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

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

**JOINT DECLARATION OF JEFFREY C. KISSELL AND SCOTT M. ZIMMERMAN**

1. My name is Jeffrey C. Kissell. I am the Vice President of National Marketing for GTE Business Development & Integration (GTE BD&I), a unit of GTE Service Corporation. As part of GTE BD&I, I am responsible for developing marketing programs and evaluating product performance for GTE. I was also part of the original team that, in late 1996, developed GTE's CLEC strategy -- which led to the formation of GTE Communications Corporation (GTECC).

2. My name is Scott M. Zimmerman. I am the Assistant Vice President of Operational Performance for GTECC. I am responsible for developing GTECC's strategic and tactical operating plans, including out-of-franchise strategies, and for developing and implementing performance measurement systems. I also oversee the implementation of all new initiatives within GTECC through the Program Management function.

3. We have been asked to address the following topics related to the GTE-Bell Atlantic merger: (1) the emerging national market for bundled telecommunication services; (2) the merger's impact upon GTE-Bell Atlantic's ability to offer out-of-franchise local exchange service; (3) the relative ability of the merged company to build a national brand; and (4) the likelihood of any injury to competition in the local exchange market as a result of the merger. The topics will be discussed in that order.

**The National Market for Bundled Services:**

4. GTE's merger with Bell Atlantic will create the first challenger to AT&T, MCI WorldCom, and Sprint in the national market for bundled services. Currently, the Big Three control the market for national telecommunications services by virtue of their dominance in the long distance and data markets. GTE-Bell Atlantic's combined ability to provide advanced voice and data services (like Frame Relay, ATM, and Virtual Private Networks (VPNs)) along with its ability to provide facilities-based long distance, IP, and local services to large business customers across the country, will create a much-needed fourth player among the national, full-service telecommunications providers.

5. The emerging national market for bundled services is the key telecommunications market of the future. Because businesses are increasingly looking for integrated solutions to their telecommunications needs, demand for a full bundle of nationally provided services is high, particularly among large business customers that represent key anchor tenants in out-of-franchise markets. GTE market research indicates that 86 percent of businesses that spend over $60,000 per year on traditional telephone service are interested in purchasing multiple voice and data

communication services from a single company. With integrated bundled offerings, large businesses benefit by receiving deeper volume discounts and by eliminating the cost and complexity of managing multiple service providers. But only a small percentage of large business customers currently purchase a full bundle of telecommunication services from one provider.

6. Among all telecommunications services, long distance, local, data communications, and Internet services have the highest demand among large businesses interested in bundling. GTE market research indicates that those businesses interested in purchasing multiple services from a single provider want to receive the following services:

| | |
|---|---|
| Long Distance | 67% |
| Local | 62% |
| Data Communication Services | 48% |
| Internet Services | 43% |
| Wireless | 29% |
| Paging | 21% |
| Network Management | 18% |
| Web Hosting | 14% |
| Systems Consulting | 10% |

Moreover, it is increasingly important to offer these multiple services without geographical limitation. GTE research shows that 68 percent of large firms consider it important to be able to standardize communication providers across geographic locations.

7. Advanced voice and data services, as well as Internet services, are critical components of a national bundled offering, as they are increasingly demanded by large businesses to address their complex communications needs. GTE market research indicates that 76 percent of large businesses buy or plan to buy Frame Relay within the next twelve months.

ATM demand is also growing, with 24 percent of large businesses currently using it or planning to buy it in the next year. Similarly, demand is rising for VPNs among large businesses: International Data Corporation research indicates that 25 percent of businesses with over 5,000 employees already have or plan to get VPNs within the next 12 months. Finally, among Fortune 500 companies, demand for Internet services approaches 100 percent.

**Competition in the Local Exchange Market:**

8. In addition to allowing the new GTE-Bell Atlantic to compete effectively with AT&T, MCI WorldCom, and Sprint in providing advanced voice and data services on a national scale, the merger will also enhance competition in local exchange markets across the country. The merger will achieve this substantial pro-competitive benefit by marrying the two company's complementary assets and capabilities -- without which neither company alone could mount such a rapid, broad, and effective out-of-franchise offering. These enhanced capabilities will allow GTE-Bell Atlantic to seek to enter 21 markets with local service offerings within 18 months of the merger's closing.

9. On its own, GTE's out-of-franchise local service activities have been quite limited. GTE's strategy is to offer services out-of-franchise primarily through its subsidiary GTECC. GTECC's business plan, which was developed in late-1996 and resulted in the formation of GTECC in May 1997, focused primarily on providing bundled services -- including local, long distance, wireless, and Internet -- to customers *inside* of GTE's franchise territories. It thus targeted consumers and small business customers (3-50 employees) in GTE's franchise areas, but only small businesses out-of-franchise, and then only in areas contiguous to GTE's

franchise ("near out-of-franchise") and in GTE's wireless markets. Consumers were not targeted out-of-franchise because acquisition costs were too high. Likewise, large businesses were not targeted because GTE has a limited presence in that market segment. GTECC's plan, moreover, was resale-based. Local service was provided in-franchise by reselling from GTE Network Service (GTENS), GTE's ILEC, and was offered out-of-franchise to small businesses by reselling from other ILECs. But even this modest out-of-franchise strategy was less successful than anticipated.

10. Since its first launch into California in September 1997, GTECC has learned that the assumptions upon which it built its business plan were simply too optimistic. In addition to encountering higher than expected costs of service delivery -- *i.e.*, order entry, provisioning, billing, and customer care -- GTECC has learned that customer acquisition costs, especially for out-of-franchise small business customers, are higher than expected. For example, in February 1998, GTE BD&I estimated the following average small business acquisition costs:

| | In-Franchise | Near Out-of-Franchise |
|---|---|---|
| 3-9 Employees | $900 | $1,600 |
| 9-50 Employees | $1,300 | $2,300 |

GTECC's September 1998 year-to-date acquisition cost, however, was much higher than any of these estimates -- $3,309 per small business customer. And since this figure includes in-franchise acquisitions -- which traditionally cost less -- GTECC's out-of-franchise small business acquisition cost is actually higher. Indeed, due to GTE's low out-of-franchise brand awareness, GTECC's experience has shown that the further small businesses are located from GTE's franchise territory, the higher acquisition costs rise.

11. Moreover, revenue and gross margin indicators also demonstrate the stark difference between GTECC's predictions in its business plan and its actual results. As to revenues, the business plan assumed $658 in revenue per customer per month for the small business bundle of services. GTECC's actual September 1998 year-to-date financials, however, show only $168 in revenue per small business customer per month. Gross margin actuals are just as disparate. Depending on the product type, the business plan assumed between 17 and 53 percent gross margin for the small business bundle. GTECC's actual September 1998 year-to-date gross margin is *negative* 73.92 percent. In light of these lower than anticipated revenues and higher than anticipated costs, GTECC has suspended marketing to small business customers -- both in- and out-of-franchise -- until acquisition costs can be reduced. GTECC is therefore only marketing to in-franchise consumers at this time, and is in the process of developing a new facilities-based strategy.

12. GTE's minimal out-of-franchise presence does not justify investment in new facilities on a broad scale. Due to capital fund limitations for GTE as a whole and the resulting prioritization of opportunities, GTECC only plans to expand out-of-franchise with local services in one market in 1999. To prioritize target markets, GTECC focused on cities where GTE already had an existing presence. Looking at four factors -- Metropolitan Statistical Areas (MSAs) with (1) large data revenue opportunities for new business; (2) existing GTE facilities (*i.e.*, switching facilities and access to the GNI); (3) a business customer base to which GTECC can upsell additional services; and (4) existing GTE brand awareness -- San Francisco was selected.

13. This sole 1999 out-of-franchise local exchange launch will test GTECC's new facilities-based strategy: GTECC will upgrade a GTE Wireless (GTEW) switch to provide wireline services. Also, to the extent possible, GTECC will rely upon GTEW's brand awareness to help reduce acquisition costs and increase win rates. By the third quarter of 1999, GTECC hopes to begin selling to medium-sized business customers to whom it currently sells CPE (*i.e.*, PBX, key systems, and internal network monitoring and maintenance). The total plan in 1999, according to GTECC's projections, would likely generate no more than about $1 million in local exchange revenue and the sale of additional services to about 60 new accounts. Overall, GTECC's San Francisco trial is a fairly modest plan that uses GTE's limited resources in the most effective way possible.

14. In contrast, the GTE-Bell Atlantic merger will provide the new company the capabilities to mount a broader, more rapid out-of-franchise local service launch than either company could undertake on its own. While GTE currently only plans to expand out-of-franchise with a local service offering in one city in 1999, the new company plans to enter on an economic basis 21 cities within 18 months of the merger's closing. It will seek to do so by marrying several complementary capabilities: Bell Atlantic's large business customer base will provide the scale to justify the investments in facilities that are required for a broad out-of-franchise strategy. GTE's GNI will allow the combined company immediately to offer the full suite of facilities-based services -- including advanced voice and data, Internet, and long distance -- necessary to attract high-volume customers. GTE also brings experience in marketing and provisioning bundled services. And the new company's combined scale will provide the

resources and business justification to build a national brand rivaling that of AT&T, MCI WorldCom, and Sprint -- a component necessary to compete on a nationwide basis with the top-tier providers.

15. Building the facilities required to implement this plan, however, will require up-front capital costs that must be justified by serving a high volume of traffic. GTE, however, does not have a significant large business customer base to offset the required up-front costs of broad facilities-based out-of-franchise expansion. Bell Atlantic, on the other hand, has the relationships with large business customers that GTE lacks. For example, Bell Atlantic serves the headquarters of 175 of the Fortune 500 companies in its wireline territory. GTE serves only 20. In terms of business accounts that purchase over $60,000 annually in traditional telephone service, Bell Atlantic manages approximately 14,500 accounts that bring in approximately $3.7 billion in annual revenue; GTE only serves approximately 2,700 such accounts, bringing in about $1 billion.

16. These large business customers are critical anchor tenants. GTE conducted an actual analysis of the economics of entry into two of the markets that GTE Chairman Charles R. Lee identified to Congress: one in which the combined company will have some facilities and existing brand recognition; and another in which the merged company will have neither facilities nor brand recognition. The results of this analysis indicated that, by drawing on both companies' customer relationships, entries that would be profitable for neither company alone should (absent unexpected developments) be profitable for the merged company. It also indicated that, when looking at the number of customer relationships GTE, Bell Atlantic, and the merged company

will have in the 21 target cities, the merged company had enough customers to enter into all 21 markets -- something neither GTE nor Bell Atlantic could accomplish alone.

17. Moreover, the merger will allow GTE and Bell Atlantic to recover their initial investment, and earn a positive return, in a much shorter time frame than either company could alone. For example, a facilities-based entry employing a wireless switch would generate the following returns in a medium-sized market:

| | **GTE Alone** | **Bell Atlantic Alone** | **Combined** |
|---|---|---|---|
| Net Present Value Over 5 Years | ($5.2M) | ($3.3M) | $0.7M |
| Discounted Payback Period | >5 years | >5 years | 4.6 years |

18. Likewise, a facilities-based entry into a large market, relying on the placement of a new switch, would generate the following returns:

| | **GTE Alone** | **Bell Atlantic Alone** | **Combined** |
|---|---|---|---|
| Net Present Value Over 5 Years | ($0.2M) | ($2.8M) | $13.5M |
| Discounted Payback Period | >5 years | >5 years | 3.1 years |

19. GTE Internetworking (GTEI) customers were included in these two examples, demonstrating that they do not provide the required relationships to justify GTE's entry alone. Even apart from this, however, it is unreasonable to assume that GTEI customers provide GTE access to the large business market. Of GTEI's $740 million 1998 total revenue outlook, business applications -- *i.e.*, Internet access and Web hosting and security -- sold to businesses of all sizes will only generate $152 million in revenue. While these applications are an integral

part of a bundle, GTEI's share represents an insignificant amount of purchasing decisions compared against the $86 billion 1998 voice and data revenue opportunity in the Fortune 1000 market segment. Moreover, many of GTEI's business application relationships are with purchasers of Web hosting, who are typically not the same telecommunications and IT managers who make the larger telecommunications purchasing decisions for large businesses.

20. GTE also believes that the new company's out-of-franchise capability will be enhanced by GTECC's experience developing platforms for the delivery of bundled services from multiple vendors. Bell Atlantic has no such experience. Given that GTE will have spent over two years developing its platforms and service delivery processes, GTE believes its experience should prove useful in putting Bell Atlantic ahead of its current capabilities and saving the up-front costs of purchasing or developing its own platforms.

**Building a National Brand:**

21. Brand awareness is likewise a necessary component to compete in the national market for bundled services. The Big Three have powerful national brands and the RBOCs have strong regional brands. Therefore, national awareness is necessary to compete effectively against all of them. Neither company, however, has the plans or the resources to create a national brand on its own. The GTE-Bell Atlantic merger will give the combined company the needed resources to develop the brand awareness and image to compete on a broad scale, and will also allow it to take advantage of efficiencies from national advertising buys and higher volume purchases.

22. A strong brand image translates generally into shareholder value and profit for a company by attracting resources (such as customers, investors, and employees), securing customer retention and loyalty, offering a competitive advantage, and increasing sales and income. More fundamentally, a brand represents a promise from the company to deliver a product or service at a certain level of quality and performance. In this regard, however, GTE's brand imagery has suffered from a lack of consistency over time and thus fails to convey the image of a technologically sophisticated national provider of services. Indeed, GTE research indicates that, regardless of target group, GTE is still seen principally as a "local telco" and not a national leading-edge telecommunications provider.

23. This image difficulty hampers GTE's ability, on its own, to compete effectively with AT&T, MCI WorldCom, and Sprint on a national scale. For a sale to occur, the customer -- no matter how small or large -- must be convinced that the seller is a credible provider of the offered service. Thus, to sell to large business customers, GTE must convince those who make purchasing decisions for those businesses that it is an effective and reliable provider of every part of the service bundle. Brands convey messages that impact upon this process. All customers -- including individuals in charge of purchasing decisions for large businesses -- are susceptible to the cachet of a well-developed brand. Conversely, to the extent that GTE's brand conveys images of a local telco, rather than a leading-edge national provider, it will have a substantial negative impact upon those individuals' purchasing decisions. In this regard, a national brand that is built to convey the proper image is important to be able to compete with the Big Three for customers in all market segments.

24. GTE is also hampered by its lack of brand awareness generally. GTE research indicates that, as of the second quarter of 1998, the Big Three long distance companies have substantially higher brand awareness than GTE. For example, unaided brand awareness is especially strong for AT&T, at 90 percent among consumers and 88 percent among businesses. MCI also demonstrates strong unaided brand recognition among consumers at 69 percent, and businesses at 80 percent. Sprint's awareness is comparable to MCI's. GTE's unaided brand awareness, on the other hand, is significantly lower than AT&T's -- even inside of GTE's franchise territories -- and is substantially lower than all of the IXCs outside of its franchise. In-franchise, GTE's unaided awareness is 68 percent among businesses and 64 percent among consumers, while out-of-franchise, unaided recognition is a low 31 percent for businesses and 29 percent for consumers. These out-of-franchise results are confirmed by a second GTE study in November 1998, which shows GTE's out-of-franchise unaided awareness (excluding Bell Atlantic states) to be 26 percent among consumers and 29 percent among business executives. In Bell Atlantic states, GTE's unaided out-of-franchise brand awareness is even lower: 15 and 17 percent for consumers and business executives, respectively. The same study puts Bell Atlantic's unaided awareness in GTE's franchise in Bell Atlantic states at 14 percent for consumers and 15 percent among business executives.

25. And with increasing competition in the telecommunications marketplace, brand preference will significantly drive customer choice of bundled telecommunications providers. GTE, with a nationally indistinct and often misunderstood brand, will be at a severe disadvantage relative to the Big Three and the RBOCs within their regions. Advertising is one of the most

effective means of enhancing brand imagery, but GTE's advertising spending -- which is affected by budget pressures within the corporation -- lags significantly behind the competition. As a percent of total sales (a commonly accepted measure of advertising/brand commitment), GTE ranks last among the 9 major IXCs and RBOCs as shown below:[1]

| | |
|---|---|
| Sprint | 1.9% |
| MCI WorldCom | 1.9% |
| AT&T | 1.0% |
| U S West | 0.9% |
| SBC | 0.7% |
| Bell Atlantic | 0.7% |
| BellSouth | 0.6% |
| Ameritech | 0.5% |
| GTE | 0.5% |

26. To become a serious player on a national level, advertising spending capable of generating meaningful levels of national awareness -- relative to the Big Three -- is critical. For reference, MCI WorldCom, AT&T, and Sprint are spending at annual levels of approximately \$548, \$538, and \$318 million, respectively. By contrast, GTE's only truly nationwide advertising effort this year -- its "People Moving Ideas" campaign -- was supported by about \$15 million, and was aired predominantly over a five week period in the first and second quarter. Moreover, that national campaign was directed, first, at the financial community, then at policymakers and GTE employees, and, only fourth, at customers.

27. After the merger, GTE-Bell Atlantic's scale will allow it to build -- on a national basis -- a brand to be competitive with the Big Three. This is illustrated by looking at the total

[1] Amounts are January-September 1998; Sprint and BellSouth are January-June 1998.

advertising expenditures for the major telecommunications companies from October 1997 to September 1998:

| | Spending | Share of Spending |
|---|---|---|
| MCI WorldCom | $548,325,700 | 24.1% |
| AT&T | $538,462,800 | 23.6% |
| Sprint | $318,397,200 | 14.0% |
| Bell Atlantic | $214,180,600 | 9.4% |
| SBC | $194,187,200 | 8.5% |
| BellSouth | $145,292,600 | 6.4% |
| GTE | $115,193,800 | 5.1% |
| U S West | $105,700,700 | 4.6% |
| Ameritech | $97,444,800 | 4.3% |

As separate companies, Bell Atlantic and GTE are fourth and seventh in terms of spending, and well behind the Big Three. After the merger, the combined company's advertising spending would place it among the Big Three with a 14.5 percent share of spending.

28. In addition, GTE-Bell Atlantic's larger combined geographic footprint creates advertising efficiencies that will enhance its ability to build a national brand. As separate entities, both GTE and Bell Atlantic have predominantly been local advertisers in their respective footprints. But as the combined entity's footprint grows larger, it will become more cost effective to purchase advertising nationally, rather than on a spot or local basis. Indeed, GTE-Bell Atlantic's preliminary calculations indicate that the company may be able to take advantage of this efficiency with national print and network and cable television advertising. An additional advantage presented by advertising on network television, as opposed to purchasing spot advertising, is that ads appear "in program" -- *i.e.*, at fifteen or forty-five minutes past the hour -- when viewers are less likely to change channels or tune out.

29. Neither company on its own, however, has the resources or the footprint required to create a national brand. For example, to advertise on par with MCI WorldCom's $548 million in annual spending, GTE would have to more than quadruple its current expenditure of $115 million by spending an additional $433 million. Bell Atlantic would likewise have to spend an additional $334 million -- more than double its current $214 million. Furthermore, as separate companies, there would be little payback for GTE or Bell Atlantic to invest substantial resources in attempting to develop a national brand. Without a national presence in the bundled service market, there would be nothing in the marketplace to reinforce the brand image, and therefore the investment in brand would not be cost-justified. The merger, however, will allow GTE-Bell Atlantic to build the brand to compete with AT&T, MCI WorldCom, and Sprint, while at the same time providing the complementary capabilities to support a national bundled offering.

**<u>The Merger Will Not Injure Competition in the Local Exchange Market</u>:**

30. The merger will achieve these substantial pro-competitive benefits without risking any injury to competition in the market for local exchange service. GTE's current strategy is to use GTECC as its vehicle for out-of-franchise expansion. But from GTECC's perspective, in light of its prior launch experiences and its current facilities-based strategy, Pennsylvania and Virginia do not present a decent business case for out-of-franchise expansion. As already mentioned, GTECC has never targeted out-of-franchise consumers and has currently stopped marketing to small businesses both in- and out-of-franchise. And, because of capital constraints, GTECC only plans to expand into one city -- San Francisco -- with an out-of-franchise local exchange offering in 1999. While predictions are difficult because GTECC lives year-to-year

with regard to expansion plans, if GTECC's assumptions about customer acquisitions and product penetration prove out and the San Francisco wireless switch upgrade is ultimately successful, GTECC would -- at most -- consider applying this wireless-upgrade strategy to three or four additional cities in 2000.

31. Based on the criteria GTECC considers in evaluating target cities -- MSAs with (1) large data revenue opportunities for new business; (2) existing GTE facilities (*i.e.*, switching facilities and access to the GNI); (3) a business customer base to which GTECC can upsell additional services; and (4) existing GTE brand awareness -- GTECC would not target Bell Atlantic states for its facilities-based strategy. No markets in these states meet GTECC's criteria; they are either too small or too remote to give GTE any strategic presence.

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 21, 1998.

Jeffrey C. Kissell

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 21, 1998.

Scott M. Zimmerman

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**SECOND DECLARATION OF DEBRA R. COVEY**

1. I am the Vice President of Market Solutions for GTE Communications Corporation (GTECC). I am currently on special assignment to review GTE's strategic and tactical plans for the effective deployment, management, and operation of the Global Network Infrastructure (GNI) -- GTE's national voice, data, and IP network. Prior to this assignment, I was responsible for all product development, customer billing, operations support systems, business process design, vendor management, contract negotiations, and network requirements development for GTECC. I was also the leader of the original team that, in late-1996, developed the operations and system strategy for GTECC. In addition, I was on the team that launched GTE's long distance business in 1996. Prior to joining GTE, I was employed by Sprint for eleven years, and before that I worked at Southwestern Bell for five years. The majority of my

twenty years in the telecommunications industry has been in network operations and management, systems management, access optimization, and service provisioning. In connection with the GTE-Bell Atlantic merger, I have been asked to discuss the combined GTE-Bell Atlantic company's capabilities as a provider of advanced voice and data services.

2. Customers use advanced voice and data services to communicate between and among multiple remote locations; therefore, providers with national capabilities have an advantage over those with geographic limitations. GTE's network will be a national fiber backbone, supporting ATM, Frame Relay, Virtual Private Network (VPN), Internet backbone and long distance services. The GNI will have points of presence (POPs) in many cities across the United States, but because GTE lacks significant customer relationships in the Northeast, it will have a limited number of POPs in that region.

3. I understand that the network that Bell Atlantic would likely build, on the other hand, would only be regional. When operational, it would provide ATM, Frame Relay, and long distance services to customers located in the Bell Atlantic region. Because of its network's geographic limitations, Bell Atlantic would have to resell from another provider -- or possibly from several different providers -- to offer advanced voice and data services nationally. By having to rely on resale to achieve broad geographic coverage, Bell Atlantic would be disadvantaged relative to competitors with national network capabilities -- especially when attempting to serve large businesses with locations spread throughout the country that demand broad facilities-based coverage to ensure compatible services for all branch or affiliate locations.

Based on GTE's resale experience -- for example, as a reseller of long distance service from MCI WorldCom and Frame Relay from Sprint -- GTE has concluded that national facilities-based coverage is necessary to competitively offer advanced voice and data services.

4. For several reasons, facilities-based providers have a distinct advantage over resellers. *First*, facilities-based providers enjoy lower unit costs than resellers. This disparity is driven, in large part, by the fact that facilities-based providers have the ability to aggregate larger amounts of traffic onto a single network, thereby lowering their unit costs. Unit costs are also more controllable for the facilities-based provider, because such a provider can determine for itself when to grow bandwidth, expand switching capabilities, develop software versions for new functionalities, and increase security and fraud control. Given its lower costs, a facilities-based provider will almost always be able to offer its services at a more competitive price than a reseller.

5. *Second*, a facilities-based provider controls its own destiny by determining its market strategy -- including which new services and functionalities to invest in and when to roll them out -- as opposed to being submissive to a supplier's strategy that may be more generic and not offer as much unique product functionality. Some services in high demand by large business customers -- and particularly by Fortune 500 companies with multiple locations -- are not competitively available for resale. VPN services, for example, are not available for resale on terms or with functionality that can compete with the Big Three's retail offerings. Because large business customers want customized solutions to their telecommunications needs, the absence

of a single product is enough to create a competitive disadvantage relative to carriers offering a full suite of services. When competing for Fortune 500 companies, GTE's experience has shown that national VPN coverage is essential.

6. *Third*, it is extremely difficult for a reseller to cobble together a full suite of services from a single supplier, and using multiple suppliers creates further difficulties. A reseller's already high unit cost is further increased when it purchases services from multiple suppliers, because the reseller loses out on volume discounts and, with more suppliers, additional back office investments are necessary for service delivery.

7. *Fourth*, those services that can actually be competitively purchased for resale are not available in as many locations as can be reached by a facilities-based provider. To serve markets not near a supplier's POP, Bell Atlantic -- as a reseller -- would either have to purchase from a second reseller (a prospect that creates prohibitive back-office complications and expenses) or backhaul traffic to one of the supplier's POPs. But this would likely make the price of Bell Atlantic's offering uncompetitive.

8. *Fifth*, resellers are also handicapped because they are typically unable to offer service guarantees comparable to those offered by facilities-based providers. Large business customers generally demand a service guarantee program. Resale contracts, however, typically do not hold the supplier liable for performance failures, leaving the reseller unable to make the service guarantees that large businesses will not do without. Facilities-based providers, on the other hand, can engineer and invest in their networks to provide whatever level of security their

customers require. Moreover, large business customers recognize that because resellers are at least one step removed from the network, they are reliant on the provider for technical support and repair. Because they have hands-on control over their own network, facilities-based providers are not only able to give performance guarantees, but they also are able to offer an added level of assurance to customers because they can react quickly and directly if a network outage actually occurs.

9. Given all of the disadvantages associated with reselling advanced voice and data services and Bell Atlantic's lack of facilities coverage outside of the Northeast, GTE's experience suggests that Bell Atlantic would be a weak provider of these services to customers with a significant presence outside of its region. GTE, in fact, has had similar difficulties penetrating the large business market. In addition to having only resale capabilities and therefore suffering the handicap of high unit costs and reduced functionality, GTE lacks a significant large business customer base -- especially within the Northeast. GTE's experience has been that without established relationships and facilities, it is very difficult to acquire these customers. The GTE-Bell Atlantic merger will allow GTE access to Bell Atlantic's marketing channels within the large business segment, while providing Bell Atlantic a national, facilities-based footprint. The combined company will therefore be able to acquire and effectively serve those large businesses with branch and affiliate locations throughout the United States.

10. The merger will also bring substantial benefits to consumers of advanced voice and data services. The GNI has an extraordinary amount of capacity and GTE needs more traffic

than it will control alone to operate this network most efficiently. The merger will allow the combined company to migrate Bell Atlantic's long distance traffic -- both originating and terminating in the Northeast -- as well as its regional advanced voice and data traffic to the GNI. This will not only reduce the unit cost of long distance service, but also the cost of all products provisioned over the network. Moreover, without the merger, the GNI will only provide access in those cities where GTE alone has the prospect of serving enough customers to recoup its investment in a point of presence. By coupling Bell Atlantic's large business customer relationships with the GNI, the combined company will be able to market and provide advanced voice and data services in many new markets.

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 21, 1998.

Debra R Covey

Debra R. Covey

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# REPLY DECLARATION BY THOMAS W. HAZLETT

## INTRODUCTION

1) My name is Thomas W. Hazlett, and I am an economist specializing in telecommunications policy. I currently serve as Professor of Agricultural and Resource Economics at the University of California, Davis, where I am Director of the Program in Telecommunications Policy. I am also, during the 1998-99 academic year, a Resident Scholar at the American Enterprise Institute in Washington, D.C. I have written many papers for academic and popular publications on the topic of telecommunications regulation, and have previously served as Chief Economist of the Federal Communications Commission (1991-92). At the request of Bell Atlantic, I submitted a Declaration analyzing the competitive implications of the proposed merger under examination. This Reply Declaration responds to comments in this proceeding regarding the economic analysis developed in my previous filing.

2) In my previous declaration I examined various aspects of the Bell Atlantic-GTE merger that could differentiate pro-efficiency consequences from anti-competitive effects. I also presented key evidence supporting the pro-efficiency view of the merger in the form of an "event study." That analysis focused on investor reaction to the announcement of the merger. The central results of that analysis are seen in Table 1, which summarizes the announcement-date returns to stockholders of the major telecommunications service firms most likely to feel a competitive impact from the Bell Atlantic-GTE combination. Every major competitor to the newly merged firm – AT&T, SBC, MCI/WorldCom, and Sprint – saw negative returns in investor's equity (relative to

the market) over the 1-day and 3-day trading windows surrounding the announcement of the merger on July 28, 1998.

| Table 1. Bell Atlantic/GTE Merger Announcement: Abnormal Stock Returns for Four Major Competitors | | | | | |
|---|---|---|---|---|---|
| | MCI/WorldCom | AT&T | SBC | Sprint | S&P 500 |
| Window | Absolute Returns | | | | |
| 1 day | -5.1% | -1.6% | -1.8% | -2.8% | -1.5% |
| 3 day | -4.8% | -1.8% | -1.6% | -3.9% | -1.4% |
| | Abnormal Returns (Adjusted by S&P 500) | | | | |
| 1 day | -3.6% | -0.1% | -0.3% | -1.3% | |
| 3 day | -3.4% | -0.4% | -0.3% | -2.6% | |

Announcement Date: July 28, 1998

3) The importance of this financial market evidence is that it provides an unbiased cross-check on the various theories advanced to predict the likely effects of the proposed merger. Since the requirements for constructing a theory are fairly simply met – one need only devise a plausible story as to how the market works – testing the theory against the reactions of actual investors adds a reality check. While the market does not fully explain why prices move as they do, the observed pattern of security price movements will tend to fit certain explanations more convincingly than others. That is why financial event studies are accepted analytical tools in the economics literature.

THE CRITIQUE OF EVENT STUDIES

4) While acknowledging event studies as a standard technique used by economists,[1] the Baseman & Kelley paper concludes with the disclaimer: "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."[2] Yet, while all methods of economic analysis have their limitations, much can be discerned from careful examination of the stock market reaction to the Bell Atlantic/GTE merger announcement. This is especially true in light of the

[1] "In general, event studies are used in antitrust to assess the perception of investors in financial markets concerning the likely effects of a merger." Declaration of Kenneth C. Baseman and A. Daniel Kelley, filed with Comments submitted by MCI/WorldCom in this proceeding, Nov. 23, 1998 ["B-K"], at 60.

[2] B-K, at 66.

arguments made in the papers by Baseman & Kelley and Besen, Srinagesh, & Woodbury.[3]

5) Baseman & Kelley write: "First, the [event study] method assumes that investors are fairly well informed, and in a good position to judge quickly the effects of such a merger. Critics of event studies point out that many mergers to which investors reacted favorably turned out later to be disasters for the shareholders."[4] While the assumption of "fairly well informed" investors is uncontroversial (and easily met), the latter comment has no bearing on the analysis. Surprises obtain in the financial marketplace with some regularity – witness the degree to which securities prices change. But the validity of event studies does not rest on investors perfectly forecasting the future. It merely relies on investors making unbiased forecasts of future values. Because generous financial returns await those investors who find even momentarily unseen opportunities to make better forecasts, economists logically see the market setting securities prices which constitute unbiased predictions of future values.

6) Baseman & Kelley also point out that there is no theoretically unambiguous window to focus on in analyzing market events.[5] While true, this is addressed by focusing on short windows surrounding unambiguous event dates to obtain an unbiased estimate of the *direction* of change. That is, while shorter windows often provide incomplete estimates of the aggregate change in value associated with a given event, they provide sharper predictions as to whether such an event tends to raise or lower security value.[6] For that reason, I confine my empirical investigation to 1-day and 3-day returns.[7]

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[3] Stanley M. Besen, Padmanabhan Srinagesh, and John R. Woodbury, "An Economic Analysis of the Proposed Bell Atlantic/GTE Merger," paper filed with Comments submitted by AT&T in this proceeding, Nov. 23, 1998.

[4] B-K, at 60.

[5] B-K, at 61.

[6] The important issue concerns whether or not the "event" is accompanied by new information. If something important happens but has already been widely anticipated, one would not expect stock prices to move in reaction to the event. There are cross-checks on whether information contains at least some element of "news," however, including the reaction of stock prices themselves. One will also note that event studies do not typically examine windows around merger *dates* but around merger *announcements*.

[7] In a footnote (B-K, at 66), Baseman & Kelley argue that expanding the window to a period including the 30 days prior to merger announcement date is useful. The problem with this, of course, is that many other 'contaminating' events inevitably intercede over the longer window (such as AT&T's proposed acquisition of TCI, which was announced on June 24, 1998). If effects are difficult to discern in the short window, they are likely to be even more difficult to filter out over the longer period. Choosing amongst the various possible time periods can also provoke suspicions of "window shopping."

INTERPRETING THE MARKET RETURNS

7) Neither the analysis by Baseman & Kelley nor that of Besen, Srinagesh & Woodbury dispute the empirical finding that negative returns for interexchange carriers are associated with the Bell Atlantic/GTE merger. Instead, they argue that such an effect is caused not by the anticipation of enhanced competitiveness in national and international telecommunications markets, but by increased opportunities for Bell Atlantic and GTE to limit local telephone competition. The empirical problem with this interpretation, however, is that the shares of both SBC and Ameritech – which would stand to gain from this presumed reduction of competition – *also* experience abnormal negative returns during the merger announcement window. Likewise, the combined BA/GTE entity, allegedly in the process of enhancing its monopoly power via merger, sees no increase in aggregate value.

8) Baseman & Kelley then rearrange the industry by eliminating the IXCs and pulling in two smaller LECs, BellSouth and USWest. They calculate abnormal returns for this new sample of firms around the Bell Atlantic/GTE merger announcement, as seen in Table 2.

Table 2
Baseman & Kelley's Abnormal Returns Estimates
3-day Windows Around Merger Announcement Date

| SBC | Ameritech | BellSouth | USWest | Bell Atlantic | GTE | BA+GTE |
|---|---|---|---|---|---|---|
| -0.3% | -2.16% | 2.2% | 3.29% | 2.32% | -4.36% | -0.65% |

9) Baseman & Kelley conclude that these results are inconsistent with the pro-efficiency view of the Bell Atlantic/GTE merger. They argue that the positive returns realized by shareholders of BellSouth and USWest indicate that investors do not anticipate greater competition in local telephone markets. But the inclusion of the two smaller BOCs is problematic due to a well known phenomenon on Wall Street, *the take-over effect*. Where a merger announcement is likely to excite interest in the purchase of similar firms in the industry, capital values often increase to reflect the premium typically associated with merger targets. This windfall can easily swamp whatever other such effects (efficiency or monopoly) are anticipated. [8]

[8] Of course, many market analysts believe that these two firms are likely takeover targets (Sprint and foreign telecommunications firms are widely mentioned as possible buyers), or that they may merge with each other. The prices of either firm are thought to contain at least a partial premium for this "take-over play."

10) Baseman & Kelley go on to argue that the shareholders of SBC and Ameritech, witnessing negative returns, are hurt because of the "piling on" effect – the announcement of yet another large telecom/RBOC merger lowers the probability that an existing merger proposal will be approved by regulatory authorities. This explanation contradicts another part of the Baseman & Kelley analysis, however: if the BA/GTE announcement were to lower the probability that SBC/Ameritech were to be approved, then long distance stocks – under their foreclosure-enhancement theory of the merger – should react favorably to the merger news. They do not. The "piling on" explanation is clearly uncompelling.[9]

11) Alternatively, there are strong reasons for looking at the top five US telecommunications providers (AT&T, MCI/WorldCom, Sprint, SBC/Ameritech, BA/GTE) as long-run competitors. In this light, the pattern of returns tells an internally consistent story, one of intense rivalry for market share between integrated competitors of national scope. This is surely the way industry analysts on Wall Street routinely characterize the relevant market for financial investment purposes, and how many informed observers view the dynamic for consolidation now developing.

12) Thus defined, observed stock price movements point to an efficiency explanation of the Bell Atlantic/GTE merger. While BellSouth and USWest see positive returns associated with the increased possibility of a take-over yielding stock price premia, all four of the major telecommunications competitors – *including* SBC/Ameritech which presumably stands to gain from the alleged foreclosure of long-distance carriers and CLECs – display negative returns around the time of the Bell Atlantic/GTE merger announcement. Investor expectations of increased competition in the overall telecommunications marketplace is the explanation that most comfortably fits such a pattern.

13) A final piece of the puzzle remains: The negative returns to the combined BA/GTE entity. Baseman & Kelley assert that "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 that the merger is not in the interests of their shareholders."[10] While the managers of private firms are most assuredly held to account for the role they play in creating shareholder value, this advice is aimed in the wrong direction. Negative returns for the merging parties may reflect a number of different investor expectations, including that of enhanced competition triggered by the merger. But it is plainly inconsistent with the expectation that the merger will create higher profitability through enhanced market power. And that is the relevant information for purposes of the FCC's "public interest" review.

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[9] The directional impact of any "piling on" effect, moreover, is far from obvious. At least two other large mergers were already pending in the telecom marketplace (WorldCom/MCI and AT&T/TCI) when the Bell Atlantic/GTE announcement was made in July 1998. The new merger could well have been seen to reflect an underlying industry dynamic driven by economies of scale and scope. If so, the probability of regulatory approval would have increased rather than fallen.

[10] B-K, at 66.

CONCLUSION

14) In sum, the original analysis still stands: Market investors, voting with their dollars, do not see the proposed merger of Bell Atlantic and GTE as foreclosing competition, but expanding it.

15) I, Thomas. W. Hazlett, do hereby declare under penalty of perjury that the forgoing is true and correct.

Thomas W. Hazlett

22 December, 1998

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

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

## REPLY DECLARATION OF DOREEN TOBEN

1. I am providing this declaration in response to comments filed in this proceeding concerning the financial synergies that will be created by Bell Atlantic's merger with GTE.

2. The comments and the testimony at the Commission's en banc hearing last week confirm my initial declaration. For example, the Communications Workers of America filed comments supporting the merger because the increased output of the combined company will support the growth of good jobs. CWA Comments at 8.

3. Similarly, subsequent to my initial declaration, market analysts have issued reports crediting the merger's financial efficiencies, in part based on Bell Atlantic's success in achieving synergies in the NYNEX merger. Montgomery Securities, for example, issued a "buy" recommendation on Bell Atlantic's stock, explaining that Bell Atlantic has cut costs and improved revenues "in merging with NYNEX. Expenses [in the third quarter of 1998] grew at

2.6% -- a little more than half the rate of revenue growth (5%) during the past year and the projected synergies are only half implemented. We expect Bell Atlantic to do the same following its pending merger with GTE." R. Mitchell, Montgomery Securities (Nov. 25, 1998). *See also* Guy Woodlief, Prudential Securities (Oct. 21, 1998) ("We believe that Bell Atlantic is slightly ahead of schedule with regard to the achievement of [NYNEX] merger-related cost synergies."); Jack Grubman, Salomon Smith Barney (Oct. 21, 1998) ("The company has been able [to] improve consolidated revenue growth [and] trim down expenses."); Bruce Roberts, Desdner Kleinwort Benson (Sept. 29, 1998) ("In equipment procurement, the BEL-NYNEX merger has far exceeded cost savings projections. Equipment reductions have been as high as 30%, and BEL executives expect similar reductions once the GTE merger is completed."); Kevin Moore, BT Alex. Brown Inc. (Nov. 10, 1998) ("The [Bell Atlantic-GTE] merger is expected to produce cost synergies totalling $2 billion within three years of completion, principally related to economies of scale and operating efficiencies. The combination is expected to generate an additional $2 billion in revenue synergies.); *id.* ("The merger integration between Bell Atlantic and Nynex continues to progress on track, with a targeted $300 million in capital expenditure savings almost all realized in 1998. These savings should come primarily from procurement efficiencies. Other expense savings are targeted at $450 million in 1998, ramping up to $750 million and $1.1 billion by the year 2000.").

4. Several of the comments asked for additional detail concerning the cost savings and revenue improvements. In arriving at specific figures, initially we used the Bell Atlantic-NYNEX experience to create a template for quantifying GTE-Bell Atlantic synergies. Since the

merger announcement, we have continued to refine the numbers as the senior managers of the two companies have begun joint planning for the post-merger organizations. The $2 billion annual expense savings we will be achieving within three years of the closing is broken down into the following components:

- General and administrative expenses -- $500 million (this is primarily achieved by eliminating duplicative functions in areas such as finance, treasury, human resources, regulatory, and planning)
- Information systems -- $300 million
- Procurement expense -- $200 million
- Network and customer service -- $140 million
- Product management and advertising -- $110 million
- Consumer and business -- $135 million
- Research and development -- $50 million
- Wholesale -- $15 million
- Long distance -- $300 million
- Wireless -- $200 million
- Directory -- $100 million
- Internet/data services -- $200 million

(The sum of the individual components exceeds $2 billion, and ensures that we meet the $2 billion expense reduction even if there is slippage in any individual component.)

5. These expense savings figures, plus the additional $0.5 billion annual capital savings that we will achieve within three years of the merger close, are not based on fuzzy

concepts of "best practices" that might be achieved without the merger but instead are based on reducing overheads, sharing fixed costs over a broader base, and enabling our suppliers to achieve greater efficiencies in serving a combined company.

6. Similarly, within three years of the closing of the merger, additional annual sales of $2 billion will come from the following areas:

- Vertical services -- $300 million
- Long distance acceleration -- $200 million
- Large business -- $500 million
- Data and web hosting -- $1 billion

These amounts reflect additional sales, not additional profits.

7. Of all the commenters, only Sprint and MCI WorldCom questioned the amount of financial synergies that the combined Bell Atlantic-GTE will achieve. Sprint claims that the synergies are not sufficiently established because (quoting from my initial declaration) the synergies are reflected in "'real budget commitments that department heads must meet or exceed' and . . . the compensation of officers responsible for the lines of business would be based on their ability to meet these commitments." Sprint Comments at 46. Sprint seems to be confusing the quantification of efficiencies with their enforcement. The financial synergies were quantified by comparison to the synergies achieved in the Bell Atlantic-NYNEX merger, and by sizing the costs and opportunities of the components of the business. The synergies will be enforced by putting them into the budgets of the individual organizations (subtractions from allowed expenditures and additions to required revenues).

8. MCI WorldCom states simply that "GTE and Bell Atlantic are already very large carriers and have likely exhausted all available scale economies." Comments of MCI WorldCom, Inc., Declaration of Kenneth C. Baseman and A. Daniel Kelley at 8. MCI WorldCom has no support for its assertion; by contrast, the efficiencies described above are fully supported by our experience in the comparable Bell Atlantic-NYNEX merger. MCI WorldCom's own prior merger experience may not offer the same perspective. According to CWA President Morton Bahr, the result of the MCI-WorldCom merger was "MCI has 'zeroed out' all local network development, in addition to announcing cuts of as many as 3,500 jobs, despite assurances to the FCC and other regulators that jobs would not be eliminated." Press Release, CWA Tells FCC: Bell Atlantic-GTE, SBC-Ameritech Mergers Will Boost Competition and Benefit All Consumers, http://www.cwa-union.org/pressreleases (Dec. 14, 1998).

9. AT&T's house economist, Mr. Levinson, suggests that the efficiencies of this transaction might be achieveable without the merger because (in a familiar AT&T refrain) the companies' costs are too high. AT&T Comments, Aff. of Stephen B. Levinson at 7-8. Mr. Levinson in no way disagrees with the size of the efficiencies, but he asserts "it is reasonable to question whether" Bell Atlantic and GTE are operating "as efficiently as possible" on a stand-alone basis. However, all of the efficiencies described above are merger specific and will come in addition to any other efficiencies the companies might achieve on their own. As one analyst has noted, "Although Bell Atlantic is a fine company in its own right -- we believe the merger with GTE is essential to lift BEL to a much higher performance level." Bruce Roberts, Desdner Kleinwort Benson (Sept. 29, 1998).

10. I said in my initial declaration that the financial efficiencies will allow the new company to meet its commitments to improve service quality, accelerate new services, and build new businesses that compete with Sprint, MCI WorldCom, and AT&T. These consumer benefits also occurred in the Bell Atlantic-NYNEX merger. Tim Carey, Chairman and Executive Director of the New York State Consumer Protection Board, testified in the December 14, 1998 en banc hearing that "consumer advocates are skeptical" about mergers, but in the Bell Atlantic-NYNEX merger New York consumers "were well served" because the merger parties invested $1 billion in infrastructure and hired 700 employees to improve service quality in New York, and succeeded in meeting stricter quality standards. Mr. Carey further testified that the companies used the merger synergies to fund market opening measures and to lower intrastate access charges. He concluded that "the average New Yorker is better off today than if the merger had not occurred." In response to questions from Chairman Kennard, Mr. Carey testified that the "bottom line" was, "the company did what they said they would do."

I declare under penalty of perjury that the foregoing is true and correct. Executed on December 23, 1998.

Doreen Toben

Doreen Toben