by Hazlitt, on the use of stock market event studies to predict the effects of a merger. The goal is to determine whether the market reaction is consistent with one view of a merger and inconsistent with another. We will show that Hazlitt's results, even if accepted at face value, are in fact of no assistance in distinguishing between the major competing hypotheses on the competitive effects of the Bell Atlantic-GTE merger.

108. In a conventional horizontal merger (where, for example, the merger would reduce the number of competitors from 5 to 4 or 4 to 3) the two competing hypotheses are that the merger will reduce competition by leading to collusion or some other lessening of the intensity of market price competition, or that it will increase competition as the merged company passes through to final customers some of the merger-related efficiencies, thereby making life more difficult for the competition. Event studies can be useful in choosing between these two hypotheses. If investors predict a merger will be pro-competitive, the stock prices of the merging firms should rise, and the prices of competing firms should fall. If investors expect a reduction in the intensity of competition from a merger (e.g., tacit collusion), then the prices of both the merging companies and its rivals should increase.

109. Dr. Hazlitt's event study sheds no light on the expected effects of Bell Atlantic's acquisition of GTE for two reasons. First, the competing theories on whether this merger will enhance or reduce competition are different than the theories for a traditional horizontal merger. To the extent that antitrust enforcement will generally not allow a merger if it will have the effect of permitting unilateral market dominance, horizontal mergers of the type studied in the event study literature cannot lead to predatory or exclusionary behavior. Therefore the sole remaining antitrust issue is whether the merger lessens the intensity of competition between horizontal rivals. But clearly the anticompetitive concern with mergers between major ILECs is not that they will collude with IXCs or other ILECs to raise the price of long distance service and/or bundled services.

110. The competitive danger with both the Bell Atlantic-GTE merger and the SBC-Ameritech merger is that they will increase the ability and/or the incentive of merging companies to engage in exclusionary or predatory behavior, such as discrimination against IXCs in long distance or bundled long distance/local services, or discrimination against local entrants within their service territory, to effectively forestall the development of local competition there. Thus, the observation that the stock prices for AT&T, MCI WorldCom, and Sprint fell with the announcement of the Bell Atlantic-GTE merger is consistent either with the view that the merger is anticompetitive or procompetitive. Investors could expect MCI WorldCom's future prospects were adversely affected by the merger either because it will suffer from increased exclusionary behavior that harms both it and consumers, or that it will suffer from increasing legitimate competition that harms it and helps consumers.[75/] The event study observation that MCI WorldCom's stock price fell when the merger was announced is thus consistent with both anticompetitive and procompetitive interpretations of the merger, and therefore is of no use in distinguishing between the theories.

111. Second, Hazlitt does not provide the abnormal stock market returns for other parties whose stock valuations should be influenced by the merger. In a proper event study, one looks examines changes in the stock prices of all such firms. The table below lists the abnormal returns, in percentage terms, for a three day window around the Bell Atlantic-GTE merger announcement for several companies of interest that were not covered by Hazlitt.

75/ Given that the long distance market is already quite competitive, investor concerns over increased discrimination against MCI WorldCom are more likely than concerns over increased competition.

Cumulative Abnormal Returns (%)

Three Day Window Around Bell Atlantic-GTE Merger Announcement[76/]

SBC	Ameritech	BSouth	USWest	BA	GTE	BA + GTE
-0.3%	-2.16%	+2.2%	+3.29%	+2.32%	-4.36%	-0.65%

112. If Bell Atlantic and GTE were correct in their belief that the merger generates substantial efficiencies and that the merger will facilitate significant out-of-region entry by the merged company, and if Hazlitt is correct that an event study is appropriate here, then we should observe that:

a) the combined market value of Bell Atlantic and GTE should increase (because of the efficiencies and synergies), and

b) the prices of the other BOCs should be negatively affected because they will be presented with a significant new competitor for local service and bundled services in their regions.

113. In fact, the event study does not support either of these predictions. The combined value of Bell Atlantic and GTE shows negative abnormal returns (-0.65%), indicating that investors

76/ None of the qualitative observations we make below would be changed if we used a one-day window.

believe that the merger entails negative synergies (i.e., from the shareholders' perspective, the costs of the merger outweigh the benefits).[77/]

114. The stock prices of US West and Bell South show positive abnormal returns, which is not what one would expect if the merger were likely to significantly increase local competition in their regions. On the other hand, the stock prices of SBC and Ameritech show negative abnormal returns. It is not likely that investors would expect out-of-region entry by Bell Atlantic-GTE in the SBC and Ameritech regions, but not in the USWest and BellSouth regions.[78/] So we need another explanation for the price pattern.

115. The stock price pattern may be explained by a "piling on" phenomenon. This has often happened in antitrust merger reviews. Two companies in an industry announce a merger. Two other competitors then immediately follow with their own merger. The managements for the firms in the second merger may reason that they don't know whether the first merger will get antitrust clearance, but if it does, they want their own merger judged at the same time, expecting that the antitrust authorities will approve both mergers or neither. Something similar may be happening here. SBC and Ameritech probably did not welcome the Bell Atlantic/GTE announcement because it forces the FCC to consider two very large LEC mergers at the same

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77/ Investors also apparently think that Bell Atlantic struck a good bargain and GTE did not. GTE's abnormal returns were -4.36%. Between the lack of overall synergies from the merger and the bad deal struck by its management, investors think GTE lost almost five per cent of its total value from the merger.

78/ Bell Atlantic-GTE had not announced specific entry targets at the time the merger was announced.

time. To the extent the Commission finds the cumulative change in concentration troubling, investors may believe that it is more likely to turn down the first merger than if the second merger were never announced. This could explain why the announcement of Bell Atlantic's acquisition of GTE reduced the stock prices of SBC and Ameritech, but not USWest and BellSouth.

116. Skeptics who may doubt the wisdom of inferring anything from stock price movements are of course free to throw out event studies in their entirety. We believe event studies are one useful tool (among many) for merger analysis, so long as they properly use all the available information to attempt to choose among hypotheses.[79/]

79/ Skeptics are sometimes uncomfortable with event studies because they suspect that if the market quickly knows the economic effects of a merger, it may have anticipated the merger, so the stock price movements on the day of the announcement may reflect only reactions to the financial terms of the merger, and may not be reactions to the merger itself. This does raise serious issues, but they can be addressed within the event study framework. If the merger is anticipated (perhaps because of leaks from financial advisers or from the fact that the merger negotiations are not secret) then the appropriate approach is to lengthen the event window. Abnormal returns can be easily estimated over a much longer period than the one to three day windows Hazlitt employs. With a longer window, the results may become more unreliable to the extent that other important events, affecting the stock prices of the merging companies or their rivals, occur in the window.

We have run the event study including the thirty days prior to the announcement of the merger. The abnormal returns over the period for the IXCs and other BOCs are mixed — MCI and WorldCom had positive returns and AT&T and Sprint had negative returns, some BOCs had positive returns and some had negative returns. We are not confident that other important events affecting valuations for these companies did not occur during the period. In particular, the mixed IXC results may reflect perceptions about the prospects for the then-pending merger of MCI and WorldCom.

Interestingly, however, the abnormal returns were negative (on the order of -10%) for both GTE and Bell Atlantic over the period. If markets were aware of the merger negotiations during this period, and if Bell Atlantic and GTE believe that the Commission should be guided by the implications of event studies, then they should withdraw their merger application. The market is telling them the merger is not in the interests of their shareholders. If Bell Atlantic and

117. In our opinion, a properly interpreted event study, contrary to Hazlitt's claims, indicates investors believe that Bell Atlantic's acquisition of GTE will not result in synergies or efficiencies, and that the merger will not result in significant new, out-of-region local entry. Hazlitt's inference that the IXCs will face consumer-enhancing competition from Bell Atlantic-GTE is not warranted, since the hypothesis that the merger will result in anticompetitive exclusion is equally consistent with the observed changes in stock prices.

VII. SUMMARY AND CONCLUSIONS

118. We have shown here that this merger will not improve consumer welfare and is in fact likely to reduce it. As we noted at the outset, this merger should be evaluated using the learning produced in the aftermath of the Bell Atlantic-NYNEX merger. Even though the Commission believed it was anticompetitive, it approved that merger because of its belief that merger conditions would provide substantial benefits. That merger has not had the intended effects. As we demonstrated in Sections III and IV this merger is also anticompetitive and the Bell Atlantic-GTE local entry argument does not resuscitate it. The prognosis for other mergers among large ILECs is no better.

119. The Bell Atlantic-GTE merger is not in the public interest whether Bell Atlantic-GTE enters local service out of region or not. If Bell Atlantic-GTE decides after the merger not to enter local service out of region, then the public interest approval would have been based on a false premise.

GTE believe that the market really doesn't understand what is going on, they should not present the Commission with event studies to justify their merger.

120. If Bell Atlantic or GTE would have entered each other's territory absent the merger, then the substantial consumer benefits from entry by one ILEC into another ILEC's territory will likely be lost, because local competition is now so poorly developed and one could not presume that other, non-ILEC entrants would replace the competitive effect of the lost out of region entry by GTE or Bell Atlantic in the other merger partner's region.

121. We think it likely, based on our own analysis and GTE's and Bell Atlantic's presentations, that either or both would engage in out of region local entry in the near term as and if facilities-based competition for local business access develops within region. This developing competition creates strong incentives for "defensive" out-of-region entry, to protect their in-region business with major corporate customers. Indeed, unlike Bell Atlantic and NYNEX two years ago, who denied any corporate interest in out-of-region entry, GTE and Bell Atlantic acknowledge that each has a strong interest in out-of-region entry today.

122. If a merged Bell Atlantic-GTE enters out-of-region local markets where neither would have entered as independent companies, it is probably only because they can discriminate more effectively than smaller ILECs to get the business of major business customers.

123. The merger exacerbates the problem of discrimination by Bell Atlantic-GTE to monopolize the emerging Internet and advanced services (such as xDSL). On a stand-alone basis, the discrimination threatens the evolution of local competition in their service territories. If the local operations of Bell Atlantic and GTE are consolidated, the discrimination will also

threaten competition on the Internet. Indeed, GTE anticipates its backbone business will benefit from preferential access to Bell Atlantic's customer base.

124. The merger would remove benchmarks that are helpful to regulators as they try to control market power and introduce competition in local telephony.

125. The merger would exacerbate potential competitive problems in the long distance business (assuming ILECs are allowed into interLATA service before local competition has developed).

126. Finally, we have found no compelling reason to believe the merger will allow realization of efficiencies that are not available absent the merger.

We declare under penalty of perjury that the foregoing is true and correct.

Kenneth C. Baseman

A. Daniel Kelley

November 23, 1998

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of GTE Corporation, Transferor and Bell Atlantic Corporation, Transferree For Consent to Transfer of Control	)))	CC Docket No. 98-184

JOINT DECLARATION OF MARCEL HENRY AND JOHN TROFIMUK IN SUPPORT OF COMMENTS OF MCI WORLDCOM, INC.

We, Marcel Henry and John Trofimuk, declare:

1. We submit this joint declaration in support of the Comments of MCI WORLDCOM, Inc. ("MCI WorldCom") concerning the proposed merger between Bell Atlantic Corporation ("Bell Atlantic") and GTE Corporation ("GTE"). The purpose of this Declaration is to discuss the role of benchmarking in negotiating with incumbent local exchange carriers ("ILECs") and to provide examples of differences between Bell Atlantic and GTE on issues of importance to competitive local exchange carriers ("CLECs"). As described below, each of us has significant knowledge concerning the actions and positions of one of the two companies -- Marcel Henry concerning Bell Atlantic and John Trofimuk concerning GTE.

2. Marcel Henry currently holds the position of Vice President of Financial Operations for MCI WorldCom. His duties in that position include responsibility for negotiating and implementing interconnection arrangements between Bell Atlantic and MCI WorldCom concerning local services, and for managing MCI WorldCom's relationship with Bell Atlantic as a purchaser of exchange access. Because of his responsibilities, he is familiar with the terms and conditions on which Bell Atlantic is willing to provide interconnection, unbundled network

elements, and services for resale to CLECs, including MCI WorldCom, and the terms and conditions on which it is willing to provide exchange access to interexchange carriers, including MCI WorldCom. The information described below concerning Bell Atlantic is based on Mr. Henry's personal knowledge through direct dealings with representatives of Bell Atlantic and from information learned in the ordinary course of business from colleagues at MCI WorldCom who deal first-hand with representatives of Bell Atlantic.

3. John Trofimuk currently holds the position of Regional Executive for MCI WorldCom. His duties in that position include responsibility for negotiating and implementing interconnection arrangements between GTE and MCI WorldCom concerning local services, and for managing MCI WorldCom's relationship with GTE as a purchaser of exchange access. Because of his responsibilities, he is familiar with the terms and conditions on which GTE is willing to provide interconnection, unbundled network elements, and services for resale to CLECs, including MCI WorldCom, and the terms and conditions on which it is willing to provide exchange access to interexchange carriers, including MCI WorldCom. The information described below concerning GTE is based on Mr. Trofimuk's personal knowledge through direct dealings with representatives of GTE and from information learned in the ordinary course of business from colleagues at MCI WorldCom who deal first-hand with representatives of GTE.

4. Our knowledge is based primarily on our experience in dealing with Bell Atlantic and GTE on behalf of MCI Telecommunications Corporation ("MCI"), which recently became a wholly owned subsidiary of MCI WorldCom. WorldCom may have had some different experiences before it merged with MCI to form MCI WorldCom. When we refer to MCI WorldCom, we include not only the current company but also its predecessors.

BENCHMARKING IN GENERAL

5. In preparation for separate negotiations with Bell Atlantic or GTE, MCI WorldCom routinely analyzes the actions and policies of other ILECs with respect to specific local competition issues. MCI WorldCom can use, and does use, the willingness or ability of one ILEC to provide a service on particular terms and conditions when it bargains with another ILEC for the same arrangement. For example, MCI WorldCom uses its experience with other ILECs when an ILEC claims that it is not technically feasible to provide a service or capability that another ILEC provides to MCI WorldCom, or that a price proposed by MCI WorldCom is unreasonably low even though other ILECs provide the same capability or service at the same price.

6. Benchmarking has proven to be a useful tool not only for federal and state regulators, but also for incumbent LECs' customers to move incumbent LECs toward providing interconnection and access on more reasonable terms and conditions. MCI WorldCom has effectively used benchmarking with Bell Atlantic, GTE and other ILECs not only in its negotiations as a CLEC but also in its negotiations concerning the price and quality of exchange access that they provide to MCI WorldCom as an interexchange carrier. For example, MCI WorldCom has used, and continues to use, the willingness of one ILEC to use a particular system, pricing structure or provisioning process to persuade other ILECs to provide exchange access on the same terms and conditions.

7. MCI WorldCom's ability as a CLEC and as an interexchange carrier to benchmark the different ILECs would be greatly diminished if Bell Atlantic and GTE, or SBC and Ameritech, are permitted to merge. To the extent that Bell Atlantic and GTE take different positions on significant issues for CLECs and interexchange carriers, it is reasonable to expect that they will no longer do so if they are permitted to merge, and that MCI WorldCom's ability to negotiate with ILECs based on positions taken by other ILECs will be reduced.

RECIPROCAL COMPENSATION

8. An example of significantly different policies and practices between Bell Atlantic and GTE involves compensation for exchange of local traffic between ILECs and CLECs. GTE agreed to the approach advocated by MCI – a "bill and keep" system under which both sides receive and complete local calls intended for their subscribers, without any exchange of money.

9. In contrast, Bell Atlantic rejected a bill and keep approach in favor of a system of reciprocal compensation. Notwithstanding Bell Atlantic's preference for reciprocal compensation, however, Bell Atlantic has subsequently refused to pay the required compensation for local traffic that MCI WorldCom terminates to Internet Service Providers, and MCI WorldCom has been forced to obtain orders from state commissions requiring Bell Atlantic to comply with its obligations.

10. At a minimum, the different approaches of GTE and Bell Atlantic provide information about the practical effects so that competitors and regulators can evaluate which system is best.

OPERATIONS SUPPORT SYSTEMS FOR MAINTENANCE

11. As is the case with most ILECs, Bell Atlantic operates an electronic system to receive, track and process "trouble tickets" reporting problems in Bell Atlantic's provision of local interconnection access to CLECs. Although the system is not without problems, it at least allows a CLEC such as MCI WorldCom to seek to resolve problems in a relatively efficient manner.

12. In contrast, GTE lacks any electronic system to handle problem reports concerning the local interconnection and access it provides to CLECs such as MCI WorldCom. Thus, to report a problem and seek a resolution of the problem, MCI WorldCom's operations staff must attempt to reach GTE's operations department by telephone. The resulting system leads to delays and inefficiencies in the resolution of problems.

ACCOUNT TEAM SUPPORT

13. GTE has committed more resources than Bell Atlantic to account team support for MCI WorldCom (although MCI WorldCom still does not always get satisfactory and timely resolution of issues with GTE). GTE has dedicated more than twenty individuals to address issues that arise with MCI WorldCom both as a CLEC and as an interexchange carrier that purchases exchange access from GTE.

14. In marked contrast, the number of Bell Atlantic personnel responsible for working with MCI WorldCom is less than half the number dedicated by GTE, even though MCI WorldCom is at least as important a customer of Bell Atlantic as of GTE. Moreover, Bell Atlantic allocates, for its entire region, a grand total of *three* individuals to work with MCI WorldCom on issues relating to MCI WorldCom's efforts as a CLEC to compete with Bell Atlantic. Bell Atlantic's lower staff commitment has lead, at a minimum, to unjustified delays in the resolution of business issues between the two companies including, including for example, the processing of orders and development of efficient systems.

15. Beyond the staffing levels themselves, Bell Atlantic has divided its few support staff members into two groups -- one for exchange access service and one for CLEC issues -- and refuses to permit MCI WorldCom to work with a single support group, even on issues that involve both access and CLEC aspects. This splitting of support functions significantly complicates MCI WorldCom's ability to solve problems with Bell Atlantic.

16. In addition, MCI WorldCom has information that Bell Atlantic has already made clear to GTE that after a merger of the two companies, the merged company will reduce the level of staffing provided to support its business relationship with MCI WorldCom.

We declare under penalty of perjury that the foregoing is true and correct.

I, Marcel Henry, hereby attest and state that the statements contained herein are true and correct to the best of my knowledge, information and belief.

Marcel Henry

Subscribed and sworn to before me this 23rd day of November, 1998.

Linda D Clonts
(signature of notary)

My commission expires:

May 1st 2000
(appropriate date)

I, John Trofimuk, hereby attest and state that the statements contained herein are true and correct to the best of my knowledge, information and belief.

John Trofimuk

Subscribed and sworn to before me this 20th day of November, 1998.

Pauline M. Kerkstra
(signature of notary)

My commission expires:

8/29/99
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GTE Corp.

Company Update

Rating: Hold *(Low Risk)*

- ☐ Operating results in line with expectations.
- ☐ Core telco EPS growth of 10%.
- ☐ Dilution from data initiatives of $0.10
- ☐ 40% cellular EBITDA margin.

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GTE (58 ¾)— NYSE October 27, 1998

	Earnings Per Share Fiscal Year Ending 12/97	12/98E	12/99E	P/E 12/99E	Ind. Div.	Yield	Shares O/S (Mil.)	5 W Ra
New	**$2.90**	**$3.07**	**$3.50**	**16.8X**	**$1.88**	**3.2%**	**968**	**64**
Old		3.05						

DJIA: 8366.04

S&P 500: 1065.35 Priced as of the close. October 27, 1

GTE Reports 3Q98 EPS Of $0.85 Versus Our $0.84 Estimate: Operating Results In Line; Raising 1998 EPS Estimate To $3.07 From $3.05

Highlights

- ☐ GTE reported 3Q98 recurring EPS of $0.85 versus our $0.84 estimate and $0.79 in the year-ag period.
- ☐ EPS from the core telco were $0.95, in line with our $0.95 estimate, and dilution from new data initiatives was $0.10 versus our $0.11 estimate.
- ☐ We are increasing our 1998 estimate to $3.07 from $3.05, which reflects an estimate of $0.88 in 4Q98, consisting of $0.98 from core operations (10% growth) and $0.10 dilution from data initiatives. We are maintaining our 1999 estimate of $3.50 with some minor changes in the quarterly progression, which reflects about 10% growth in the core in each quarter offset by dilution from data initiatives of $0.10 in 1Q99, $0.09 in 2Q99, $0.09 in 3Q99, and $0.08 in 4Q99.
- ☐ Volume and revenue growth at the core telco were strong. Switched access line growth was 5.3 versus our 5.3% estimate; interstate access MOU growth was 8.1% versus our 7.5% estimate; intrastate access MOU growth was 18% versus our 18% estimate; revenue growth was 8%.
- ☐ In the domestic cellular business GTE continued its focus on slower but more profitable growth. Domestic cellular subscriber net adds were 54,000, the ARPU remained flat sequentially at $49, and the EBITDA margin increased to 40% versus 36% in the year-ago period.

- GTE added 272,000 interLATA long distance customers to reach a total of 2.516 million.

- Competitive activity remained modest, as evidenced by strong business switched access line growth of 9.7% and total resold lines of only 102,000 (40% of which were to GTE's own CLEC operations).

Investment Opinion

GTE plans to merge with Bell Atlantic (BEL, 49 9/16, rated Strong Buy) in a transaction in which GTE shareholders are t receive 1.22 shares of Bell Atlantic for each GTE share. Based on this exchange ratio, the spread between GTE and Bell Atlantic is currently 7%. Given that we expect thorough regulatory scrutiny of this proposed merger to result in it closing late as the end of 1999, we don't believe that a 7% spread is large enough to warrant more than a Hold rating on GTE at th time.

Additional Information

GTE reported diluted EPS of $0.85 versus our $0.84 estimate and $0.79 in the year-ago period. Earnings from the core business were $0.95 versus our $0.95 estimate and dilution from new data initiatives was $0.10 versus our $0.11 estimate. We expect 10% earning growth from core operations in 4Q98 and $0.10 dilution from data initiatives, leading to an estima of $0.88 in 4Q98. This increases our 1998 EPS estimate to $3.07 from $3.05. We are maintaining our 1999 EPS estimat of $3.50.

GTE's Domestic Wireless EBITDA Remains At About 40%. Throughout this year, GTE has endeavored to strike profitable balance between subscriber growth and profitability in a wireless environment characterized by higher churn due to greater competition. In the third quarter, GTE continued its execution of this strategy with an EBITDA margin of 39.6% versus 35.7% in the year-ago period and 39.3% in the second quarter. Gross additions rose to 426,000 in the third quarter versus 403,000 in the second quarter, but a churn rate of 2.5% versus 2.3% in the second quarter resulted in net additions o 54,000. ARPU dropped modestly to $49 from $51 in the year-ago period and remained flat sequentially.

Most of the RBOCs are following similar strategies of focusing on high-value customers at the expense of some subscriber growth and are achieving EBITDA margins in the 45% to 50% range (with the exception of Ameritech (AIT, 49, rated Strong Buy)), whose EBITDA margin is running at about 40% due to intense pricing competition in its region). We think i may be difficult for GTE to drive its EBITDA margin much above 40% because of its competitive position in an environment in which national reach is increasingly important. Given its fragmented wireless territories, GTE will most likely have to pay out relatively high amounts of roaming charges to other carriers if it ends up matching national offers fro the likes of AT&T with no additional charges for roaming or for long distance. GTE is always trying to negotiate better roaming rates with other carriers, but even a low roaming rate will be a competitive disadvantage versus carriers with national reach. Obviously, the merger with Bell Atlantic, if consummated, will address this competitive issue to a large extent. In the meantime, GTE plans to fight to keep its high-value customers. GTE has not matched AT&T's Digital OneRate plan yet, but plans on contacting one-third of its customers whom it considers to be high-value and offering them more attractive pricing plans.

We believe that GTE should be able to maintain a wireless EBITDA margin in the high 30's in the fourth quarter. Acquisition cost per gross addition in 3Q98 was $300 versus $324 in the second quarter. We believe there could be room for GTE to reduce that number further as a result of declining handset prices and ongoing cost reduction measures such as distribution channel rationalization.

Consolidated Revenues Grew 9.1% Versus Our 10.0% Estimate. Adjusted for an unfavorable currency translation related to GTE's Canadian operations, revenue growth would have been in line with our estimate. Revenue growth in **local services** was 6.9% versus our 8.0% estimate. Switched access lines growth continued to be strong at 5.3% versus our 5.3%

estimate and special access line growth was 22.3%, resulting in total access line growth of 7.7%. Residential access line growth was 3.6% and business access line growth was 9.7%. Of the $113 million increase in local services revenues, abc $93 million was domestic and $20 million was international. Of the domestic increase, about $20 million was due to verti services, which still have a lot of room to grow. Caller ID penetration was 17.6%; Voicemail penetration was 8%; and C Waiting penetration was 38%. **Interstate access revenues** grew 5.5% versus our 3.9% estimate. Interstate access MOU grew 8.1% versus our 7.5% estimate. **Intrastate access** revenues grew 5.6% versus our 3.9% estimate and despite intrast access MOU growth of 18% (due in part to the loss of intraLATA toll minutes to competition, which generates intrastate access MOU for GTE) versus our 18% estimate. Taking interstate and intrastate access revenues together, the increase w $66 million versus the year-ago period. About two thirds of the increase was due to growth in special access services. Special access lines grew 22.3% and special access revenue was $136 million in the quarter, about 10% of access revenue Price reductions in the quarter netted to about $90 million when both per-minute price declines and increased flat charges considered. **Toll services** revenue declined 5.7% versus our estimate of a 5.6% decline. GTE's market share of intraLAT toll is now about 50% and seems to be leveling off, similar to the experience of several RBOCs in regions in which they ha faced "1+" competition for some time. In the interLATA toll business GTE continues to sign up customers quickly. GTE added 272,000 (versus 209,000 in the second quarter) interLATA toll customers to reach a total of over 2.5 million. InterLATA long distance revenue was an estimated $160 million in the quarter. Average revenue per interLATA long distance customer was about $23 per month, in line with our expectations. The interLATA long distance customer mix continues to be about 90% residential and 10% business. **Other services and sales** revenue growth was a strong 19.5%, b down from growth rates in excess of 30% in the first two quarters. This line item's growth rate can fluctuate significantly because it includes a variety of businesses, some of which have "choppy" revenue recognition. The largest example of this GTE's government systems business, which had revenue growth of about $47 million in the second quarter of this year versus the year-ago period but revenue growth of only about $17 million in the third quarter versus the year-ago period.

GTE's **data initiatives** are included in Other services and sales and continued to grow quickly, with revenue of $202 millic of revenue in the quarter, a 60% increase versus the year-ago period. Growth in data initiatives revenues represented abou 15% of overall GTE revenue growth. Adjusted for several items which slowed the overall growth of this category (such as declining AT&T contract), revenue growth in GTE's "core" Internet businesses was closer to 80%.

GTE's Operating Margin Was 25.5% Versus Our 25.1% Estimate. Consolidated operating income grew 11.0%, yet operating income at the domestic wireline business grew only 1.3%. By backing out from consolidated results the results o the domestic wireline business, the domestic wireless business, and the data initiatives we deduced that the operating margi on the remaining businesses – primarily the international and directory businesses – increased from 21% to 29%. In order for GTE to meet our 1999 EPS estimate of $3.50, the domestic wireline business will obviously have to contribute significantly more to operating income growth. We believe that the domestic wireline operating income margin has been temporarily depressed over the last two quarters due to spending by GTE to establish a national sales, service, and marketi organization to be leveraged by its CLEC going forward.

Expenses Grew 8.5% Versus Our 9.9% Estimate. Costs of services and sales grew 13.3% versus our 20.4% estimate, but that favorable comparison was partially offset by **SG&A** expense growth of 8.1% versus our estimate of a 1.4% declin In general, those two expenses categories taken together should increase more slowly as dilution from GTE's data initiative declines. We estimate that dilution from GTE's data initiatives will decline gradually from $0.10 in 4Q98 to zero in the second half of 2000. We also estimate that interLATA long distance will be dilutive through the end of 1998 and for all of 1999 before turning positive in 2000. **Depreciation and amortization** expense declined 2.5% as a result of asset retiremen that were part of the one-time charges announced in April of this year and as a result of accounting changes at GTE's Canadian operations.

GTE's ADSL Plans Are On Track. GTE has equipped 200 central offices (COs) with ADSL and has an initial contract place with Microsoft (MSFT, not rated) for 500 units. GTE also has resale agreements in place with 46 ISPs. GTE plans make ADSL available to six million of its customers by the end of this year, bringing the total COs to 300. GTE's offerin include 5 service packages with downstream speeds ranging from 258 kilobits per second to 1.5 megabits per second.

Competitive Activity Remains Modest In GTE's Regions. We have always expected GTE to come under competitive pressure in its local exchange business at a slower rate than the industry as a whole due to the fact that up to 90% of its access lines could be defined as rural. An important determinant of a CLEC's business plan is density of access lines, sinc a dense access line configuration allows for very efficient capital deployment. GTE's ILEC ended 3Q98 with 102,000 resc lines, a modest increase from 83,000 at the end of the second quarter. About 40% of the 102,000, however, are being resol by GTE's own CLEC. GTE's out-of-region CLEC activities are proceeding very slowly as the company awaits regulatory clarity in the industry. GTE is not alone in this approach. Given current resale discounts, we have seen many would-be resellers abandon that approach and go back to the drawing board.

Figure 1. GTE Quarterly Income Statement

($Millions)

	1Q97	2Q97	3Q97	4Q97		1Q98	2Q98	3Q98E	4Q98E
Revenues and Sales									
Local services	1,605	1,613	1,647	1,742		1,730	1,771	1,760	1,873
Network access services									
Interstate	728	794	788	748		841	810	829	783
Intrastate	424	466	483	492		485	480	508	517
Toll services	643	608	609	569		591	572	574	538
Cellular services	677	719	714	707		718	745	770	745
Directory services	186	372	407	542		195	379	495	564
Other services and sales	1,018	1,120	1,292	1,547		1,325	1,520	1,544	1,916
Total revenues and sales	**5,281**	**5,692**	**5,940**	**6,347**		**5,885**	**6,277**	**6,480**	**6,935**
Operating Costs and Expenses									
Cost of services and sales	1,952	2,194	2,309	2,748		2,498	2,671	2,617	2,967
Selling, general and administrative	1,027	1,115	1,156	1,262		1,071	1,231	1,250	1,357
Depreciation and amortization	956	977	988	965		969	943	963	988
Total operating expenses	**3,935**	**4,286**	**4,453**	**4,975**		**4,538**	**4,845**	**4,830**	**5,311**
Operating Income	**1,346**	**1,406**	**1,487**	**1,372**		**1,347**	**1,432**	**1,650**	**1,624**
Interest expense - net	275	289	299	282		289	311	312	308
Other expense - net	20	20	(12)	20		23	21	10	10
Income before income taxes	1,051	1,097	1,200	1,070		1,035	1,100	1,328	1,306
Income taxes	386	426	444	368		411	427	506	449
Net Income before Nonrecurring Items	**665**	**671**	**756**	**702**		**624**	**673**	**822**	**857**
Nonrecurring Items	0	0	0	0		(802)	0	0	0
Net Income as Reported	**665**	**671**	**756**	**702**		**(178)**	**673**	**822**	**857**
Diluted Earnings Per Share (Recurring)	**$0.00**	**$0.00**	**$0.00**	**$0.73**		**$0.65**	**$0.69**	**$0.85**	**$0.88**
-- Growth				-10.2%					21.4%
-- Average Common Shares Outstanding	0	0	0	963		968	972	968	968
Basic Earnings Per Share (Recurring)	$0.69	$0.70	$0.79	$0.73	#	$0.65	$0.70	$0.85	$0.89
-- Growth	11.1%	6.3%	0.9%	-9.9%	#	-6.1%	0.3%	7.8%	21.1%
-- Average Common Shares Outstanding	960	956	956	957	0	959	962	964	964

Source: Company reports and Prudential Securities estimates.

Figure 2. GTE Income Statement
($Millions)

	1994	1995	1996	1997	1998E	1999E	2000E	2001E	2002E
Revenues and Sales									
Local services	5,234	5,839	6,155	6,607	7,134	7,661	8,197	8,763	9,364
Network access services									
Interstate	2,722	2,741	2,917	3,058	3,263	3,386	3,462	3,523	3,568
Intrastate	1,626	1,622	1,701	1,865	1,990	2,075	2,156	2,214	2,264
Toll services	3,285	2,548	2,500	2,429	2,275	2,383	2,447	2,502	2,558
Cellular services	1,666	2,191	2,562	2,817	2,978	3,101	3,230	3,366	3,507
Directory services	1,372	1,383	1,527	1,507	1,633	1,715	1,801	1,891	1,986
Other services and sales	3,623	3,633	3,977	4,977	6,305	8,073	10,140	12,511	14,923
Total revenues and sales	**19,528**	**19,957**	**21,339**	**23,260**	**25,577**	**28,395**	**31,433**	**34,769**	**38,170**
Operating Costs and Expenses									
Cost of services and sales	7,677	7,537	8,071	9,203	10,753	11,944	13,257	14,720	16,205
Selling, general and administrative	3,667	3,689	4,010	4,560	4,909	5,461	6,121	6,867	7,581
Depreciation and amortization	3,432	3,675	3,770	3,886	3,863	4,277	4,707	5,111	5,541
Total operating expenses	**14,776**	**14,901**	**15,851**	**17,649**	**19,524**	**21,683**	**24,085**	**26,698**	**29,328**
Operating Income	**4,752**	**5,056**	**5,488**	**5,611**	**6,053**	**6,713**	**7,348**	**8,071**	**8,843**
Interest expense - net	1,059	1,047	1,026	1,145	1,220	1,215	1,194	1,122	997
Other expense - net	(16)	5	62	48	64	65	66	68	69
Income before income taxes	3,709	4,004	4,400	4,418	4,769	5,433	6,088	6,881	7,777
	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Income taxes	1,430	1,466	1,610	1,624	1,793	2,044	2,258	2,554	2,888
Net Income before Nonrecurring Items	**2,279**	**2,538**	**2,790**	**2,794**	**2,976**	**3,389**	**3,830**	**4,327**	**4,889**
Nonrecurring Items	162	(4,682)	8	0	(802)	0	0	0	0
Net Income as Reported	**2,441**	**(2,144)**	**2,798**	**2,794**	**2,174**	**3,389**	**3,830**	**4,327**	**4,889**
Diluted Earnings Per Share (Recurring)	**$0.00**	**$0.00**	**$2.87**	**$2.90**	**$3.07**	**$3.50**	**$3.95**	**$4.47**	**$5.05**
-- Growth	0.0%	0.0%	0.0%	1.2%	5.7%	13.9%	13.0%	13.0%	13.0%
-- Average Common Shares Outstanding	0	0	972	962	969	969	969	969	969
Basic Earnings Per Share (Recurring)	**$2.38**	**$2.62**	**$2.88**	**$2.92**	**$3.09**	**$3.52**	**$3.98**	**$4.50**	**$5.08**
-- Growth	0.0%	10.0%	10.0%	1.3%	6.0%	13.9%	13.0%	13.0%	13.0%
-- Average Common Shares Outstanding	958	970	969	958	962	962	962	962	962

Source: Company reports and Prudential Securities estimates.

Figure 3. GTE Revenue, Margin, and Profitability Analysis

	1994	1995	1996	1997E	1998E	1999E	2000E	2001E	2002E
Operating Revenue Growth:									
Local services		11.6%	5.4%	7.3%	8.0%	7.4%	7.0%	6.9%	6.9%
Network access services									
Interstate		0.7%	6.4%	4.8%	6.7%	3.8%	2.2%	1.8%	1.3%
Intrastate		-0.2%	4.9%	9.6%	6.7%	4.3%	3.9%	2.7%	2.3%
Toll services		-22.4%	-1.9%	-2.8%	-6.3%	4.7%	2.7%	2.2%	2.3%
Cellular services		31.5%	16.9%	10.0%	5.7%	4.1%	4.1%	4.2%	4.2%
Directory services		0.8%	10.4%	-1.3%	8.4%	5.0%	5.0%	5.0%	5.0%
Other services and sales		0.3%	9.5%	25.1%	26.7%	28.1%	25.6%	23.4%	19.3%
Total revenues and sales		**2.2%**	**6.9%**	**9.0%**	**10.0%**	**11.0%**	**10.7%**	**10.6%**	**9.8%**
Operating Expense Growth:									
Cost of services and sales		-1.8%	7.1%	14.0%	16.8%	11.1%	11.0%	11.0%	10.1%
Selling, general and administrative		0.6%	8.7%	13.7%	7.6%	11.3%	12.1%	12.2%	10.4%
Depreciation and amortization		7.1%	2.6%	3.1%	-0.6%	10.7%	10.0%	8.6%	8.4%
Total operating expenses		**0.8%**	**6.4%**	**11.3%**	**10.6%**	**11.1%**	**11.1%**	**10.9%**	**9.8%**
Operating Margin	**24.3%**	**25.3%**	**25.7%**	**24.1%**	**23.7%**	**23.6%**	**23.4%**	**23.2%**	**23.2%**
Pre-tax Margin	**19.0%**	**20.1%**	**20.6%**	**19.0%**	**18.6%**	**19.1%**	**19.4%**	**19.8%**	**20.4%**
Tax Rate	38.6%	36.6%	36.6%	36.8%	37.6%	37.6%	37.1%	37.1%	37.1%
Net Margin - Recurring	**11.7%**	**12.7%**	**13.1%**	**12.0%**	**11.6%**	**11.9%**	**12.2%**	**12.4%**	**12.8%**
Profitability Analysis:									
Net Margin	11.7%	12.7%	13.1%	12.0%	11.6%	11.9%	12.2%	12.4%	12.8%
x Asset Turnover	0.55	0.50	0.57	0.59	0.60	0.62	0.64	0.66	0.68
= Return on Assets	6.4%	6.4%	7.4%	7.0%	7.0%	7.4%	7.8%	8.2%	8.8%
x Financial Leverage	6.82	4.58	5.31	5.08	5.04	4.93	4.51	4.05	3.60
= Return on Equity	43.5%	29.2%	39.3%	35.8%	35.4%	36.6%	35.1%	33.4%	31.6%
Memo:									
EOP Employees	111,000	106,000	102,000	114,000	115,140	116,291	117,454	118,629	119,815
-- Growth		-4.5%	-3.8%	11.8%	1.0%	1.0%	1.0%	1.0%	1.0%

Source: Company reports and Prudential Securities estimates.

Figure 4. GTE U.S. Cellular Operations

	1994	1995	1996	1997	1998E	1999E	2000E	2001E	2002E
U.S Cellular									
Service revenues	1,539	2,019	2,347	2,549	2,640	2,687	2,732	2,774	2,815
Equipment sales and other	129	129	134	193	218	243	268	293	318
Total revenues and sales	**1,668**	**2,148**	**2,481**	**2,742**	**2,858**	**2,930**	**3,000**	**3,067**	**3,133**
-- *Growth*	*41.1%*	*28.8%*	*15.5%*	*10.5%*	*4.2%*	*2.5%*	*2.4%*	*2.3%*	*2.1%*
Depreciation and Amortization	265	332	385	405	429	437	444	451	457
Other Operating Expenses	1,125	1,406	1,635	1,888	1,929	1,975	2,019	2,061	2,102
Operating Income	278	410	461	449	500	519	537	555	573
Operating Cash Flow (EBITDA)	543	742	846	854	929	955	981	1,006	1,031
Capex	(610)	(709)	(600)	(297)	(250)	(225)	(200)	(200)	(200)
Margin Analysis (% of Total revenues):									
Depreciation and Amortization		15.5%	15.5%	14.8%	15.0%	14.9%	14.8%	14.7%	14.6%
Other Operating Expenses		65.5%	65.9%	68.9%	67.5%	67.4%	67.3%	67.2%	67.1%
Operating Income		19.1%	18.6%	16.4%	17.5%	17.7%	17.9%	18.1%	18.3%
Operating Cash Flow (EBITDA)	35.3%	36.8%	36.0%	33.5%	36.0%	38.0%	39.0%	40.0%	40.0%
Capex		33.0%	24.2%	10.8%	8.7%	7.7%	6.7%	6.5%	6.4%
Operating Statistics:									
Adjusted POPs (000s)	53,000	61,700	61,900	61,900	61,900	61,900	61,900	61,900	61,900
Subscribers (000s)	2,339	3,011	3,749	4,487	4,743	5,027	5,324	5,633	5,954
-- Growth									
Gross Adds			1,773	1,869	1,565	1,672	1,766	1,863	1,964
Disconnects due to Churn			1,035	1,131	1,309	1,388	1,469	1,555	1,643
Net Adds	754	672	738	738	256	285	297	309	321
-- Growth		-10.9%	9.8%	0.0%	-65.3%	11.3%	4.2%	4.1%	4.0%
Churn per month		0.0%	2.3%	2.1%	2.3%	2.3%	2.3%	2.3%	2.3%
Penetration (% of adjusted POPs)		4.9%	6.1%	7.2%	7.7%	8.1%	8.6%	9.1%	9.6%
Service revenue per sub per month	$68	$63	$60	$51	$50	$48	$46	$44	$42
Change	-4.2%	-7.4%	-4.8%	-15.0%	-2.0%	-4.0%	-4.0%	-4.0%	-4.0%
U.S. PCS									
POPs				9,697	9,697	9,697	9,697	9,697	9,697
Subscribers				19	56	84	118	153	184
-- Growth				0	2	1	0	0	0
Revenue per sub per month				$51	$50	$48	$46	$44	$42
Revenue				6	22	40	56	72	86
GTE Domestic Subscriber Growth Including both Cellular and PCS					**6.5%**	**6.5%**	**6.5%**	**6.3%**	**6.1%**

Source: Company reports and Prudential Securities estimates.

Figure 5. GTE Balance Sheet
($ Millions)

	1994	1995	1996	1997E	1998E	1999E	2000E	2001E	2002E
ASSETS									
Current Assets									
Cash	323	332	405	256	202	464	847	1,151	1,561
Accounts receivable	4,022	4,227	4,482	4,885	5,372	5,964	6,602	7,303	8,017
Inventories and supplies	676	719	673	734	807	896	991	1,097	1,204
Prepaid and other	613	614	473	516	567	629	697	771	846
Total Current	**5,634**	**5,892**	**6,033**	**6,391**	**6,948**	**7,953**	**9,137**	**10,321**	**11,628**
Net PP&E	29,328	22,437	22,902	24,144	25,687	26,897	27,782	28,394	28,714
Other L-T Assets	7,538	8,690	9,487	10,341	11,371	12,624	13,975	15,458	16,970
Total Assets	**42,500**	**37,019**	**38,422**	**40,876**	**44,006**	**47,474**	**50,893**	**54,173**	**57,312**
LIABILITIES & EQUITY									
Current Liabilities									
S-T Debt	2,042	2,156	2,497	2,622	2,622	2,622	2,622	2,622	2,622
Accounts Payable	4,010	3,858	4,156	4,530	4,981	5,530	6,122	6,772	7,434
Other	2,169	2,298	1,661	1,811	1,991	2,210	2,447	2,706	2,971
Total Current	**8,221**	**8,312**	**8,314**	**8,963**	**9,594**	**10,363**	**11,191**	**12,100**	**13,027**
L-T Debt	12,163	12,744	13,210	13,210	14,400	14,400	13,800	12,400	10,300
Employee Benefit Obligations	4,651	4,638	4,688	5,110	5,619	6,238	6,906	7,638	8,386
Deferred taxes, credits and other	6,982	4,454	4,874	5,313	5,842	6,486	7,180	7,941	8,718
Equity	10,483	6,871	7,336	8,281	8,550	9,988	11,817	14,094	16,881
Total Liabilities & Equity	**42,500**	**37,019**	**38,422**	**40,876**	**44,006**	**47,474**	**50,893**	**54,173**	**57,312**

Source: Company reports and Prudential Securities estimates.

Figure 6. GTE Corporation Cash Flow Statement

($Millions)	1994	1995	1996	1997	1998E	1999E	2000E	2001E	2002E
Net Income	2,441	(2,144)	2,798	2,794	2,174	3,389	3,830	4,327	4,889
Depreciation & Amortization	3,432	3,675	3,770	3,886	3,863	4,277	4,707	5,111	5,541
Other	(1,133)	3,502	(669)	674	29	35	38	41	42
Net Cash Provided by Operating Activities	**4,740**	**5,033**	**5,899**	**7,354**	**6,065**	**7,701**	**8,574**	**9,479**	**10,472**
Capex - U.S. Telephone	(2,821)	(2,564)	(2,690)	(3,607)	(3,643)	(3,825)	(3,940)	(4,058)	(4,180)
Capex - U.S. Cellular	(610)	(709)	(600)	(297)	(250)	(225)	(200)	(200)	(200)
Capex - Other operating units and corporate	(761)	(761)	(798)	(1,224)	(1,513)	(1,437)	(1,452)	(1,466)	(1,481)
Total Capital Expenditures	(4,192)	(4,034)	(4,088)	(5,128)	(5,406)	(5,487)	(5,592)	(5,724)	(5,861)
Acquisitions and investments	(244)	(798)	(476)	(650)	0	0	0	0	0
Other	1,167	331	287	0	0	0	0	0	0
Net Cash Used in Investing Activities	**(3,269)**	**(4,501)**	**(4,277)**	**(5,778)**	**(5,406)**	**(5,487)**	**(5,592)**	**(5,724)**	**(5,861)**
Dividends Paid	(1,806)	(1,827)	(1,825)	(1,849)	(1,904)	(1,952)	(2,000)	(2,050)	(2,102)
Proceeds from Sale of Common Stock	422	385	444	0	0	0	0	0	0
Purchase of Common Stock for Treasury	0	(133)	(967)	0	0	0	0	0	0
Other	(86)	1,052	799	125	1,190	0	(600)	(1,400)	(2,100)
Net Cash Used in Financing Activities	**(1,470)**	**(523)**	**(1,549)**	**(1,724)**	**(714)**	**(1,952)**	**(2,600)**	**(3,450)**	**(4,202)**
Increase (Decrease) in Cash	**1**	**9**	**73**	**(149)**	**(55)**	**262**	**383**	**305**	**410**
EBITDA	8,184	8,731	9,258	9,497	9,916	10,990	12,055	13,182	14,384
EBITDA as a % of Sales	41.9%	43.7%	43.4%	40.8%	38.8%	38.7%	38.4%	37.9%	37.7%
Free Cash Flow	(125)	(4,330)	655	(297)	(1,273)	227	945	1,663	2,468

Source: Company reports and Prudential Securities estimates.

Prudential Securities Incorporated acts as a specialist that makes a market in the common stock of GTE Corp. At any given time, the specialist may have a position, either long or short, in the [security], and, as a result of the associated specialist's function as a market maker, such specialist may be on the opposite side of orders executed on the floor of a national securities exchange.

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Merrill Lynch

Comment

United States
Telecommunications/Services - Local

20 October 1998

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GTE Corp

3Q Results In Line; Strong Core Continues to Drive Accelerating EPS Growth

ACCUMULATE*

Reason for Report: Third Quarter Earnings Reported

Long Term
ACCUMULATE

Price: **$56 ¾**

Estimates (Dec)	1997A	1998E	1999E
EPS:	$2.92	$3.05	$3.50
P/E:	19.4x	18.6x	16.2x
EPS Change (YoY):		4.5%	14.8%
Consensus EPS:		$3.06	$3.48
(First Call: 16-Oct-1998)			
Q3 EPS (Sep):	$0.79	$0.85	
Cash Flow/Share:	$6.95	$7.03	$7.67
Price/Cash Flow:	8.2x	8.1x	7.5x
Dividend Rate:	$1.82	$1.88	$1.88
Dividend Yield:	3.2%	3.3%	3.3%

Opinion & Financial Data

Investment Opinion:	B-2-2-7
Mkt. Value / Shares Outstanding (mn):	$54,990 / 969
Book Value/Share (Jun-1998):	$8.12
Price/Book Ratio:	7.0x
ROE 1998E Average:	NA
LT Liability % of Capital:	65.8%
Est. 5 Year EPS Growth:	11.5%

Stock Data

52-Week Range:	$64 3/8-$40 1/2
Symbol / Exchange:	GTE / NYSE
Options:	AMEX
Institutional Ownership-Spectrum:	41.9%
Brokers Covering (First Call):	20

ML Industry Weightings & Ratings**

Strategy; Weighting Rel. to Mkt.:		
Income:	Overweight	(07-Mar-1995)
Growth:	Underweight	(07-Mar-1995)
Income & Growth:	Overweight	(07-Mar-1995)
Capital Appreciation:	In Line	(30-Jun-1998)
Market Analysis; Technical Rating:	Average	(27-Jul-1998)

*Intermediate term opinion last changed on 31-Jul-1998.
**The views expressed are those of the macro department and do not necessarily coincide with those of the Fundamental analyst.
For full investment opinion definitions, see footnotes.

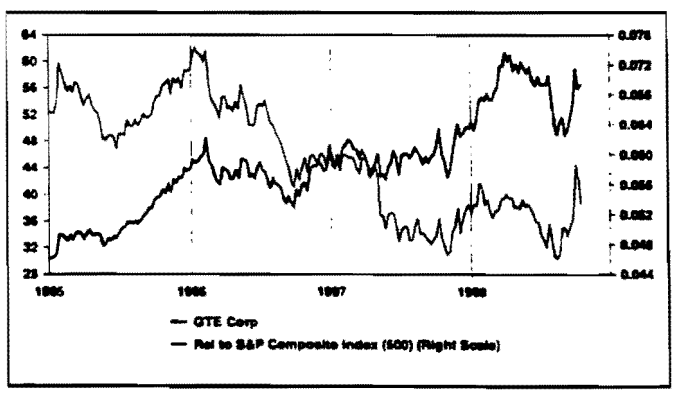
Investment Highlights:

- **We continue to rate GTE Shares Accumulate. With GTE trading at a 7% discount to the merger exchange ratio with BEL, we see 35% upside over the next 12-18 months given the 1.22 exchange ratio applied to our BEL target price of $62 — based on targeted relative P/E of 90%.**
- **We expect EPS growth to accelerate to 10% in 4Q and to 15% in '99 due to expanding data, CLEC and LD contributions. No changes to our EPS ests. of $3.05 in '98 and $3.50 in '99.**

Fundamental Highlights:

- **EPS were 85¢ (up 7.6% y/y), in line with our est. and a penny better than First Call consensus. After excluding the start-up expenses associated with all new initiatives, core operating income and EPS would have increased by approx. 15%.**
- **Normalized for currency exchange rate conversions and a directory publishing shift, revenues rose approx. 9% vs. our 12% est. However, operating expense growth rose only 8.5% vs. our 11.9% est. leading to a solid 11% increase in operating income.**
- **Strong growth in data revs (+48%), switched access lines (+5.3%), dedicated lines (+22.3%), LD revs (+66%), and enhanced services (+28%). Domestic wireless remained soft with 7% revenue growth (which was actually better than our 5% estimate) and 9.1% subsciber growth.**

Stock Performance



Merrill Lynch & Co.
Global Securities Research & Economics Group
Global Fundamental Equity Research Department

RC#20129343

Third Quarter Review:

GTE reported 3Q EPS of 85¢, up 7.6% from 3Q97's 79¢. The results were in line with our estimate but a penny higher than First Call's consensus. Though puzzled by a slowdown in other service and sales revenue and continued softness in its wireless results, we view GTE's 3Q results as solid reflecting EPS growth acceleration from 2Q's 1.4% decline. Data initiatives lowered GTE's EPS by 10¢ per share vs. 7¢ per share reported a year-ago and the 11¢ in 3Q. In addition, we estimate that costs associated with the rollout of PCS, long distance and CLEC businesses further diluted EPS by almost 10¢ (vs. about 5¢ in 3Q97). **We estimate, after excluding the start-up expenses associated with all new initiatives, core operating income and EPS would have increased by approximately 15% y/y.**

Reported revenue growth was 9.1% y/y, hurt by the impact of Canadian currency exchange rate conversions (-$64M) and helped by a directory publishing shift (+65M). However, after adjusting for the currency exchange rate conversions and the directory publishing shift, **we estimate total revenue growth was 9%, below our estimate of 12% and 2Q's 10.3% rise.** On a reported basis, local service revenues rose 7% y/y. After normalizing for the exchange rate conversion, we estimate local service revenues increased almost 9% y/y, a deceleration from our forecasted and 2Q's 9.8% rise. Access revenues rose 5.2% in the quarter, up from 2.5% in 2Q and in line with our estimate. Strong demand in access minutes (+12% y/y) and dedicated access lines (+22.3%) was offset by a mandated $90M (net of SLC and PICC receipts) reduction in access rates. Strong growth in data revenues, drove "other services and sales" growth of almost 20% vs. 2Q's 36% rise and our 30% estimate. We believe the deceleration is mainly due to a slowdown in the roll-out of the out-of-region CLEC, a good thing since we've long viewed out-of-region CLEC efforts as costly, risky and unnecessary given the strength of in-region opportunities.

Domestic wireline revenue grew 8.1%, up from 2Q's 7.7% increase. Switched access lines increased 5.3% which were in line with our estimate but an acceleration from 5% in 2Q. Residential and business switched line growth was 3.3% and 9.7%, respectively (vs. 3.3% and 9.4% in 2Q). Additional lines grew only 7.6% vs. about 9% in 2Q. Special access line growth remained robust, increasing almost 22% y/y vs. 2Q's 26% rise. Minutes of use grew 12%, vs. 2Q's 12.5% increase. Data revenues rose 42% y/y to $430M (or 6.6% of total revenues) and a 22.1% sequential increase from 2Q's $352M (or 5.6% of revenues). In addition, enhanced services (i.e., vertical services, CentraNet, CyberPop) revenues increased 28% y/y, which was a slight deceleration from 2Q's 30%. Total vertical service revenues increased 16.4%, in line with 2Q.

GTE has accumulated 9% LD market share (higher than our forecast of 6-7%) and has done so without crashing the LD pricing stucture. Long distance revenues were approximately $160M in 3Q, a 66% y/y increase from 3Q97's $95M and $140M last quarter. Long distance customers now total over 2.5 million, with over 250,000 net additions in 3Q (in line with in 2Q's additions). Long distance customers now represent almost 13.2% of GTE's 19 million domestic switched lines, up 1.2 percentage points from 2Q's 12%. On a minutes of use basis, we estimate GTE's LD minutes — currently running at 1B/quarter– represent about 9.1% market share. We calculate that GTE's average LD rate per minute is 16¢, close to the industry average prior to GTE's entry into LD while its average customer's monthly LD bill is $22.

Although a marked improvement over 2Q's 3.6% growth rate, GTE's domestic wireless revenue growth of 7% remained weak. GTE continues to place emphasis on higher-end wireless customers. In addition, PCS competition and new nationwide pricing plans continue to negatively impact GTE customer retention. Churn rose to 2.5%/month vs. 2.3% in 2Q and is higher than the 2%-2.2% per month industry average. As a result, subscriber growth was only 9.1%, down from 11.6% last quarter. GTE added only 58,000 subs in the quarter, down from the 86,000 added in 2Q and 3Q97's 140,000 net adds. Average revenue per customer was $49, down 7.5% y/y but steady for the last 3 quarters reflecting its successful focus on higher revenue per month customers. Domestic wireless OCF margins increased to 39.6% vs. 3Q97's 35.7%, and 2Q's 39.3%.

GTE's operating expenses rose 8.5% y/y, better than 2Q's 13% rise and our forecast of 12%. The lighter than expected expense growth was driven by less than expected growth in cost of service expenses and depreciation and amortization. Normalizing for an accounting change which decreased depreciation expenses by approximately $50M, we estimate normalized expense growth would have been 9.5%. Reported operating income growth was a solid 11%. Normalized for the accounting change, operating income rose 7.6%, an improvement over 2Q's 1.8% rise but less than our 11.8% forecast. In total, below-the-line items were slightly better than our forecast. The effective tax rate was 38.1%, vs. our estimate of 38.5%.

Investment Conclusion: By our estimates, GTE's earnings from core operations (excluding data, CLEC, PCS, LD start-up expenses) continue to grow near 15% y/y. We expect EPS growth including start-up dilution to accelerate to about 10% in 4Q on its way to almost 15% in '99 as the new initiatives become less dilutive in '99 and profitable during 2H00. With GTE shares trading at a 7% discount to the merger exchange ratio set with Bell Atlantic, we see 35% upside over the next 12 months given the 1.22 exchange rate applied to our Bell Atlantic (BEL, $49 9/16 B-2-2-7) target price of $62 which, in turn, is based on a targeted relative P/E of 90%. We continue to rate GTE shares Accumulate.

Consumer Communications
REPORT Vol. 15, No. 16—August 1998

Bell Atlantic Merges With GTE: Wild Things Are Happening!

Executive Summary

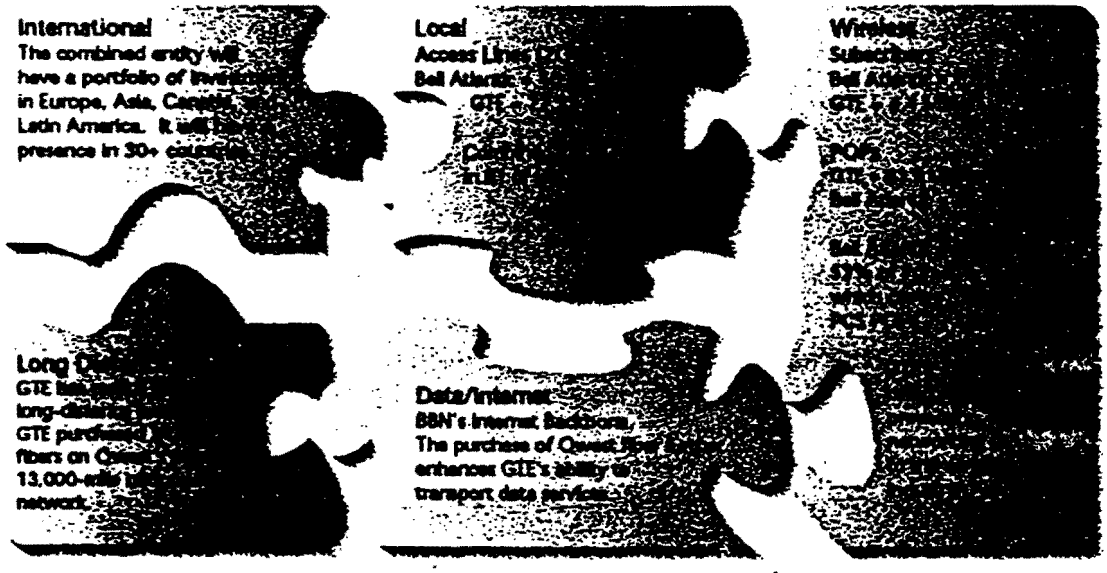
On July 28, after much speculation, Bell Atlantic and GTE formally announced their intentions to merge. If approved, the yet-to-be-named new company will create a local, long-distance, wireless, and Internet powerhouse well-positioned to compete with the likes of other integrated providers such as AT&T and WorldCom/MCI (see Exhibit 1).

This deal, valued at $52.8 billion, reinforces the importance to telecom providers of scale, scope, and a diversified portfolio of telecom and Internet services. In a nutshell, it prepares Bell Atlantic and GTE for the future telecommunications industry, a market dominated by a handful of integrated carriers that can serve the national and international needs of their customers by providing local, long-distance, data, wireless, and global capabilities. While this deal will be scrutinized carefully by skeptical regulators, there is no doubt the combined Bell Atlantic/GTE will argue that the merger will create more competition, not less.

No matter how this debate is resolved, the merger further concentrates power in the telecommunications market, and eliminates a potential competitor. These factors just might give the regulators and the Justice Department enough fodder to either reject the deal or extract new concessions from the combined company. Such concessions may include stiffer policing of the companies' competitive activities in the local markets, and a spin-off of wireless or Internet assets.

Overall, we believe that this "merger of equals" bodes well for both Bell Atlantic and GTE as well as their customers. Besides the obvious economies of scale that are gained by combining two telecommunications giants, each side brings to the table some valuable assets (i.e., thriving wireless businesses, extensive local properties, long distance, a plethora of international investments, and a nationwide data network) that position the new entity for explosive growth on both a national and international scale.

Exhibit 1
Putting the Pieces Together
Source: the Yankee Group, 1998



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I. Terms of the Deal

Under the terms of the merger, GTE shareholders will receive 1.22 shares of Bell Atlantic stock for each share of GTE. Adhering to the norm it established with the NYNEX merger, Bell Atlantic did not pay a premium for GTE. In fact, the deal valued GTE at $54.90 per share, below its July 27 closing price of $55.75. This has fueled speculation that another company, perhaps BellSouth, may make a counteroffer for GTE. It is also likely to raise some eyebrows among GTE's shareholders.

The new company will be headquartered in New York City with a strong operational presence in Dallas and other locations. The combined entity will be the largest local provider in the United States, with combined revenues of $53 billion, 63 million access lines, approximately 10.6 million wireless subscribers, and international operations in more than 30 countries. In its first three years of operation, the new company expects synergies of $2 billion in revenue, $2 billion in expense, and $500 million in capital expenditures.

Each side will be equally represented on the new entity's board of directors. GTE's Charles Lee will serve as chairman and co-CEO, while Bell Atlantic's Ivan Seidenberg will serve as president and co-CEO. This unusual power-sharing arrangement will eventually be phased out as Seidenberg assumes sole control, first as CEO on June 30, 2002, and then as chairman on June 30, 2004.

Will these corporate cultures clash, or will the two top executives be able to share power? And what will happen to the rest of the top executives at both companies? While GTE executives are known as a management team with a "let's do" attitude—as illustrated by the innovative launch of a competitive local exchange carrier (CLEC) unit to compete in-region and out-of-region, the deal with Qwest for 24 dark fibers along its national network, and the purchase of BBN—Bell Atlantic's executive team has been more traditional in its strategy. The top executives mirror their cultures. Seidenberg's experience working for the assertive Ray Smith will serve him well as he begins his new partnership with Charles Lee. As with any merger, we expect there will be some initial corporate angst, particularly as the chairs are reshuffled in the executive suite. However, since there is very little operational overlap, most jobs should be secure. In spite of their differences, we believe that these two executives will produce a high-growth, highly competitive company.

Who Brings What to the Table?

It is clear that both companies believe the winners in the current telecom war of attriti will be the integrated carriers—full-service national and international telecommunicat providers. It is equally clear that this merger is designed to ensure the new company a place in the winner's circle. Is it enough? In general Bell Atlantic brings mass, qualit customer service, superior marketing skills, wireless and international assets, and acce to telecommunications-intensive *Fortune 500* companies. GTE brings national scope, long-distance expertise, data/Internet assets, and wireless and international assets.

Bell Atlantic, the incumbent local exchange carrier (ILEC) in the Northeast, dominate the region from Maine to Virginia. This area is home to a substantial portion of the U.S.-based *Fortune 500* companies, the federal government and its agencies, 13% of U.S. households, and 23% of the U.S. population. Almost 27% of the switched acces lines in the United States operate in this territory, including over 28% of the business lines and 26% of the residential lines. Bell Atlantic controls 40.8 million access lines the territory. This region is responsible for over 28% of the originating and terminatir interstate minutes of use in the United States. Although Bell Atlantic is the dominant local provider, the company cannot provide long-distance voice and data services to it in-region customers until it receives regulatory approval, a factor that severely limits t company's ability to service large corporate customers.

In addition to the sheer mass of customers and enterprises that Bell Atlantic contribute the company also brings a very successful provider of solutions for integration of local and wide-area networks, Bell Atlantic Network Integration (BANI). Beyond its domestic wireline operations, Bell Atlantic also has approximately 55 million domestic wireless POPs and 6 million subscribers. Its international assets include a 38% interes in the Fiberoptic Link Around the Globe, Ltd. (FLAG) partnership, plus additional international wireline and wireless assets.

Bell Atlantic also delivers a reputation for quality customer service, particularly among consumers. The company demonstrated its superior marketing skills after the NYNEX acquisition as it raised the penetration rates of vertical services in the NYNEX territory The new company expects that leveraging these skills will contribute to the anticipated $2 billion revenue increase.

In contrast, GTE's local territories are dispersed, with 22.3 million access lines scattere throughout 28 states. Although GTE's franchises are primarily in second- and third-tie cities, the company also has a presence in some key markets such as Los Angeles, Tampa, and Dallas. Unlike Bell Atlantic, GTE can and does offer long-distance voice and data services to its in-region customers. In fact, through its 1997 acquisition of BBN and recent purchase of Qwest dark fiber, GTE has a nationwide long-distance voice, data, and Internet network.

GTE also contributes significant wireless assets to the new company, including 4.6 million domestic and 2.2 million wireless subscribers. GTE Government Systems, a major player in international wireless systems integration, will come in handy as the new company pursues additional opportunities overseas. Finally GTE brings the historically undervalued GTE TSI, a wholly owned subsidiary of GTE that plays an important role in providing international roaming, fraud protection, an SS7 backbone, and a billing clearinghouse to the wireless industry.

So, is the new company an integrated provider? It will have:

- A substantial local market presence;
- A foothold in the long-distance market, long-distance capacity, and operational expertise that can be leveraged by market-savvy Bell Atlantic;
- Extensive domestic wireless assets; and
- Substantial international assets, including transcontinental capacity, that will reduce operations costs.

The merger is very complementary, and the new company will have all the basic components of an integrated carrier. Although there are many challenges facing the combined company, including obtaining access to the Bell Atlantic in-region long-distance market and finalizing a name, the Yankee Group believes that the new entity will be a formidable competitor.

This deal lands Bell Atlantic right in the middle of some prime SBC territories—which is sweet revenge for SBC's incursion into the heart of the Bell Atlantic footprint with its purchase of Connecticut's Southern New England Telephone (SNET). With access to in-region long distance, the company will truly compete for the multinational and national business customers. We also view the numerous international assets of the combined company as a stepping stone for future global partnerships in both the wireless and wireline arenas, an important leap that the company must make to become a truly integrated global provider.

II. The New Competitive Landscape

Beyond the specifics of this particular deal, it is apparent that there is something larger afoot in the North American telecommunications market. As evidenced by the flurry of recent mergers, acquisitions, and joint ventures, large telephone companies in the United States believe that the future of the communications industry will be dominated by a few, very large companies that offer local, long-distance, wireless, data, and Internet services on both a domestic and global basis (see Exhibit 2). For the last few years, the annual reports of the largest communications companies have contained statements that allude to a predetermined future that is made up of merely half a dozen large, dominant telecommunications providers, and each company believes that it will be among this chosen few. The proof of this supposition seems to exist solely in the fact that it has been repeated over and over. Whether it is true or not is less important than the fact that the large telecommunications providers believe that it is true.

For local phone companies, the options available to reach this dream of hugeness are limited. Federal regulators publicly frowned on the rumor of a merger between AT&T and SBC, indicating that they were not disposed to let ILECs grow by joining forces with a long-distance carrier of any size. In fact, ILECs do not need to acquire a long-distance company as much as they simply need authority to enter the market. The actual infrastructure needed to begin selling long distance is minimal, due to a flourishing wholesale industry.

Exhibit 2
Bell Atlantic/GTE vs. Other Integrated Carriers*
Source: the Yankee Group, 1998

	AT&T/TCI	WorldCom/MCI	SBC/ Ameritech/SNET	Bell Atlantic/GTE	Sprint
[redacted]	$59.30 billion	$27.10 billion	$42.39 billion	$53.45 billion	$14.87 billion
	TCG had 282,700 access lines and networks in 66 markets	Networks in 92 cities covering 70% of U.S. businesses	56.25 million access lines throughout 13 states	61.46 million access lines throughout 38 states	7.40 million access lines in 19 states
	41,000	45,000	None	24 fibers along Qwest's planned 13,000-mile national network	26,000
	580 POPs	400+ POPs	N/A	300+ POPs	200+ POPS
	8.1 million subscribers and 225 million POPs	Wireless resale activities about 400,000 subscribers	9.4 million subscribers and 102 million POPs	10.6 million subscribers, 100 million domestic POPs, and 115 million international POPs	1.4 million subscribers and 148 million POPs
	International presence in 100+ countries; recently announced a joint venture with BT	Presence in 200+ countries	Presence in 25 countries	Presence in 30+ countries	Global One Alliance—joint venture with France Telecom and Deutsche Telekom

* *Data is for year-end 1997*

It is because the RBOCs are somewhat limited in their choices of acquisition that they have gone the route of joining forces. As U.S. Representative W.J. Tauzin remarked, "This only points out what I've been saying all along: If the FCC won't allow the regiona Bell companies into the long-distance market, they are going to merge their way into it."

The companies have similar organizational structures, competitive pressures, and capabilities. Unlike other mergers of late (WorldCom/MFS/Brooks/UUNET and AT&T/TCG/TCI), for the RBOCs, and more specifically in the case of GTE, these mergers all come down to size and efficiency, not necessarily to additional capabilities.

III. What Does This Mean for Businesses?

If you believe what Ivan Seidenberg has been saying all along, that he'd rather own 10% of the world than 100% of his local market, then, when you come right down to it, this deal is about the ability to serve large domestic and multinational corporations on a national and even global scale. This merger of equals gives Bell Atlantic the ability to serve its large business customers with an expanded portfolio of value-added services, and an extended local presence to give it a national and international reach.

In fact, 35%, or 175, of the *Fortune 500* companies headquartered in the Bell Atlantic territory spend between $50 and $55 billion annually on telecommunications services. Today, only 8% of that is spent with Bell Atlantic. The new company sees this deal as a means to increase that percentage by expanding its product portfolio and, more importantly, its data capabilities. The new company plans to selectively follow customers out-of region. This most likely translates into securing the headquarters account of those corporations in the Bell Atlantic/GTE territory and then expanding service to these customers nationwide.

Indeed, this deal gives Bell Atlantic a big push forward in its efforts to deploy a data network, something of an Achilles' heel for the carrier. Not surprisingly, Bell Atlantic has been hard pressed to compete in the data arena against a number of the more data advanced CLECs that have been successful particularly in the New York market.

While Bell Atlantic has yet to receive in-region long-distance authority, it is working closely with the regulators to ensure that its New York long-distance application satisfies the 14-point checklist and gets approved. We expect that the company will gain entry in New York before the closing of this merger. This too opens up a number of opportunities for Bell Atlantic. GTE's portion of the Qwest backbone should be complete sometime in 1999, and this should considerably improve overall margins. Consider that 40% to 45% of all of Bell Atlantic's toll traffic originates and terminates in-region, and that 75% of the remaining originating traffic could be carried on the Bell Atlantic/GTE network.

While the merger between Bell Atlantic and GTE is not as critical to small and medium businesses (SMBs) as it is to large businesses, there are modest implications for many medium-sized businesses. For those businesses that possess multiple sites across the country, the new company could serve as the single source provider of bundled solutions. In the early stages of the merger, we believe it will only lightly affect small businesses, as these companies are either located at a single site or on a very local basis. While the added girth does little to initially enhance Bell Atlantic/GTE's ability to address the specific needs of this market, in the long run we see the added ability to provide bundled services benefiting the company in its pursuit of SMBs. Indeed, the SMB market, which continues to understand and embrace the importance of more sophisticated technologies such as Internet access, LANs, and WANs, has been a lucrative niche for CLECs, and this may just be Bell Atlantic's opportunity to win back some of those customers.

In a recent small-business survey that looked at customer loyalty, the Yankee Group found Bell Atlantic and GTE to be on opposite ends of the spectrum. GTE received a loyalty score of 60% from small businesses, the lowest ranking among carriers. Conversely, Bell Atlantic ranked highest among all carriers, with 78% of its small-business customers stating that their loyalty has been earned. Indeed, this merger will give Bell Atlantic an enlarged small-business market base to which it can apply its quality customer service and improve GTE's ranking among small-business customers.

Overall, this merger moves the new company closer to becoming a complete provider of communication services to businesses. Its robust data network, enhanced Internet backbone, expanded local presence, and experienced long-distance team will provide it with the tools necessary to compete against other integrated carriers for both the corporate user and SMBs.

IV. What Does This Mean for Consumers?

From a consumer perspective, the merger is of little consequence, especially for those consumers currently being served by Bell Atlantic; however, consumers served by GTE will probably see a concerted effort by the new company to improve customers' perceptions once the merger is approved. While neither Bell Atlantic nor GTE meets the U.S. average when it comes to customer service ratings, Bell Atlantic has been able to get the message across to customers that the company is doing a good job, as evidenced by its overall ranking by subscribers (see Exhibit 3).

In addition to improved customer service, consumers currently served by GTE should expect to have more Custom Local Area Signaling Services (CLASS) such as Call Waiting with Caller ID marketed to them. As shown in Exhibit 4, GTE lags behind Bell Atlantic in penetration rates for these services. Expect to see the success of Bell Atlantic's marketing skills put to the test of improving GTE's overall penetration of Custom Calling Services (CCS)/CLASS.

Lastly, the area where it is likely that Bell Atlantic will create some big waves is in the marketing of GTE's long-distance services. The Yankee Group believes Bell Atlantic will do for GTE long distance what it did for take rates on NYNEX's CLASS services, which is to boost them to an acceptable level of availability and penetration. Today, only 10% of GTE residential customers subscribe to GTE long distance, which when compared to other ILECs offering long distance (e.g., SNET), reveals some underperformance in its marketing. For example, over 40% of SNET's customers also subscribe to SNET long-distance; and what makes the low 10% rate of long-distance subscription in the GTE area even more disturbing is that in our Technologically Advanced Family (TAF) survey almost 76% of GTE residential customers said they were either very (28.1%) or somewhat (47.7%) interested in having a single provider for both local and long-distance phone service. Additionally, as penetration rates for GTE long distance increase among GTE subscribers, the bundle of local and long distance will help decrease the number of subscribers who would change their local carrier because of the convenience of the combined services.

Exhibit 3
Bell Atlantic and GTE—Room to Improve Customer Service
Source: the Yankee Group TAF Survey, 1998

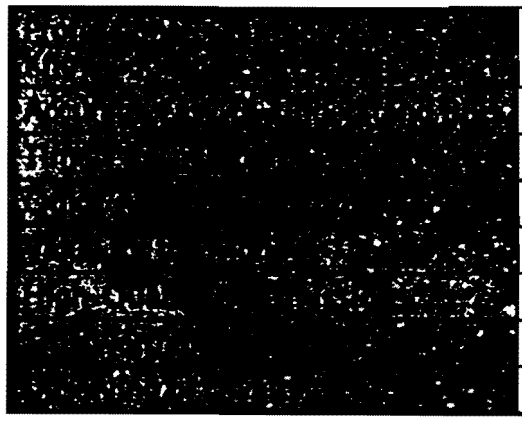
	Percent Ratings		
	U.S. Average	Bell Atlantic	GTE
	51.8	48.9	46.6
	51.8	47.4	50.3
	44.6	42.7	37.8
	41.6	41.3	39.4
	32.7	30.3	29.3
	52.4	51.8	47.9
	46.0	43.5	44.5
	43.3	40.1	41.6

Exhibit 4
Enhanced Service Penetrations
Source: the Yankee Group TAF Survey, 1998

	Percent Penetration		
	U.S.	Bell Atlantic	GTE
[redacted]	20.1	16.3	14.5
	19.3	13.9	13.5
	4.0	3.4	2.0
	62.9	75.5	47.1
	38.4	53.7	31.9

V. Implications for the Wireless Industry

From this deal flow a number of important implications that will ultimately affect the wireless industry. A combined Bell Atlantic/GTE would have the largest installed base of wireless subscribers in North America—at over 10 million. The new company would cover 100 million proportionate POPs, and would be the country's second largest CDMA network after Sprint PCS. In particular, Bell Atlantic has been one of the most aggressive among the cellular carriers with respect to rolling out digital service, reaching about 80% of its potential subscribers to date. The combined entity will have a larger and more comprehensive CDMA network, which will certainly help secure better agreements from infrastructure and handset manufacturers. AT&T Wireless, which has about two-thirds of its total POPs at 1,900 MHz, will likely retake the number-one position from Bell Atlantic/GTE as it ramps up subscribers in its PCS markets (see Exhibit 5).

Exhibit 5
Top Five Wireless Carriers in Terms of Subscribers*
Source: the Yankee Group, 1998

Carrier	Total Licensed POPs	Number of Subscribers (June 1998)
[redacted]	100 million	10.6 million
	102 million	9.4 million
	225 million	8.7 million
	91 million	7.3 million
	84 million	5.4 million

** Assumes Bell Atlantic/GTE, SBC/Ameritech deals go through. Subscribers are reported on a consolidated basis and include partnership markets. BellSouth and AT&T include both cellular and PCS operations. Subscribers are U.S. only. POPs are adjusted for overlap.*

From a network perspective, the Bell Atlantic/GTE merger makes more sense than the Ameritech/SBC/PacTel/SNET combination, which must meld together three disparate digital networks. GTE adds some markets contiguous to Bell Atlantic Mobile (BAM) the Mid-Atlantic and Southeast, plus major cities in Texas, Florida, and California. An even bigger advantage is that some of PrimeCo's licensed markets in the Midwest overlap in more than a few cases with the areas where GTE is strongest in providing local exchange services.

The most immediate issue the two companies must deal with is the 900,000-POP overlap in the companies' cellular businesses. No doubt, one of the parties will be forced to shed some licenses. On the PCS side, Bell Atlantic owns 53% of PrimeCo PCS, which is licensed to serve 57 million POPs, 15 million of which overlap with GTE. The critical cities in this overlap area include Houston, Tampa–St. Petersburg, Norfolk–Virginia Beach (part of the Richmond MTA), Austin (part of the Dallas MTA), Richmond, and Honolulu. In those areas where PrimeCo and GTE overlap, the total spectrum owned would exceed the FCC's 40-MHz cap, so something would have to be done with these licenses.

One scenario could involve AirTouch, which owns the remaining share of PrimeCo, taking over control of these licenses. In return, BAM/GTE would assume greater control of certain non-overlap PrimeCo markets such as Chicago. The other dynamic at work here is that BAM and AirTouch have historically had complementary cellular properties. With their sharing of PrimeCo PCS, there had been some speculation that they would ultimately merge their wireless operations. Now, GTE (which competes with AirTouch in markets such as San Francisco and San Diego) throws a new competitive monkey wrench into the Bell Atlantic/AirTouch relationship. The PrimeCo agreement states that any conflicting property be disposed of within six months.

To complicate the matter even further, there is likely to be a shake-up in the executive suite as the companies' wireless operations are combined. Dennis Strigl, who has led BAM through two particularly competitive years to emerge as one of the top performing large cellular carriers, is a frontrunner, we believe, to assume the helm of a larger, merged wireless organization if such an entity exists down the line.

Another interesting challenge for the two companies to tackle is branding. Current BAM customers, especially former NYNEX Mobile customers in New England and New York, have lived through three rebranding initiatives in as many years—from NYNEX Mobile to Bell Atlantic NYNEX Mobile to its existing branding today, Bell Atlantic Mobile. Exactly how the new company's wireless operations will be rebranded (which is what the companies have said will occur) remains a challenge, especially since BAM has a very strong brand in the Northeast and Mid-Atlantic regions. GTE's brand is also strong on a local market basis but is far more diluted nationally. Throw PrimeCo—which has spent tens of millions building its own brand—into the mix and things get even messier.

Also the Largest Cellular Data Network

Additionally, GTE Wireless and BAM are two of the more proactive carriers in targeting wireless data markets and packaging solutions-oriented services. Both have substantial CDPD implementations, and both lead in market development with highly vertical-oriented strategies such as public safety, field service transportation, and health care.

The Yankee Group estimates that, together, they have approximately 60% of the existing CDPD market. Both BAM and GTE are wisely positioning CDPD as one technology option among a menu of data services, while pursuing migration strategies to CDMA-based packet- and circuit-switched data. It is to this end that the companies have the opportunity to pool resources, industry expertise, and customer support.

The key to success in wireless data is innovative service packaging and pricing. Because the wireless data industry is maturing, operators, who were previously forced to take the initiative in selling wireless data, can now increasingly utilize technology provided by a number of third-party application developers. And the involvement of industry leaders such as Microsoft, Oracle, IBM, 3Com, and Compaq offers the opportunity for standards-based solutions that enable true connectivity between wireline and wireless environments. The combined strengths of BAM and GTE working in cooperation with these industry players would give them a leadership position in the emerging wireless/mobile data market.

More Wireless Mergers on the Horizon?

When and if it becomes clear that both the Bell Atlantic/GTE and the SBC/Ameritech deals will go through, the Yankee Group expects additional mergers in the wireless industry. There has already been a rash of deals among the second-tier players (see our April 1998 Wireless/Mobile Communications North America Report, "First Quarter Wireless Industry Update: Consolidation in the Midst of Competition"). BellSouth, which is "not looking but amenable to the idea," remains the one RBOC-based cellular carrier that has not partnered or merged with anyone, and there have been rumors that it might trump Bell Atlantic's bid for GTE. We have also been saying for a while that there will likely be some consolidation among the growing GSM-based PCS carriers, such as Omnipoint, Western Wireless, and PowerTel. And Nextel, the enhanced specialized mobile radio (ESMR) carrier that has been the fastest growing wireless carrier and a true success story with a differentiated strategy, is also a likely candidate to be acquired in the next round of consolidation.

VI. Internet/Data Issues

Data Transport Services: Network Integration Issues

The proposed merger will ultimately spawn a data services organization capable of providing long-distance frame relay and ATM services, while improving the combined Bell Atlantic/GTE's competitive position. However, integrating the disparate networks is a formidable task, and one that will require a good deal of time. In fact, the network integration challenges faced by Bell Atlantic/GTE mirror those confronting SBC, which is still working to interconnect the data networks it acquired from PacBell in 1997.

The most complicated network integration issue for the combined company is its frame relay network. Bell Atlantic, which offers frame relay services throughout its territory, relies on Newbridge 361XX switches. GTE, on the other hand, whose frame relay network reaches into 23 states, relies on Ascend B-STDX switches. The frame relay standards implemented by these switches fall far short of providing what's needed for

integration, so some custom development will be necessary. In the meantime, Bell Atlantic/GTE will probably need to maintain separate billing systems, which will likel prevent quality of service mechanisms from functioning end-to-end if all traffic is funneled through central gateways.

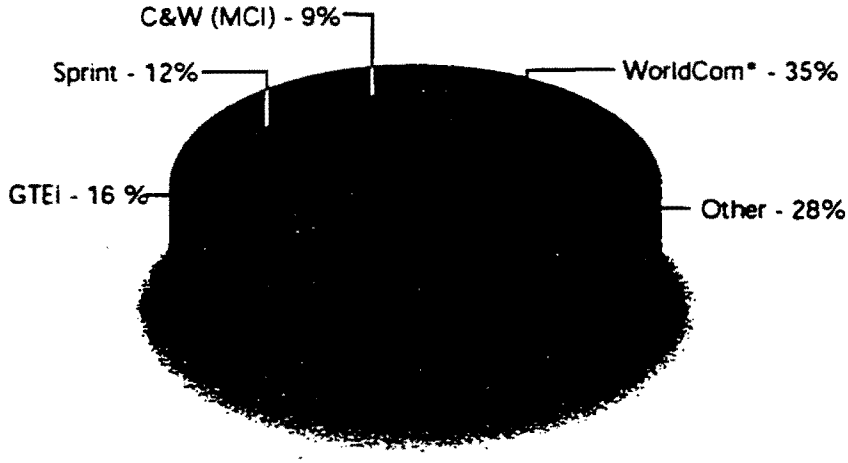
On a positive note, the network integration challenges are not nearly as daunting on the ATM side. Both carriers have deployed Ascend's CBX 500 switches. GTE also uses a variety of other switches, including Newbridge's 361XX, Fujitsu's Fetex 150, and Lucent's Globeview. But, since these switches already interoperate within GTE's network, it should be a relatively simple task to bring Bell Atlantic's Ascend switches into the fold.

Internet Services

The Yankee Group anticipates that as it crafts the next generation of Internet Protocol (IP) value-added services (VAS), GTE Internetworking (GTEI) will be the key division for the Bell Atlantic/GTE combined company. GTE holds the number-two position in corporate IP services with a 17% market share, second only to WorldCom with a 37% market share of a $2.9 billion market in 1997 (see Exhibit 6).

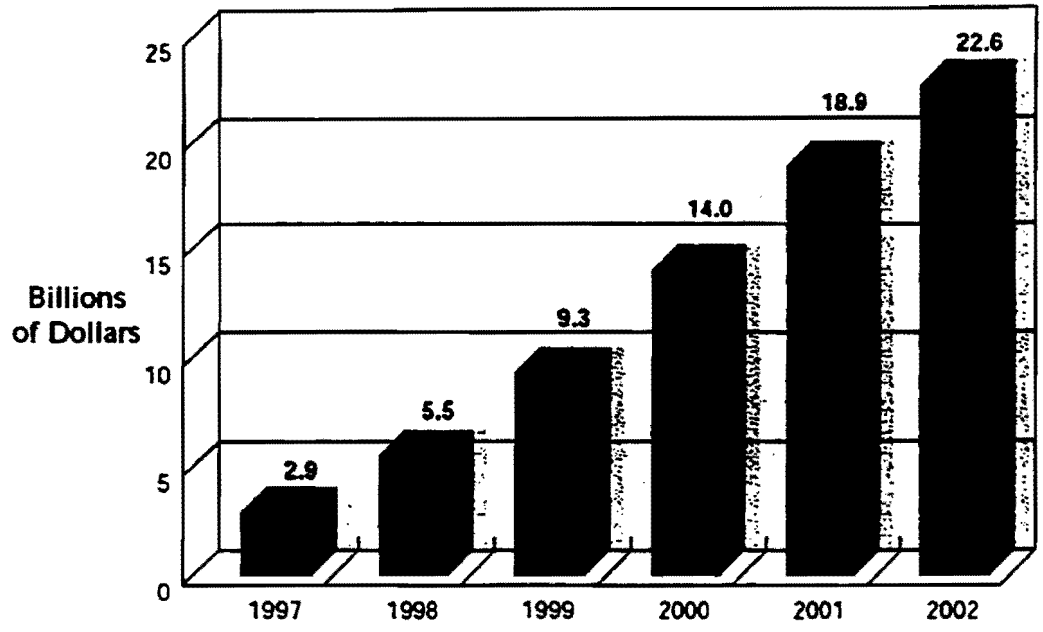
While GTEI may be the most important piece in the IP puzzle, both Bell Atlantic and GTE bring key IP services to the merger. Bell Atlantic has been aggressively rolling ou IP products in an attempt to take advantage of the growth of corporate IP services, which the Yankee Group predicts will grow from $2.9 Billion in 1997 to $22.6 Billion i 2002 (see Exhibit 7). In a relatively short time, Bell Atlantic has been able to accumulate over 1,000 dedicated access corporate customers, and 400 Web-hosting customers, but its managed firewall services are relatively new and the company has no yet realized significant customers to date (see Exhibit 8).

Exhibit 6
U.S. Corporate IP Services Market in 1997 ($2.9 Billion)
Source: the Yankee Group, 1998



**WorldCom revenues include revenues from ANS and CompuServe Network Services.*

Exhibit 7
U.S. Corporate IP Services Market (1997–2002)
Source: the Yankee Group, 1998



In contrast, GTEI, which has continued to build on the expertise of the BBN Planet organization it acquired in mid-1997, has become the solid number-two IP service provider. As such, GTEI offers consumers, businesses, and government agencies customer dial-up and dedicated Internet access, Web hosting, network security, consulting and systems integration, and 24x7 network monitoring and troubleshooting from its Network Operations Centers. GTEI has clearly positioned itself as a leader in the firewall space by providing both managed firewall services and Adaptive Network Security Management (intrusion detection and security assessment). In addition, GTEI was one of the early leaders in offering IP-based virtual private network (VPN) services, and with roughly 1,000 Web-hosting customers, it is among the top four providers of high-end dedicated Web hosting.

Exhibit 8
Internet Customers
Source: the Yankee Group, 1998

	Dedicated Access (Corporate)	Dial Access	Web Hosting	Managed Security
	4,000 (estimated + $200 million in wholesale revenue from on-line service providers, such as AOL, and ISPs)	650,000	1,000 (50% dedicated, 50% virtual hosting)	270+ managed firewall customers
	1,000	160,000	400 (20% dedicated, 80% virtual hosting)	Beginning to roll out service

On the network side, GTEI has completed 5,200 miles of its planned 16,000 mile G Network Infrastructure build based on fiber capacity purchased from Qwest networ has over 200 POPs in the United States and is available in over 220 countries.

The Yankee Group believes that Bell Atlantic's Internet operations will be merged in the GTEI family and the combined company will continue to leverage BBN's expert We expect that the infrastructure build that Bell Atlantic was planning will be scaled back, particularly on the long-haul and intraregion connections. The Bell Atlantic m hubs will continue to be rolled out in the areas where GTEI does not have a presence and look for Bell Atlantic to eventually consolidate some of the GTEI POP facilities its central offices.

Network Integration Services

Yet another piece that Bell Atlantic brings to the table is its success in the network integration services market, which it has been in for five years through its subsidiary, Bell Atlantic Network Integration (BANI). The subsidiary, which has been aggressive identifying key niches within the integration market, does not resell transport, but is instead devoted to integration of local- and wide-area networks, including the provisioning and remote monitoring of CPE. In fact, it was first among ILEC subsidiaries to provide a package of services and equipment for remote access particularly aimed at key vertical industries such as banking and health care; and in November 1997, BANI announced a commercialized Year 2000 (Y2K) initiative to bri customers' networks into compliance with Y2K requirements.

In contrast, GTE has recently been reevaluating its network integration and managed network services portfolio targeting small and medium businesses. It is already adept a network architecture and design services, emphasizing the kinds of massive migrations required by mergers, acquisitions, and deregulation. In addition, GTE offers project management, software integration, technology deployment, education and training, maintenance and repair, and network management services.

While BANI has been active in trying to entice nationwide accounts with the promise o letters of agency and other means to guarantee service in areas of the United States beyond their own local territory, its regional limitations have been the primary reason why BANI, and ILECs in general, have had difficulty competing with other network service providers in the network integration space. The combination of long-distance opportunities and the addition of GTE's other local markets will certainly add a new dimension to the ability of BANI to compete with the IXCs and with those integrators that have a nationwide footprint. In fact, the Yankee Group believes that the combined capabilities of Bell Atlantic and GTE could make the new company emerge as a formidable player, assuming a smooth plan for merging the diverse organizations.

VII. Regulatory Issues

Indeed, we expect that this deal will receive quite a bit of scrutiny not unlike many of the recent ones between RBOCs (e.g., SBC and Ameritech). After the merger is approved by shareholders, it will need to be reviewed by state regulatory agencies in GTE's territory as well as by the Justice Department and the FCC. The companies anticipate that the deal should close in the second half of 1999, by which time we fully expect that Bell Atlantic will have gained entry into in-region long distance in New York.

Among the key issues at hand are the overlapping wireless properties, which we have already discussed, some local property issues, and long distance. In fact, on the local side, there are only two markets where both Bell Atlantic and GTE operate as local providers—Pennsylvania and Virginia. This problem is further complicated by the fact that GTE offers long distance in these two markets, something for which Bell Atlantic has yet to receive authority. We expect that unless the new company can get approval quickly it will have to divest itself of the few long-distance customers it serves in these markets. However, this is a small price to pay in the grand scheme of the deal.

Overall, the most significant hurdle Bell Atlantic will face is the elimination of a potential competitor. GTE announced that it intended to expand its local presence outside of its region, and compete against the RBOCs. When GTE formed a CLEC organization after the passage of the Telecommunications Act, it stated its intention to move beyond its traditional markets and compete for high-value customers nationwide.

While GTE has been among the most recalcitrant in opening up its local markets, Bell Atlantic has been viewed as a leader for its efforts in opening its New York marketplace to competitors. In fact, Bell Atlantic referenced the fact that the acquisition of GTE would reduce its exposure to competition. Unlike the fierce head-to-head competition that it is currently experiencing in its New York market, Bell Atlantic sees this as an opportunity to branch out to a number of steady growth markets that are less competitive than its Boston–New York–Washington, D.C., corridor.

While it is evident that Bell Atlantic/GTE will challenge opponents and regulators by claiming its merger will create competition rather than impede it, we believe that regulators will certainly go to any lengths to make the duo prove their case. Despite the concessions that we expect both sides will have to make, the precedent has been set. By allowing the previous mergers to pass, regulators must allow other competitors to compete on the same playing field, something that regulators probably weren't anticipating as an aftermath of the Telecommunications Act.

VIII. Conclusion

In spite of Wall Street's cool reception to the deal, we believe that the marriage of Bell Atlantic and GTE was the best choice for both companies. The combined assets will allow the new company to survive and thrive in a market that is quickly requiring a national rather than a regional presence. The principal players in this deal expect that it will take between 12 and 18 months to complete, by which time the competitive landscape will likely have changed. The challenges facing this new player include not only integrating networks and corporate cultures, but also integrating the changes taking place in the market.

Is there any end in sight to this merger madness? We anticipate that further consolidation will occur among both wireline and wireless carriers. There is talk of BellSouth joining forces to create a "Bell East," which would create a formidable competitor to SBC, presently on its way to becoming a "Bell West." But still, many other prime acquisition candidates exist among new and emerging wireless and wireline carriers. While a number of wireless players have already been mentioned as potential acquisition targets, there are still a number of prime targets on the CLEC side. Indeed, some top CLEC candidates with integrated service portfolios and built-out networks, including Intermedia, ICG, and e-spire, look ripe for the picking.

While carriers have tended to merge within industry segments (e.g., WorldCom/MCI, SBC/Ameritech/SNET/PacTel), this trend will soon need to evolve to the next step. There is a natural limit to how long these carriers can continue to merge within their own industry segment. Either these carriers will become large enough to develop the product lines and capabilities necessary to satisfy customer expectations, or carriers will need to progress to the next step by crossing industry boundaries. No one can predict the success of this deal, but we can predict that the greatest profits from these mergers will be made by those who paint the service trucks!

Further Reading

"AT&T and TCI: Fortune Favors the Bold," *Yankee Group Report, Consumer Communications*, Vol. 15, No. 14, July 1998.

"SBC/Ameritech Merger: And Then There Were Four," *Yankee Group Report, Telecommunications*, Vol. 13, No. 8, May 1998.

"First Quarter Wireless Industry Update: Consolidation in the Midst of Competition," *Yankee Group Report, Wireless/Mobile Communications North America*, Vol. 6, No. 10, April 1998.

"AT&T CLECts Its Local Business Entry Strategy," *Yankee Group Report, Telecommunications*, Vol. 13, No. 2, January 1998.

"SBC from Sea to Shining Sea," *Yankee Group Report, Telecommunications*, Vol. 13, No. 1, January 1998.

"Grow The Enterprise: GTE Goes National," *Yankee Watch Telecommunications*, Vol. 12, No. 4, June 1997.

"Bell Atlantic and NYNEX: Opportunities Gained and Lost," *Yankee Watch Telecommunications*, Vol. 11, No. 9, May 1996.

BEFORE THE
ILLINOIS COMMERCE COMMISSION

IN THE MATTER OF:)
)
TELECOMMUNICATIONS POLICY)
OPEN MEETING)
)
)
)

Chicago, Illinois

October 8, 1998

Met pursuant to notice.

BEFORE:

CHAIRMAN RICHARD MATHIAS

COMMISSIONER RUTH KRETSCHMER

COMMISSIONER TERRY HARVIL

COMMISSIONER RICHARD KOLHAUSER

COMMISSIONER BRENT BOHLEN

APPEARANCES:

MR. MARK J. MATHIS,
Sr. V.P. Regulatory, Bell Atlantic;

MR. GEOFFREY C. GOULD,
V.P. Government & Regulatory Affairs, GTE;

MR. ED WASHINGTON II,
Bureau Chief, Public Utilities Board,
Office of General Counsel;

MS. ELLEN D'AMATO,
V.P. State Regulatory Affairs for Sprint;

MR. WILLIAM DAVIS,
Chief Regulatory Counsel,
Law and Governmental Affairs for AT&T;

MR. DAVID PORTER,
V.P. Regulatory Economics for MCI/WorldCom.

SULLIVAN REPORTING COMPANY, by
Jennifer Natale, CSR

I N D E X

reject this merger? Sure it is, because you're not just saying no. But you're saying what it would take to approve the merger. So it's not a flat out disapproval. It's disapproval but once you've shown us what we're requiring you to do, then we'll entertain it, and if you meet our standards, we'll approve it.

COMMISSIONER KRETSCHMER: Thank you.

CHAIRMAN MATHIAS: Commissioner Bohlen.

COMMISSIONER BOHLEN: I want to follow up on Commissioner Kolhauser's question about the competition in Chicago.

I'm assuming that Chicago is the only Illinois city on the list of 21?

MR. GOULD: Yes, that's correct.

COMMISSIONER BOHLEN: And, Mr. Gould, you indicated what the merger would do for GTE in terms of the competition and the coming competition in Chicago.

I'm curious as to what the merger does for Bell Atlantic in terms of coming to competition in Illinois. It seems to me that

Illinois -- or Chicago would be attractive to Bell Atlantic for local competition without GTE.

MR. MATHIS: Well, right now we're here in Chicago. We've got 300 customers. It hasn't been much of an entry as reseller of long distance.

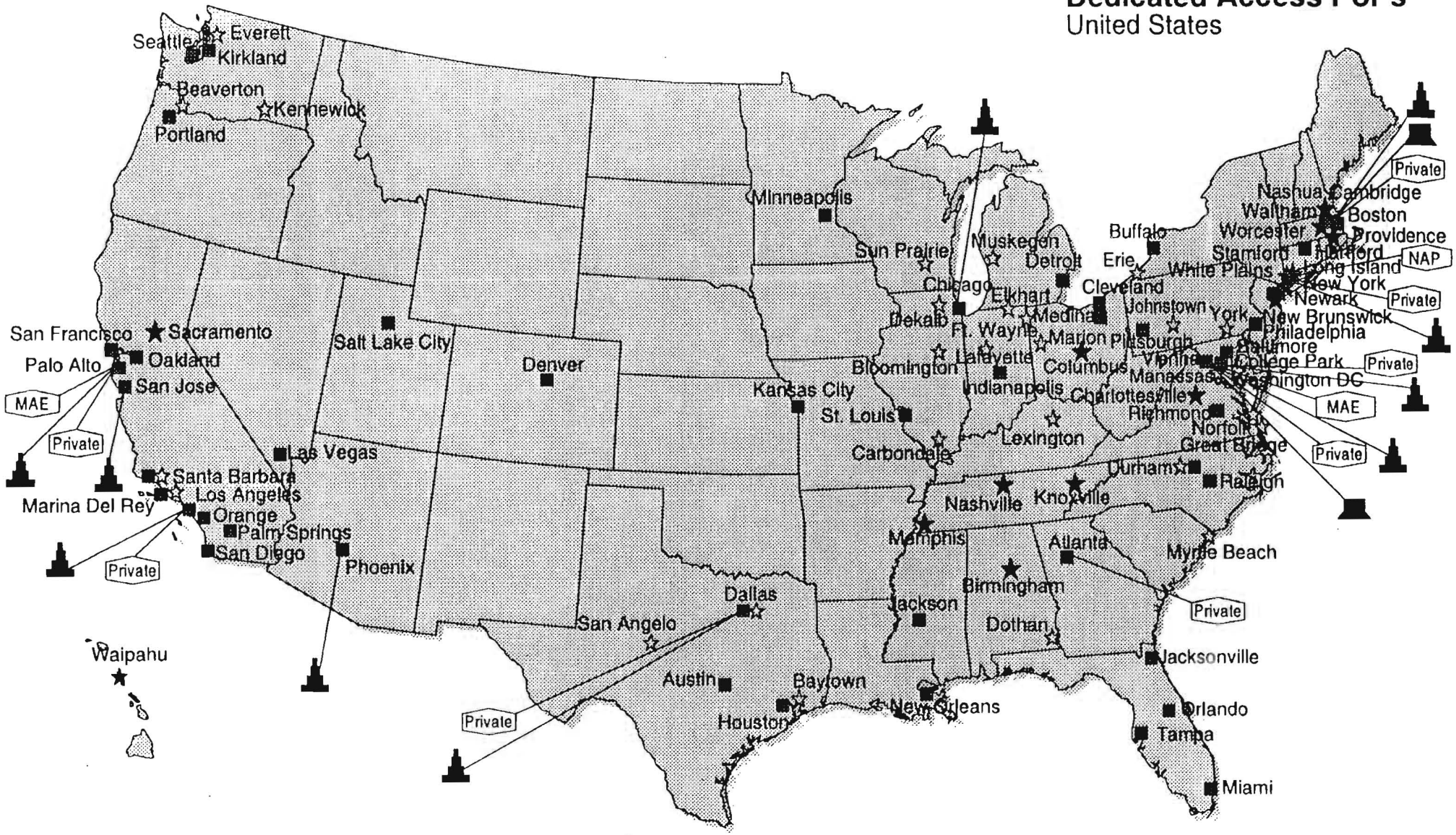
What GTE brings to the table is they've got this Internet backbone network. It's got a point here in Chicago. They've got real-life facilities. They know Illinois, we don't.

Those are the two things we think that they bring to the table here in Illinois that we don't have. And we think that putting the partnership together of our customers, the example I gave of Marriott with their knowledge of Illinois and their Internet backbone, is something that at least offers the possibility of us being able to be successful in Chicago.

And that's why I sort of -- you know, I listened to the discussion here today from our friends down the table. I'm sort of struck by two points. One is they say that we didn't live

GTE Internetworking

Dedicated Access PoPs
United States



GTE

INTERNETWORKING
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- T3 PoP
- T1 PoP
- Frame Relay PoP
- Peering Point
- Data Center

GTE Internetworking

Dial-Up Access
United States

Alabama
- Birmingham
- Huntsville
- Mobile-Theodore
- Montgomery
- Opelika

Arkansas
- Fayetteville
- Hot Springs
- Jonesboro
- Little Rock

Arizona
- Phoenix
- Tucson

California
- Anaheim
- Bakersfield-Mojave
- Bishop Ranch
- Canoga Park
- Carlsbad
- Chico-Oroville
- Concord
- Covina
- El Centro
- Fairfield
- Fremont
- Fresno
- Fullerton
- Inglewood
- Laguna Beach
- Long Beach
- Los Angeles
- Marysville
- Merced
- Modesto-Turlock
- Monterey
- Napa
- Oakland
- Ontario
- Palm Springs
- Palo Alto
- Rialto
- Sacramento
- San Diego
- San Francisco
- San Jose
- San Luis Obispo-Pas
- San Mateo
- San Rafael
- San Ramon
- Santa Ana
- Santa Barbara
- Santa Clarita

California - continued
- Santa Cruz
- Santa Monica
- Santa Rosa
- Stockton
- Stockton-Tracy
- Thousand Oaks
- Ventura
- Walnut Creek
- Woodlawn Hills

Colorado
- Colorado Springs
- Denver
- Fort Collins-Lovel
- Grand Junction

Connecticut
- Bridgeport
- Gales Ferry-Water
- Hartford
- New Haven
- Stamford

Delaware
- Dover
- Wilmington

District of Columbia
- Washington DC

Florida
- Boca Raton
- Daytona Beach-Ora
- Fort Lauderdale
- Fort Myers-Cape Co
- Gainesville-Lochlo
- Jacksonville
- Kissimmee
- Lakeland
- Lakeland-Winter Hv
- Melbourne
- Miami
- Naples
- Ocala
- Orlando
- Pensacola-Century
- Sarasota
- Sarasota-Venice
- St. Petersburg
- Tallahassee
- Tampa
- Vero Beach
- West Palm Beach

Georgia
- Athens
- Atlanta
- Augusta
- Macon
- Savannah-Garden Ci

Idaho
- Boise

Illinois
- Belleville
- Champaign
- Chicago
- DeKalb
- Downers Grove
- Evanston
- Hinsdale
- Joliet
- Kankakee
- Lansing
- Libertyville
- Northbrook
- O'Fallon
- Rock Island
- Rockford
- Rockford-Loves Pa
- Schaumberg-Roselle
- Schiller Park
- Springfield
- Sycamore
- Tinley Park
- Waukegan

Indiana
- Evansville
- Indianapolis
- Lafayette
- Marion
- South Bend
- Terre Haute

Iowa
- Burlington
- Davenport
- Des Moines
- Dubugue
- Iowa City-Lone Tree

Kansas
- Leavenworth
- Salina
- Topeka
- Wichita

Kentucky
- Ashland
- Lexington
- Louisville
- Oak Grove
- Paducah

Louisiana
- Baton Rouge
- Lafayette
- New Orleans
- Shreveport
- Slidell

Maine
- Augusta
- Brewer-Bangor
- Portland-Windham

Maryland
- Aberdeen
- Annapolis
- Baltimore
- Bel Air
- Columbia
- Frederick-Burkitts
- Salisbury
- Silver Spring
- Waldorf

Massachusetts
- Amherst
- Amherst-Northamp
- Billerica
- Boston
- Brockton-Middlebo
- Dedham
- Fall River
- Falmouth
- Framingham
- Groton
- Lawrence
- Lexington
- Lowell
- Lynn
- Manchester
- Marshfield
- Plymouth
- Springfield
- Taunton
- Worcester

Michigan
- Benton Harbor
- Detroit
- Grand Rapids
- Jackson
- Kalamazoo-Portag
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BEFORE THE PUBLIC SERVICE COMMISSION OF WEST VIRGINIA

CASE NO. 92-0347-SWF-CN

WORLDCOM, INC.
Petition for Consent and Approval to
Acquire All Outstanding Shares of Stock
of MCI Communication Corporation.

TRANSCRIPT OF PROCEEDINGS had or testimony adduced at a hearing held in the above-styled case, taken pursuant to notice, on the 25th day of June, 1998, commencing at 9:30 a.m. and concluding at 5:25 p.m., before the Public Service Commission, in the Howard Cunningham Hearing Room, Charleston, West Virginia, before Pamela Pauley, Court Reporter and Notary Public.

VOLUME I

BEFORE: CHARLOTTE LANE - CHAIRMAN

RICHARD FRUM - COMMISSIONER

OTIS CASTO - COMMISSIONER

Connie Doughty DeMuth & Associates

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THE WITNESS: Thank you.

(Witness excused)

CHAIRMAN LANE: Next witness.

MS. KIDDOO: I think it's Ms. Covey, Madame Chairman.

MR. NIGRO: GTE would like to call Ms. Debra Covey.

(Witness sworn)

THEREUPON

DEBRA R. COVEY

was called as a witness and, after being first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION BY MR. NIGRO

Q Ms. Covey could you state your full name for the record, please?

A Debra, D-E-B-R-A, R. Covey, C-O-V-E-Y.

Q What is your current position at GTE?

A Vice President of Market Solutions for GTE Communications Corporation.

Q Prior to joining GTE where were you employed?

A I was employed by Sprint for 11 years before coming to GTE in 1995 and Southwestern Bell for five years prior to that.

Q While at Sprint what were your responsibilities?

A I was responsible for at various things network design, engineering, systems development, vendor management, contract negotiations and compliance, and so forth.

Q On March 3, 1998, did you cause to file a direct testimony to this proceeding that has been marked as GTE Exhibit Number 2?

A Yes, I did.

Q Do you have any corrections or changes to make to that testimony?

A I have corrections to make at the present time to the title and address change. I don't know if this important or not. They're different. They're right on the rebuttal and incorrect on the direct. Do I need to correct that?

MR. NIGRO: Your Honor, would you like Ms. Covey to go ahead and correct that. It's not in her direct testimony and it's in her rebuttal.

CHAIRMAN LANE: It's in the rebuttal?

MR. NIGRO: Yes.

CHAIRMAN LANE: The corrections?

THE WITNESS: Yes.

CHAIRMAN LANE: Then that's sufficient.

BY MR. NIGRO:

Q Would you give the same answers as you gave

in your prefiled testimony marked as GTE Exhibit 2 if you were asked those same questions today?

A Yes.

Q On April 18, 1998, did you cause to be filed rebuttal testimony in this proceeding that as been marked as GTE Exhibit Number 3? Excuse me, June 18, 1998?

A Yes.

Q Do you have any corrections or changes to make to that testimony?

A No, I don't.

Q Would you give the same answers that you gave in your prefiled testimony marked as GTE Exhibit Number 3 if you were asked the same questions today?

A Yes.

Q At this time I would like to offer into evidence GTE Exhibits 2 and 3.

CHAIRMAN LANE: Those may be so marked and admitted into the record.

(WHEREUPON, the documents referred to were duly marked for identification as GTE Exhibits 2 and 3 and were received into evidence.)

MR. RODECKER: This is just a matter of

housekeeping and I'm sure I understand what's happening, but I'm going to make sure for the record. My documents indicate that the rebuttal testimony of Ms. Covey was faxed to the Commission on June 19th and the original was actually filed on the 22nd. I believe Mr. Nigro referred to June 18th and I'm wondering if there is a different document.

MR. NIGRO: There is not. I believe we are referring to the same testimony. I apologize.

MR. MCJUNKIN: It was faxed on the 18th, I believe.

MR. SCHELTEMA: Well, mine shows the 19th and --

MR. MCJUNKIN: It's the same document, Bob.

MR. RODECKER: Okay. Good.

CHAIRMAN LANE: Repeat the question again.

MR. NIGRO: As I discussed previously, we have just a couple of questions relating to Mr. Gates' direct testimony and your rebuttal testimony. Ms. Fell is going to ask those questions.

DIRECT EXAMINATION BY MS. FELL

Q Okay. Ms. Covey, do you have a copy of Mr. Gates' testimony with you?

A Yes, I do.

Q And have you reviewed that testimony?

A Yes, I have.

Q Starting on page five of his testimony wher he reports to respond to Doctor Harris on talking abo efficiencies to be generated from the merger and we'l go on from there. Do you have any response to that testimony?

A I think I can probably answer several questions at once if I just speak generically about it If that's okay, it will save some time. There are several places in the document that Mr. Gates speaks tc efficiencies that will be realized in this merger and I agree with him that there are efficiencies to be gained at different levels, depending on which piece of the company you're looking at here. I think those are accurate statements. I think the question comes in to play as what is the result of those efficiencies? Are there gains to be made that benefit the end-users in the state of West Virginia? Are there gains to be made to benefit the shareholders? I think they've made that very clear here. Are there gains to be made that benefit the wholesale markets and resale markets, are there services to be made available? I don't have any direct information or indirect information that tells me that that's the case.

Are there impacts to any other competitors

that are here in the industry, other impacts to -- what the exchange companies -- if you go through the document and reference all the places were savings or efficiencies are spoken to, there are claims of efficiencies that will be honored, but there is no explanation of what the efficiencies are. What scale they're on, what the end result will be. And who the beneficiary is other than a stockholder. The fact that there is and efficiency that will somehow flow through the value of the company. Which is a fair statement. But in order for that value to flow through, there is some action that has to occur and my questions really revolve around part of those actions are going to occur because as the customer in this case, I haven't been, obviously, made privy what those plans are and it presents quite a bit of concerns.

If you look no page five to page six where cost savings are considered. It says for the combined company in West Virginia if the merger is approved, again, it says we've done no West Virginia's specific studies to find cost savings significant but it's clear the merger will benefit combine company and consumers. I don't believe it's fair at all that there is a plan and there is no statement of what that benefit will be, and to me it's very easy to say there

is a benefit, but the proof is in the pudding. And I would question what the value of that statement is without some part of clarification to go with it. On page seven --

MR. SCHELTEMA: Your Honor, excuse me. I object to this entire line. Mr. McJunkin stated initially that she would be addressing "direct" portions of the testimony. Clearly, from page five on it's referring directly to Mr. Harris' direct testimony. This is not Mr. Gates' direct testimony. This is, in fact, rebutting positions taken by Doctor Harris. This is, in fact, close surrebuttal.

MS. FELL: If I may, Madam Commissioner. In another jurisdiction, Doctor Harris spent some time on his testimony analyzing efficiencies. He did not do that in his testimony in West Virginia and in response to his non-addressing the efficiencies in West Virginia, Mr. Gates has attempting his so called rebuttal testimony, has spent the six to seven pages talking about the efficiencies in West Virginia. All we're asking is that Ms. Covey have a chance to respond to them.

MR. SCHELTEMA: Your Honor, Mr. Gates' testimony starts out by even referencing the page in the direct testimony that Doctor Harris makes his

position. I mean, I really have to spend -- and object that this is surrebuttal and not addressing a new direct position at all.

CHAIRMAN LANE: Now, what we see before us today is somewhat complicated and has a lot of ramifications and the Commission isn't really interested in getting into an argument whether something that is rebuttal, surrebuttal,direct or indirect. We're interested in having some questions answered, so we will move this witness to answer some question.

BY MS. FELL:

Q Okay. Ms. Covey, I believe you were on page seven?

A Yes. Page seven if you -- I was just focusing on several lines instead of going line by line, but in the paragraph that begins on line four, on my copy. There is comments about efficiencies that relate to allowing MCI/WorldCom in office trunking with the ILEC you drop down to line seven. It says the newly available to capacity will be free to the ILECs. I have been in network operations for 20 years and have never seen free capacity in my life. And I would question a comment that says any incapacity is free at any opportunity. I do agree that there are

efficiencies to be gained by putting two large amounts of traffic together that would allow them from an engineering perspective to move from tandem trunks to direct office trunks which would improve their cost position as a carrier, however, I think that the impact of the ILEC is misrepresented here because there are in fact dual trunking required for a period of time because while they move to direct in office trunks the ILEC would be required to install direct in office trunks while there in the tandems still, so the customers there would have to be served. Then they would roll the customers to the direct in office trunks and disconnect the tandem trunks. So there for a period of time you would actually be duel trunking required by the ILEC and, of course, they would have to pay the bill for that. So its not free to anyone.

Additionally, once they abandoned the tandem trunks then the ILEC has a significant number of highway trunks being used by the companies that they have to do something with or they have abandoned facilities which is a capitol cost for them, so that's an impact to the ILEC. Once they move to the direct in office trunks the ILEC has had to over bill for the in office trunks. So while in theory I agree with the concept that they would get an efficiency. I disagree

with the simplicity of the statement that says there is frequent aspects with the ILEC. In fact, capitol employment would have to be made in the local company to be duel facilities there for awhile and then at the end of the day when all the transitions are made there would abandoned facilities at the tandem. Granted another carrier could come in and perhaps purchase those facilities. Perhaps the question that needs to be asked is if there is wait list of requirements for capacity at the tandem in these offices in West Virginia. And is there a capacity constraint to the tandem? If there is, then it's probably good news. If there's not, then its stranded facilities that someone is going to have to deal with. So I think that is an understatement issue.

If you move on to page eight, again from let's just say line five down to line 12 there is several comments about WorldCom avoiding lease payments for the costs made by the MCI costs. Savings significant sums of money using MCI's network, complaining traffic will accompany to reducing the average cost per minute. Every line includes some mentioned to savings to the company which I think are valid and are good points to the company and to its shareholders. Again, probably two or three questions

here. One would be what is the value to the end users in West Virginia? Are all these savings going to be passed through? I don't think how much is going to be passed through is as important as the fact that is there commitment to pass the savings through. Absolutely, since that is an absolute given in the testimony that there is a savings to be made.

I think the second point in this paragraph is these two companies will put there traffic together and they will save money because of engineering and harmony, but what is the impact to the end user by putting these facilities together? When you think the customers from the WorldCom network which is leased today and move to the MCI network which is a facility based today. So the assumption is on my part. I believe Mr. Porter testified to this. The MCI network would be the network that would remain closer in West Virginia that would be used. Then those customers must be transitioned off of WorldCom. It's not just a notice on the bill that says were going to be moving to MCI. There is actually a process to go through of notification. The customers contact number that they use for customer service, their billing information. All of that will change to MCI records. The customers has went through a big process where they actually

choose WorldCom as there carrier, but now they've moved to MCI. I'm sure they will be given an option if they want to do that or not, but it's up to them if they want to go to MCI. The customers who have dedicated facilities, they may be buying from WorldCom, if there are any and I don't know if there are. But if there are any, they would actually go through a physical move of their service to have it disconnected off the WorldCom location and relocate to an MCI location which involve a short service outage. Not one that would be catastrophic, but one that would, you know, bring a new arm to the business, but for a business that is transmitting data or has an ongoing 24 hour business, it would be a hit in their service. So while all the impacts might be far rushed, I think they need to be realized because there could be impacts to the end-users involved when those transitions occur and even in the best of plans the networks that have been intergraded in the past they are customers who did not have service and this stuff happens so and I don't believe it's a bad thing but it is just something that needs to be realized and recognized and needs to be given thought to. The fact that's not as simple as perhaps it might be portrayed.

If you move on to page nine, again down

around lines 10 and 11, there is again mention of the significant savings and efficiencies by combining traffic on the MCI existing network which goes back to my point that I believe the traffic would be moved to MCI.

Could we just move forward to page 11. There is a question about successful integration of prior networks. I believe Doctor Harris -- the question is and Doctor made a point about successfully interaction as speaks at best, but the response is no. WorldCom has -- there are no difficulties in integrating the networks and there's no support. I've been involved in integrating several networks in several years and its never easy. Your best plan on your best day always has kinks and your best customers always seem to be the one to get impacted. So I think that you should also look at previous acquisitions and previous integrations and exactly what has been integrated and how it has occurred. There are many companies that have been acquired by both of these companies and by other companies in the industry. There are very few companies that have actually performed full integration. Very few companies that have actually combined billing systems, network facilities, network management systems, customer service support. Most of

them are acting independently today even though they are all managed by the same company and their financials are all recorded in an integrated fashion. Many of them are operated in wholly independent function. And I would offer that WorldCom is an example of that and that even the best experts Union Net, for example, those companies that are subsidiaries of WorldCom that are not operationally integrated and in fact function independently today. And so while they all their networks might not be appropriate to fully to integrated, their operations have not been upgraded on a financial level either because I do business with them on a daily basis and new businesses with a different set of people that still work independently in different sets of companies. So I don't think we should over state the success of integration in the past and we should recognize that this would be by far the largest integration that either company has tried to undertake. And we shouldn't minimize how important it would be.

And if we move to page 12, line three through eight, there is a comment about and a supplier for MCI in the same region. I think the region is referred but I think this is in the northwest. I don't believe it applies to West Virginia at all, so I won't speak to

such carriers. The point, I believe, Mr. Gates is trying to make is that there are substitutes who can provide network facilities for me its a switchless reseller and while I agree with them that there are transport providers who can give dark fiber or who can give me reduced rates they don't all the back office support that WorldCom offers. They don't have the billing systems. They don't have the pick processing to convert customers. They don't have the wholesale accounts support at the same level and the same depth and so they are good substitute transport providers perhaps, but they're not network service providers to give me a turnkey solution.

MS. KIDDOO: Ms. Covey.

MS. COVEY: Yes.

MS. FELL: If you wouldn't mind clarifying something. You talked a lot about islets (ILECs) and direct and office trunk tandems and I know you are very knowledgeable about how networks were managed and how they are run, but I unfortunately am not quite so knowledgeable so could you bring that -- can you explain it so that a lay person what you're talking about on the direct and office trunking?

MS. COVEY: What was that?

MS. FELL: The direct and office trunking of

the tandems --

MS. COVEY: All right. I'm sorry. The presentation and material says that because of efficiencies WorldCom and MCI will move from tandem to direct and office trunking. Today because of their relative size it may not be cost efficient for them every central office to have a trunk that serves their needs because they may not have enough traffic to justify it. So instead that it's industry practice that you aggregate the facilities at the access tandem of the local company and provide your customers service to that local tandem and the local exchange company takes that service and fibers it out to each end-office so you get more traffic in certain areas and you have more concentration of traffic. Then you separate yourself from the tandem and extend your trunk group all the way in to each end office and that's a cheaper pricing scheme and what it speaks to a carrier has more volume. For example, when you look at AT&T volume in the state, they most likely are direct and office trunk in many locations because they have a lot of volume in this state. By putting the two volumes of WorldCom and MCI together they would enjoy that same amount of requirement and they would extend that facility to the end office. Which makes all the sense in the world is

the correct thing to do from a economic point of view. They will most leave some sort of trunk for that tandem to use for the overflow should the direct end office trunks be full so they don't experience blocking on their network. But they would definitely downsize the trunks that are there and they would be abandoned. Is that what you're looking for?

MS. FELL: Thank you.

MS. COVEY: Again, the on page 15 where you talk about rates. The merger of MCI and WorldCom will not result in an increase in rates and I certainly believe that's true. It would not be competitive behavior at all for them to come in and increase rates, but further I don't think that the testimony goes far enough to speak to the question of what happens to rates. You know they don't go up, staying the same, is certainly is an option as is going down and I think as an end user of wholesale services or as every user in the state, are we going to know -- are the rates going to go down based on the efficiencies explained in the testimony.

MS. FELL: Thank you. At this time we offer the witness for cross-examination.

MS. KIDDOO: Thank you, Madam Chairman.

CROSS-EXAMINATION BY MS. KIDDOO

Q Good afternoon, Ms. Covey. It's nice to see you again. Ms. Covey, I want to first explore with you a little bit about GTE's interest in the impact of this merger on West Virginia, if I might. Now, GTE no longer offers local service as a local exchange carrier in West Virginia does it?

A GTE telephone operations as a local company does not offer local service here, but GTE Communications Corporation our C-LEC, which I am employed by, intends to offer local service here next year.

Q Does it offer service now?

A No.

Q Has GTE Communications obtained certification to operate as a C-LEC in West Virginia?

A I don't think so, no.

Q Has it applied for certification?

A I don't believe so, no.

Q With respect to long distance service, you testified that GTE offers long distance services within the state of West Virginia. GTE does that on a resale basis; is that correct?

A We resale WorldCom One Plus service here, yes.

Q Has GTE, therefore, by saying that you resale

WorldCom services, it's correct than that GTE is not itself invested in any facilities or switching equipment or other investment to provide service on any of its own facility; is that correct?

A Yes. We are a specialist reseller nationwide. We don't have switches or facilities that we own under our name or GTE Long Distance Service anywhere in the United States to include West Virginia. We resale WorldCom's service everywhere.

Q Does GTE offer any other telecommunication services in West Virginia, for example, cellular or PCS services or paging services?

A I'm not familiar with all the service locations that offer wireless service. But as C-LET we will offer bundled services, wireless paging, internet, local, but today we currently offer 800 calling cards, Number One Plus LD service and we offer a service that's called 800 pin, just like a call to the 800 service where you can route your 800 number through to a specific location.

Q Are all of those services that you just mentioned resold WorldCom services?

A No.

Q What services are not resold WorldCom services?

A The 800 pin service is sold as a stand alone product and is provided by IXC Communications.

COURT REPORTER: Provided by who?

MS. COVEY: IXC Communications and the 800 calling cards are provided by our own platform which is owned entirely and operated by GTE Card Services.

BY MS. KIDDOO

Q Who provides you the transport services who's network facilities you use?

A The point to point transport is provided by MCI. The switching is provided by another company that we switch from providing service.

Q Does GTE offer private line services?

A No. We offer private line services in some locations. I'm not aware that we have private line customers in West Virginia.

Q If you had private line customers that sought your services in West Virginia would you commission them to?

A Yes, we would.

Q And how would you do that?

A It depends on the customer and what services they wanted. For the time a number of our services are provided by Sprint, but we do have private line customers who use other carriers of their choice.

Q So basically is it correct to characterize what you're saying is that what you purchase from WorldCom for resale is basic One Plus type of long distance service?

A Yeah.

Q What else is there?

A What I resale from -- what I purchase from WorldCom -- did you say purchase or resale?

Q Purchase for resale?

A Okay. I purchase for resale one plus service. Included in that purchase, however, is the provision of all the back office support because from the carriers that we question I don't get that same back office service. I buy very simple stand along products so the relationship between myself and IXC, myself and Sprint, myself and MCI, are radically different than our relationship with WorldCom.

Q Why aren't you purchasing those services from WorldCom?

A Well, not all of the services are available from WorldCom.

Q Are any of the services available from WorldCom?

A WorldCom does have a calling card platform. They do not have an 800 pin in process and they do have

private lines.

Q Why aren't you purchasing private lines and the calling card platform services?

A The prices offered on the private line product from WorldCom are not competitive and we are, in fact, renegotiating are private line rates with them as we speak so that we can offer those services through them and intend to move a couple of thousand private lines to them as soon as we can.

Q Good to here it. Now, as far as your services in West Virginia, are you advertising or promoting your services in West Virginia? Particularly your intrastate West Virginia services?

A We don't have advertising specifically geared to intrastate traffic in West Virginia nor in any other state with the exception of one I believe. And all of our long distance advertising at this time is done on a nationwide level under our GTE brand which is part of our strategic plan which is to align with the GTE brand to extend that brand into other states where we don't have local services. So our intent for the first two or three years of our LE operation will really rely on national advertising and once we feel that we've got a little more brand name recognition in the states that we have not been in recently as a local company or ever

in some cases, then we would come back in to those states and directly market directly advertise. So assuming that we stay on our time line hopefully you'll see those kinds of advertisements real soon.

Q Now, is it fair to say that GTE's marketing focus for long distance, is focused primarily at least initial on areas where GTE's brand name is well known? For example, it's existing local exchange territories?

A It's fair to say that I think we defiantly trade off of the strength of the brand name which I think I just said earlier is that our national brand campaign would obviously be more recognized in areas where we have an actual brand, where the brand has a bill that goes to consumers, so we target most of our consumer sales right now in areas where our brand is. We are moving 100 miles out from the brand, 200 miles out from that brand in an effort to expand our scope and expand our bravery into our small business customers. We are actually marketing in areas where the GTE brand is not known. We're doing face to face sales. So it's a little bit easier to have a discussion about who we are and what we're trying to do when you are face to face with someone verses over the telephone or on a TV add.

Q Does GTE have any employees in West Virginia?

A I don't believe -- well, I know that we don't particularly in the communications corporation. I can't really testify about other affiliates.

Q How many pre-subscribed access lines does GTE currently serve in West Virginia?

A The most recent count I have is that we have is we have 148 accounts representing 218 lines.

Q The reason for that is that there are some multiple lines?

A Yes.

Q So the 148 then --

A 218.

Q Okay. Did you have an opportunity to look at the FCC pre-prescribed line survey numbers that were introduced in Mr. Porters testimony?

A No.

(WHEREUPON, this portion of the transcript has been retracted as being confidential material.)

Bell Atlantic

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For Your Home
Infospeed DSL Home
What is Infospeed DSL?
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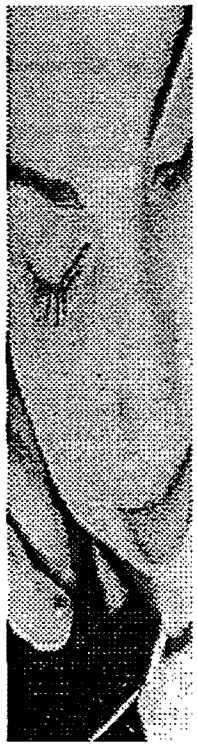
Infospeed DSL Pricing



SPECIAL OFFER

Infospeed DSL Internet Packages - Monthly Rate

Personal Infospeed (Infospeed 640 Kbps & Bell Atlantic.net)	$59.95
Professional Infospeed (Infospeed 1.6 Mbps & Bell Atlantic.net)	$109.95
Power Infospeed (Infospeed 7.1 Mbps & Bell Atlantic.net)	$189.95

Infospeed DSL - Monthly Rate

Infospeed 640 Kbps	$39.95
Infospeed 1.6 Mbps	$59.95
Infospeed 7.1 Mbps	$109.95

One Time Charges

One-time charges include the following:

Service Connection Charge:	$99.00
DSL Modem:	$325.00
Turnkey Home Installation:	$99.00

Please note that if you do not already have an Ethernet card, you will need to purchase one from Bell Atlantic or any other retail provider of Ethernet cards.

Special Offer

For customers subscribing to a Bell Atlantic.net DSL package for twelve months, the DSL modem is only $99 and the Ethernet card* and turnkey home installation are free!
*Offer available on selected Ethernet cards only.

If you're currently a Bell Atlantic ISDN customer, click here to find out about out ISDN Rewards upgrade program.

The levels of Infospeed DSL service available to you will vary based on your distance from your Bell Atlantic Central Office. Infospeed DSL is not available in all areas.

ISDN Rewards

Bell Atlantic will be "technology-change proofing" its high speed services by introducing an **ISDN Rewards** program concurrent with the launch of its Infospeed product line. Once Bell Atlantic Infospeed service is available in an area, Bell Atlantic residential customers who have purchased an ISDN modem from Bell Atlantic will be guaranteed an ADSL modem from the company at no additional charge when they subscribe to our Bell Atlantic.net DSL offering with a 12-month commitment.

Bell Atlantic residential customers who prefer to use another Internet provider will receive 1/2-off Bell Atlantic's normal ADSL modem price when they purchase an ADSL modem from Bell Atlantic. So, customers who want high-speed Internet access need not wait until ADSL-powered Infospeed is available in their area. Where Bell Atlantic Infospeed is not available or is not compatible with a person's line, customers can still order Bell Atlantic ISDN service for high-speed Internet access. Bell Atlantic ISDN service is available - today - to nearly 20 million households in the mid-Atlantic region and the Northeast. ISDN can provide Internet connections that are more than four times faster than traditional 28.8 Kbps modems. Nearly half of the one million ISDN lines installed in the United States are used by Bell Atlantic customers.

Purchase of InfoSpeed DSL not required. Limit one per household. ISDN modem must have been purchased from Bell Atlantic's Residential ISDN Center in Norfolk, VA or from Bell Atlantic's authorized sales agent IDRC or Telamon. Return of the ISDN digital modem invalidates this offer. Terms and Conditions associated with this program are subject to change.

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GTE Internetworking

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GTE Internetworking Press Release

GTE to Offer Ultra-Fast Internet Access; Nation's Largest Deployment of Asymmetric Digital Subscriber Line (ADSL) Service to Roll Out in Two Phases Starting this June in Current Market Trial Locations; Fujitsu Network Communications Selected as Supplier of High-Speed Internet Access Equipment

Dallas –April, 13 1998– GTE today announced that it will begin offering consumers, businesses, universities and Internet service providers "always-on" high-speed Internet access and remote office connectivity service that helps boost connection speeds to the Internet at rates up to 50 times faster than conventional modems.

Beginning in June, upon regulatory approval, GTE Network Services, the incumbent local exchange carrier unit of GTE Corp., will offer network-based asymmetric digital subscriber line (ADSL) service in approximately 300 central offices in portions of 16 states, creating the nation's largest deployment of ADSL. To provide the service, GTE will install ADSL equipment supplied by Richardson, Texas-based Fujitsu Network Communications, Inc. and digital subscriber line partner Orckit Communications Ltd.

In the first of two phases, GTE will convert its current ADSL trials into broad-market deployment, enabling customers in portions of Beaverton, Ore., Durham, N.C., West Lafayette, Ind., and Redmond and Kirkland, Wash., to access the World Wide Web at speeds up to 1.5 megabits per second (Mbps). During the second half of the year, GTE plans to offer ADSL service in no less than 30 additional market clusters in California, Florida, Hawaii, Illinois, Indiana, Kentucky, Michigan, Missouri, North Carolina, Ohio, Oregon, Pennsylvania, Texas, Virginia, Washington and Wisconsin. (Editor's Note: See attached list of markets)

"Since launching the industry's first data-oriented ADSL trial, we have strived to develop a simple, friendly and affordable way to revolutionize the way our customers communicate," GTE President Kent B. Foster said. "This new service offering gives Internet users at work, home and school a competitive edge, and paves the way for increased productivity, and vastly improved performance compared to lower-speed modems."

The deployment of ADSL, said Foster, helps enable GTE to offer end-to-end Internet solutions on a broader scale, and is in keeping with the company's overall goal to become a national provider of integrated telecommunications services.

By the end of the year, GTE's central offices in parts of 16 states will be equipped to offer high-speed digital connections to the Internet over existing telephone lines. The availability and timing of ADSL service in

each state will be dependent upon local market conditions, and will not be offered ubiquitously.

The network efficiency of ADSL

ADSL works by connecting a pair of modems to each end of a telephone line, with one modem located in the telephone company's central office and the other at the customer's premises, providing a continuous Internet access rather than traditional dial-up modem connections.

With ADSL, consumers can simultaneously surf the World Wide Web and place telephone calls over the same line. Compared to cable modems, ADSL offers greater flexibility when choosing Internet service providers and network connectivity alternatives. ADSL also delivers dedicated bandwidth from the central office to individual users at their homes or offices unlike cable modems that provide shared bandwidth among a group of users over the same path. Further, GTE has a track record of network reliability which provides an additional advantage to customers interested in higher bandwidth services.

Fujitsu Network Communications selected as ADSL equipment provider

In the central offices where service will be offered, GTE will install Fujitsu's SPEEDPORTTM equipment, developed with its partner Orckit (NASDAQ: ORCTF). In addition, Fujitsu-supplied Orckit modems will be installed on customer premises, providing high-speed Internet and remote access.

"As the leading supplier of fiber-optic transport solutions to local exchange carriers in North America, Fujitsu is very excited about entering the high-speed access market with an innovative service provider like GTE," said George Chase, executive vice president of sales and marketing for Fujitsu Network Communications. "Our SPEEDPORT ADSL system will provide the flexible service solutions that GTE and its customers need to make the most of high-speed Internet access for residential and commercial applications."

An information highway lined with green lights

"Our trial participants have told us loud and clear that their increased need for information requires greater bandwidth and speed. With ADSL, their information highway will be lined with green lights, and they can confidently put their interactive pedal all the way down to the floorboard," said John Appel, president-GTE Network Services. "Our world is becoming more and more digital, and voice, video and data services are converging into a single ubiquitous network. ADSL becomes the 'last mile' or local loop enabler that helps deliver a new realm of multimedia content and enhanced Internet protocol services to customers."

Pending regulatory approval, GTE plans to offer several ADSL service packages featuring various transmission speeds ranging from 256 kilobits per second (kbps) to 1.5 megabits per second (Mbps). For comparison, a 2 1/2-minute movie clip of Superman (8.8 megabytes) would take 35 minutes to download using a 33.6 kbps modem, yet less than 47 seconds using a 1.5 Mbps ADSL modem. Likewise, an initial downloading of a 50 megabyte interactive game would painstakingly take three hours and 18 minutes with a 33.6 kbps modem, but just 4 1/2 minutes with a 1.5 Mbps connection.

GTE to offer five ADSL service packages

GTE will offer customers month-to-month, multi-year term and volume discount plans with a target monthly price range of $30 to $250, excluding one-time installation, Internet service charges and modem lease. A modem lease rate of about $12 per month is expected, plus a one-time installation fee of $60 or $140, dependent upon whether or not a modem and inside wire are installed at the customer's premises.

The five service packages, excluding Internet service and modem rental, are:

- Bronze – up to 256 kpbs access for casual Internet or work-at-home users.
- Silver – up to 384 kbps access for active telecommuters and small business customers with greater bandwidth needs.
- Gold – up to 768 kbps access for highly active business customers and Internet users.
- Platinum – up to 1.5 Mbps access for intensive business users and hard-core Internet customers.
- Platinum Plus / Multi-user – up to 1.5 Mbps access for multiple business Internet users operating from the same local area network.

GTE also plans to offer customers high-speed ADSL with Internet access service, for approximately $60 a month through a relationship with GTE Internetworking, the Internet unit of GTE Corp. The company also intends to develop high-speed ADSL and Internet access service packages with other Internet service providers.

SPEEDPORT(TM) system uses industry-standard DMT technology

The SPEEDPORT system, with its core DSL technology provided by Fujitsu partner Orckit, consists of modems that will be installed at the customer's home or office, as well as high-powered equipment, known as DSL access multiplexers, to be placed at GTE central office sites. These DSL access multiplexers enable GTE to provide DSL service to a large number of customers at one time by concentrating the customers' data traffic over DS1 lines initially, providing for transparent upgrades to higher-speed backbone facilities as traffic demand warrants.

The SPEEDPORT system uses industry-standard DMT (Discrete Multi-tone) technology. It transmits data using the ethernet IP protocol, and is ATM (Asynchronous Transfer Mode) capable.

GTE's current ADSL market trials in Redmond and Kirkland, Wash., West Lafayette, Ind., Durham, N. C. and Beaverton, Ore. involve more than 1,300 users, including some 1,000-plus Microsoft employees, a small number of Intel employees in Oregon, plus students, faculty and scientists at Duke University Medical Center and Purdue University.

GTE, Fujitsu and Orckit are members of the Universal ADSL Working Group (UAWG), a consortium comprised of industry leading PC manufacturers, telecommunications providers and data networking companies, which earlier this year announced plans to develop a universal and interoperable ADSL standard to spur its deployment to the

mass market.

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About GTE

With 1997 revenues of more than $23 billion, GTE is one of the world's largest telecommunications companies and a leading provider of integrated telecommunications services. In the United States, GTE provides local service in 28 states and wireless service in 17 states; nationwide long-distance service and internetworking services ranging from dial-up Internet access for residential and small business consumers to Web-based applications for Fortune 500 companies; as well as video service in selected markets. Additional information about GTE can be found on the Internet at http://www.gte.com.

About Fujitsu

Fujitsu Network Communications, Inc., designs and manufactures fiber-optic transmission and broadband switching platforms and develops software that allows customers to perform in-service management and monitoring of the telephone network. Its customers include local exchange carriers, interexchange carriers, competitive access providers and cable TV operators, as well as large private networks in North America. Fujitsu Network Communications is part of Fujitsu Limited, a $36 billion global technology leader in computers, communications and microelectronics. Product information is available by calling 800-777-FAST. Its World Wide Web site is at http://www.fnc.fujitsu.com.

SPEEDPORT(TM) is a trademark of Fujitsu Network Communications, Inc.

About Orckit

Orckit Communications Ltd. is a leader in digital subscriber line solutions. Orckit has both core silicon expertise and a wide range of DSL systems and products, including DSLAM systems with ADSL and SDSL, and its HDSL and VDSL product lines. Orckit has alliances with several leading semiconductor companies and telecom equipment providers. For more information, visit Orckit's web site at http://www.orckit.com.

Markets Where GTE Plans To Offer Asymmetric Digital Subscriber Line (ADSL)

Service In 1998:

California: Availability begins in June Long Beach, Norwalk, Ontario, Palm Springs, Redondo, San Bernardino, San Fernando, Santa Barbara, Santa Monica, Thousand Oaks, Victorville

Florida: Availability begins in June Sarasota, St. Petersburg, Tampa

Hawaii: Availability begins in June Hilo, Oahu

Illinois: Availability begins in June Bloomington (Illinois State University), Carbondale (Southern Illinois University), Dekalb (Northern Illinois University)

Indiana: Availability begins in June Elkhart, Fort Wayne, Jasper, West Lafayette (Purdue Univ.), North Vernon, Terre Haute (Indiana St.

University), Valparaiso

Kentucky: Availability begins in June Lexington (University of Kentucky)

Michigan: Availability begins in July Mount Pleasant (Central Michigan University), Muskegon

Missouri: Availability begins in October Columbia (University of Missouri)

North Carolina: Availability begins in June Durham (Duke University)

Ohio: Availability begins in July Athens (Ohio University), Bowling Green (BG University), Norwalk

Oregon: Availability begins in June Beaverton

Pennsylvania: Availability begins in September Erie, Hershey, York

Texas: Availability begins in June Carrollton, College Station (Texas A&M University), Denton, Garland, Grapevine, Irving, Lewisville, Plano, San Angelo, Texarkana

Virginia: Availability begins in July Dahlgren, Dale City, Harrisonburg (James Madison University)

Washington: Availability begins in June Bothell, Everett, Kennewick, Kirkland, Pullman (Washington State University), Redmond, Sammamish

Wisconsin: Availability begins in September Wausau

For More Information Contact:

Bill Kula
GTE Internetworking
phone: 972-718-6924
fax: 972-718-7503
william.kula@telops.gte.com

PACIFIC BELL INTERNET DSL

DSL Internet Access Solutions

Pacific Bell Internet offers several complete solution packages designed to get you or your business on the Internet quickly and easily. Solution packages are available for individuals as well as for customers with a LAN. Both solution packages include the required networking hardware, hardware configuration, and on-site installation -- all at a significant cost savings

Home Pack DSL - *For single workstation customers*

HomePack DSL features include:

- DSL service installation from Pacific Bell (384/128, 384/384 or 1.5/384)
- DSL Basic Internet access from Pacific Bell Internet (1 year term required)
- DSL hardware package from Prime Services Group:
    - DSL modem
    - Splitter
    - Inside Wiring
    - On-site Installation

Total start-up cost for Home Pack DSL - **$299** *($249 without NIC)*

Internet Access Pack DSL - *For customers with a LAN*

Internet Access Pack DSL features include:

- DSL service installation from Pacific Bell (384/128, 384/384 or 1.5/384)
- DSL Enhanced or Business Internet access from Pacific Bell Internet (1 year term required)
- DSL hardware package from Prime Services Group:
    - DSL modem
    - Splitter
    - Inside Wiring
    - On-site Installation

Total start-up cost for Internet Access Pack DSL - **$449*** *($50 more with NIC)*

Total start-up cost for Internet Access Pack DSL with Router - **$1,224*** *($1,274 with NIC)*
(A router is required for local area networks with more than 15 workstations.)

*Pricing assumes Pacific Bell term contract for 384/384 and 1.5/384 speeds. Add $125 without term contract.

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PACIFIC BELL NETWORK

FasTrak℠ DSL

Pricing and Availability

FasTrak DSL Pricing

	Installation price	Monthly price
384/128 Kbps	$125	$59
384/384 Kbps	$125	$99
1.54Mbps/384Kbps	$125	$189

Notes: Price covers the circuit connection from the end user location to the Pacific Bell *FasTrak* DSL network and is in addition to charges for standard phone service.

Equipment and Equipment Installation Pricing

The required equipment for *FasTrak* DSL consists of an Ethernet Network Interface Card (NIC) and the following hardware: DSL modem, splitter, and inside wire. Prices include installation or phone support for one PC.

DSL hardware and Network Interface Card, with full installation	$660
DSL hardware, with full installation	$610

Notes:
Other Equipment Installation pricing options available upon request.

- Network Interface Card pricing for Macintosh computers available upon request.
- Customers may provide their own Ethernet Network Interface Card.
- Modem and splitter vendor: Alcatel.
- All rates, terms, and conditions are subject to change without notice.

Installation and Customer hardware support is provided by Prime Services Group, Inc. In addition to supporting the installation of the Alcatel 1000 ADSL modem, PSG also supports *FasTrak* DSL LAN solutions. With the Alcatel 1000 ADSL modem and a router, customers can establish a small LAN ideal for sharing the bandwidth of *FasTrak* DSL for high speed Internet access. Click here to obtain more information on the Alcatel modem.

Internet Service Provider Pricing

You must have an Internet access account with an Internet Service Provider that supports *FasTrak* DSL. You may select the Internet Service Provider of

your choice. Participating providers currently include:

- BAIS
- Concentric Network Corporation
- Direct Network Access, Inc.
- Flashcom
- InReach
- Orconet
- Pacific Bell Internet
- Sirius
- SlipNet

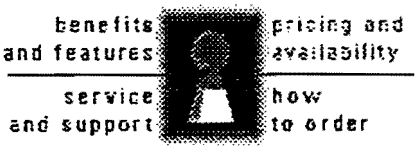
Corporate LAN Connection to The Pacific Bell *FasTrak* Network

Pacific Bell *FasTrak* ATM Cell Relay Service is required for corporate customers with the *FasTrak* DSL remote LAN access application. Please contact your Pacific Bell Account Representative for more information on ATM Cell Relay Service.

Availability

Click here to see if *FasTrak* DSL is available in your area. If you have questions, see the DSL FAQ.

go to
fastrak dsl



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PUBLIC VERSION

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

GTE NEW MEDIA SERVICES, INC., Plaintiff, v. AMERITECH CORPORATION; AMERITECH PUBLISHING, INC.; AMERITECH INTERACTIVE, MEDIA, INC.; AMERITECH INTERACTIVE MEDIA SERVICES, INC.; BELLSOUTH CORPORATION; BELLSOUTH ENTERPRISES, INC.; BELLSOUTH ADVERTISING AND PUBLISHING CORPORATION; INTELLIGENT MEDIA VENTURES, INC; BELL ATLANTIC CORPORATION; BELL ATLANTIC ELECTRONIC COMMERCE SERVICES, INC; SBC CORPORATIONS, INC.; PACIFIC TELESIS GROUP; PACIFIC BELL INTERACTIVE MEDIA; US WEST, INC; US WEST MEDIA GROUP, INC.; US WEST DEX, INC.; NETSCAPE COMMUNICATIONS CORPORATION; and YAHOO!, INC., Defendants.	Civil Action No: 1: 97CV02314

ANSWER, AFFIRMATIVE DEFENSES, AND COUNTERCLAIMS OF DEFENDANTS BELL ATLANTIC CORPORATION AND BELL ATLANTIC ELECTRONIC COMMERCE SERVICES, INC.

Defendants Bell Atlantic Corporation ("BA") and Bell Atlantic Electronic Commerce Services, Inc. ("BAECS") for their answer and affirmative defenses to the Complaint of plaintiff GTE

COUNTERCLAIMS

Counterclaim plaintiff Bell Atlantic Electronic Commerce Services, Inc. ("BAECS"), for its counterclaims against GTE New Media Services, Inc. ("GTE"), alleges upon knowledge with respect to its own actions and upon information and belief as to all other matters:

Nature of the Counterclaims

1. BAECS publishes an electronic directory service (BigYellow) that is available to persons with access to the internet. BigYellow provides telephone listings and addresses, advertisements, and other information about approximately 12 million businesses located throughout the United States. There are scores of services that provide similar information, among them GTE's "SuperPages," and competition among these services is intense. As part of this competition, GTE has secured apparently exclusive hypertext linking arrangements with companies that make SuperPages more readily accessible to internet users. For the purposes of strengthening its competitive position, GTE has also sought

[REDACTED]

GTE embroiled BAECS in a lawsuit for the purpose of preventing BAECS from securing favorable agreements with advertisers, owners of websites, and potential joint venture partners in competition with GTE.

Parties, Jurisdiction, and Venue

2. BAECS is a Delaware corporation with its principal place of business in Middleton, Massachusetts. BAECS came about in 1997 following the acquisition by BA of NYNEX Corporation. In these Counterclaims, "BAECS" refers to BAECS and its predecessors, Bell Atlantic Electronic Publishing, Inc. and NYNEX Information Technologies Company.

3. GTE is a Delaware corporation with its principal place of business in Dallas/Fort Worth Airport, Texas.

4. This Court has jurisdiction pursuant to 28 U.S.C. § 1367(a) and Fed. R. Civ. P. Rule 13(a). Venue is proper in this District pursuant to 28 U.S.C. § 1391(b) and (c).

Factual Background

5. GTE's SuperPages is an electronic directory information service that provides listings for more than 11 million businesses throughout the United States. Since the introduction

of SuperPages, GTE has secured apparently exclusive arrangements with five websites that are frequently accessed by internet users: http://www.lycos.com, http://www.excite.com, http://www.webcrawler.com., http://www.compuserve.com, and http://www.city.net. Through these arrangements, GTE has positioned itself to become the preferred provider of electronic directory services.

6. GTE has sought to dominate its competitors, including BAECS, through

[REDACTED]

7. In 1997, after BAECS had rejected its demands, GTE

learned that certain popular websites and services -- including without limitation http://www.yahoo.com (owned by Yahoo!, Inc.) -- were considering new arrangements with electronic directory service providers such as GTE and BAECS. Concerned that such popular websites and services might make agreements with providers other than GTE, and thereby stimulate competition, GTE began looking for ways to prevent rivals, including BAECS, from duplicating its own success in acquiring special hypertext linking arrangements.

8. GTE's desire for action against its rivals became particularly acute in 1997 when GTE learned that certain competing providers of electronic directory service (but not BAECS) had reached an agreement pursuant to which these providers were identified on a color "map" available through certain websites, including "Netscape Internet Guide by Yahoo!" GTE contacted BAECS for information about the map, and was informed that BAECS had played no role in its creation. GTE then sought

[REDACTED]

Request for trial by jury

BAECS respectfully requests trial by jury on its counterclaims.

Respectfully submitted,

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Counsel for Bell Atlantic Corporation and Bell Atlantic Electronic Commerce Services, Inc.

November 14, 1997

Charles R. Lee
Chairman and
Chief Executive Officer

GTE Corporation

One Stamford Forum
Stamford, CT 06904
203 965-2000

October 15, 1997

Mr. Bert C. Roberts, Jr.
Chairman
MCI Communications Corporation
1801 Pennsylvania Avenue, N.W.
Washington, DC 20006

Dear Bert:

You and I have talked over the years about the advantages of bringing our two great companies closer together. We both supported the historic Telecommunications Act of 1996, which was designed to sweep away the antiquated separation of markets by geographic and product-line boundaries and to empower companies to bring robust competition to all telecommunications markets. As I survey our industry today, I am more convinced than ever that the combination of our companies would serve the best interests of our shareholders, employees, business partners, and communities, and would achieve the vision of the Telecommunications Act by creating a dynamic competitive force capable of bringing the benefits of competition to all markets and all customers, both nationally and globally.

I am pleased, therefore, to propose that we combine GTE and MCI. Specifically, we are offering $40.00 in cash per share of MCI stock. We would propose, immediately upon execution of a definitive merger agreement, to launch a cash tender offer for the MCI shares. To expedite delivery of consideration to your shareholders, the shares would be accepted for payment, and deposited in a voting trust, upon the receipt of Hart-Scott-Rodino and European antitrust approvals. We would acquire the balance of the shares through a merger which we would be prepared to close as soon as possible following the consummation of the tender offer.

I would like to meet with you as soon as possible and am looking forward to negotiating the contemplated Merger Agreement expeditiously. To facilitate discussions, a draft agreement is being forwarded to you under separate cover. Of course, we recognize that any discussions must be consistent with any legal restrictions you are under. Because I believe so strongly in the opportunities for our combined enterprise, I am willing to explore, as an alternative to all cash, a combination of cash and stock as payment for MCI shares.

We should explore how we can best combine our outstanding teams of employees. I, and our senior team at GTE, would look forward to working with you to develop a management structure for the new organization that includes you, your senior leadership and others in your organization. We have respect and admiration for the very special culture of your organization and are intent on ensuring that it thrives within the new organization. In that regard, I would hope that upon completion of our transaction, you would become a member of the new organization's Board of Directors as a Vice Chairman, as well as joining Kent Foster, Mike Masin and me in the Office of the Chairman. I, and the other directors, would also hope you would join our Board's strategic planning committee. We, of course, are open to the possibility of other members of your Board joining the new organization's Board. In recognition of the importance to our new organization of MCI, its management and its outstanding workforce, we intend the World Headquarters of the combined organization to be located in Washington, DC in conjunction with MCI's current World Headquarters.

The logic and vision of this merger are compelling. The combined enterprise would be well-positioned to compete and grow by offering the broadest range of products and services worldwide. It would generate over $40 billion of annual revenues; serve more than 21 million local and 24 million long-distance lines and 5 million wireless customers; have a global presence in 77 countries; possess one of the world's most advanced global data communications networks; and be led by a combined management team and workforce second to none in our industry. Together, the outstanding talents, capabilities and shared values of our two companies would create a dynamic competitive force in the growing number of markets we serve.

As you know, GTE is committed to pursuit of the promise of the Telecommunications Act. We have entered the long-distance market as a reseller. Recently, we created a competitive local exchange carrier business largely in an effort to attack and compete with the RBOCs in their service areas. Last May, we announced a series of steps to position GTE as a market leader in data communications, the fastest-growing segment of the telecommunications marketplace. These steps included acquiring BBN, a leading provider of end-to-end Internet solutions; establishing a strategic alliance with Cisco to jointly develop enhanced data and Internet services; and purchasing a national, state-of-the-art fiber optic network from Qwest. To serve international markets, we have increased our stake in the Americas and established a significant presence in Asia.

Together, we can achieve the promise of the Telecommunications Act. The fit between our companies is truly extraordinary. Indeed, no two companies in the industry today are more complementary or better situated to expand the availability and breadth of bundled service offerings to local, national and international customers, and to penetrate those markets previously closed to us. GTE would bring to the new company a local exchange business, including

operational expertise and a national, though dispersed, footprint, that provides an ideal platform from which the combined company can launch competitive facilities-based service to compete with the RBOCs. In addition, GTE would bring to the combination one of the nation's largest wireless operations. MCI has demonstrated prowess and retailing acumen in long distance and in serving the needs of large multinational business customers. Moreover, the companies together can pursue aggressive, innovative strategies for the data marketplace and begin competing in earnest for RBOC customers.

Both companies are committed to the global market. GTE currently has a presence in 21 countries in four regions, and derives 15 percent of its net income from its international business. MCI also has a significant global presence. We share the global vision of our industry that brought MCI and British Telecom together and look forward to discussing with you the continued development of that relationship within the context of this proposal. In fact, realizing the growth opportunities represented by the international marketplace would be another of our top strategic priorities, including continuing to work closely with our respective international partners.

There are additional important aspects to combining our two companies that also serve the public interest while enhancing shareholder value. Together, for example, we would have the wherewithal to make the investments in infrastructure necessary to foster innovation and job creation in our industry. We would deploy and operate the advanced high-speed network infrastructures encouraged by the architects of the Telecommunications Act. These networks would provide the solid foundation upon which a wide range of entrepreneurial competitors will build their services. In fact, the combined company would invest more than $8.5 billion annually in network deployment. The benefits of these investments would accrue to all of our combined and prospective customers. Our respective track records demonstrate that we have always been committed to providing all of our services universally. That commitment will not change. Indeed, combining MCI and GTE would enhance our ability to fulfill it.

Our two companies, having both emerged outside the dominant AT&T/RBOC structure, believe strongly in the public benefits of vigorous and fair competition, and the transaction we propose is clearly pro-competitive. It would clearly create, in both scale and scope, the most substantial facilities-based competitive alternative to the RBOCs and bring to customers a full complement of communications services, including local, long distance, wireless, Internet applications and video.

In addition, the merger of our two companies would result in significantly enhanced operating efficiency as well as new revenue opportunities as we respond to consumer preference for a complete array of products and services.

For these reasons, our legal advisors believe that we will be able to obtain the regulatory approvals necessary to consummate this transaction. We have been further informed by our financial advisors that any financing required to complete the transaction would be readily available. Thus, we intend to consummate this transaction in the same time frame as contemplated in the WorldCom proposal.

In short, Bert, my colleagues and I at GTE believe very strongly that a merger of MCI and GTE is in the best interests of all of our respective shareholders, customers, employees and business partners. It would unite two of the world's great telecommunications companies under a single roof while creating significant long-term value for all of our constituencies. I am personally very excited about this proposal - - which we are prepared to discuss with you in detail immediately - - and I'm confident that after you have reviewed it, you and your colleagues will fully share that enthusiasm.

Sincerely,

Chuck

CRL/dh