State of New York
Public Service Commission

Joint Petition of New York Telephone Company and Bell Atlantic Corporation for a Declaratory Ruling that the Commission Lacks Jurisdiction to Investigate and Approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic or, in the Alternative, for Approval of the Merger.	))))))	Case 96-C-0603
Petition of the New York Citizens Utility Board, the Consumer Federation of America, the American Association of Retired Persons, Consumers Union, Mr. Mark Green, Ms. Catherine Abate, the Long Island Consumer Energy Project and the International Brotherhood of Electrical Workers T-6 Council (collectively the ?Consumer Coalition?) for an Investigation of the Proposed Merger of NYNEX Corporation and Bell Atlantic Corporation.	)))))))))	Case 96-C-0599

Testimony of Ronald J. Binz

Competition Policy Institute

November 25, 1996

Testimony of Ronald J. Binz

Q. What is your name and address?

A. My name is Ronald J. Binz. My business address is 3773 Cherry Creek North Drive, Suite 1050, Denver, Colorado 80209.

Q. What is your occupation?

A. I am President and Policy Director of the Competition Policy Institute (CPI). The Competition Policy Institute is located at 1156 15th Street, N.W., Suite 310, Washington, D.C. 20005. In addition, I am the principal in Public Policy Consulting, a Denver firm specializing in energy and telecommunications regulatory matters.

Q. Please describe the Competition Policy Institute.

A. CPI is an independent non-profit organization established to promote state and federal policies which will bring competition to telecommunications and energy services in ways that benefit consumers. Consumer advocate Debra Berlyn and I started CPI in March 1996 to provide a new voice for consumers in the debate about implementing pro-consumer, pro-competitive policies. We describe CPI as a combination consumer group and ?think tank.? Its activities include research, advocacy, and working with other consumer organizations. CPI is active before state and federal regulatory agencies and in legislative arenas. We frequently are parties to proceedings before the Federal Communications Commission (FCC) on the implementation of the Telecommunications Act of 1996, on Universal Service, rulemakings on local competition, rulemakings on Customer Proprietary Network Information and licensing of spectrum, among other

issues.

CPI has adopted a structure designed to ensure the organization? independence and grounding in consumer attitudes about the issues of competition in telecommunications and energy. First, CPI is advised by a group of consumer advocates from across the country which forms its Consumer Advisory Committee. This consumer committee meets periodically to review the policy positions taken by CPI, and to recommend positions to be taken by the organization. However, the policy positions adopted by CPI are the product of its senior staff. Second, CPI? initial funding was supplied by a broad group of competitive telecommunications carriers, but the organization is independent of these funding sources. The corporate sponsors of CPI have endorsed the organization? Charter and agree that CPI operates independently. Appendix A to this testimony contains a copy of CPI? Charter which describes our organization, governance, and funding.

Q. Please summarize your relevant experience in telecommunications policy and regulation.

A. For eleven years prior to starting CPI, I was Consumer Counsel for the State of Colorado. In that role, I represented the interests of residential and small business consumers of telecommunications and energy services before the Colorado Public Utilities Commission, the Federal Communications Commission, the Federal Energy Regulatory Commission, the courts and legislative bodies.

I served as the President of the National Association of State Utility Consumer Advocates (NASUCA) for two years and chaired the organization? Telecommunications Committee

for three years. In those roles I testified numerous times before Congressional committees on federal telecommunications and energy legislation. On behalf of NASUCA, I lobbied during the deliberations on S. 652 and H.R. 1555, the Senate and House bills which became the Telecommunications Act of 1996. I also testified in several congressional hearings on these bills and on the predecessor legislation considered in prior years and introduced by Senator Hollings, Representatives Markey and Brooks, among others.

Since passage of the federal legislation, I have testified before the Federal-State Joint Board on Universal Service and most recently, on September 11, 1996, I testified before the Senate Judiciary Committee on the status of implementation of the 1996 Act and the effect of the proposed mergers of the Regional Bell Operating Companies (RBOCs) on local exchange competition. I have also recently testified before the Public Utilities Commission of the State of Maine on the proposed Bell Atlantic/NYNEX merger and before the California Public Utilities Commission on the proposed merger of SBC Communications and Pacific Telesis.

Prior to my work with the Office of Consumer Counsel, I was a utility rate consultant. I have testified before regulatory commissions in Colorado and in other western states on behalf of a variety of clients, consumer organizations, senior citizen groups, agricultural utility consumers and local governments. A resume and summary of my qualifications is attached as Appendix B to this testimony.

Q. What is the purpose of your testimony?

A. The Public Service Commission of the State of New York (Commission or New York

PSC) is considering the application of New York Telephone Company (NYT), NYNEX Corporation, and Bell Atlantic Corporation (Bell Atlantic) for approval of the proposed merger between NYNEX and Bell Atlantic. This Commission has authority to review the transfer of control of a public utility registered in New York under Sections 99 and 100 of the New York Public Service Law. I will offer testimony on the costs and benefits of the proposed merger to New York consumers and make recommendations to the Commission on its consideration of the merger.

My testimony is organized into five sections: first, I discuss the landscape of the telecommunications industry against which the Commission should analyze this merger application and the standards the Commission should employ; second, I discuss the costs and benefits of the merger for New York consumers and regulators; third, I examine the analysis of the applicants; fourth, I discuss some ?public interest? conditions that should be attached to approval of the merger application; finally, I conclude with a set of recommendations to the Commission.

Q. Before turning to the first section of your testimony, what are your conclusions about the proposed merger?

A. After examining the merger application, the comments of the applicants in this case, and the testimony of witnesses for the applicants before the FCC and in other New England states, I have drawn several conclusions about the proposed merger.

? Mergers among large incumbent LECs, such as the Bell Atlantic/NYNEX merger and the SBC/PacTel merger, may threaten the policy goals of the New York PSC and the goals of the Telecommunications Act of 1996.

- ? There are costs and potential benefits in this merger. The New York PSC can control whether consumers are adversely affected by mitigating the costs of the merger and ensuring that any benefits flow through to ratepayers.

- ? The New York PSC can mitigate the negative effects of this merger on competition by ?borrowing?the ?competitive checklist?from ?271 of the Telecommunications Act of 1996 and requiring NYNEX and Bell Atlantic to meet the checklist before the merger is permitted to go forward.

- ? The New York PSC can partially compensate for the harm to competition caused by this merger by adopting and insisting on strict adherence to strong pro-competitive pricing rules implementing Section 251 of the Communications Act.

- ? The Commission should require NYNEX to quantify the financial benefits of the merger and ensure that New York ratepayers receive an equitable share of any such benefits.

These five conclusions add up to a single conclusion: **the proposed merger could work against New York consumers?interests unless the Commission takes strong action to prevent that from happening.**

Section 1 ? Telecommunications Industry Background

Q. Describe the background in telecommunications which the Commission should consider when evaluating this petition.

A. Pro-competitive actions taken by states like New York, together with the passage of the Telecommunications Act of 1996, have fundamentally changed the future of the telecommunications industry. At divestiture of the Bell Operating Companies from AT&T, it was assumed that local exchange service, exchange access service and even short-haul long-distance service would remain a monopoly for the foreseeable future. In the space of a few years, the paradigm for the provision of these services and all other

telecommunications services has been changed radically.

During 1995, the United States Congress debated federal legislation to open all telecommunications markets and remove barriers imposed by the Modification of Final Judgment (MFJ) on the Regional Bell Operating Companies concerning long distance service and equipment manufacturing. The Telecommunications Act of 1996 was passed in early 1996 and signed into law by the President on February 8.

The 1996 Act superseded the Federal Court? administration of an antitrust settlement which, heretofore, had been the single largest event in the development of competition in the telecommunications industry. The Modification of Final Judgment was replaced with a new statutory scheme designed eventually to permit all telecommunications providers to compete in all markets. Following the opening of local markets and evidence of competition actually occurring, the Regional Bell Operating Companies are allowed to enter the manufacturing and long distance markets, from which they have been barred since divestiture. The 1996 Act also amended provisions of the 1984 Cable Act, permitting today? large local exchange companies (LECs) to enter the cable television business.

To ensure that competition did not face legal barriers, the 1996 Act removed legal and regulatory barriers which would prohibit, or have the effect of prohibiting, any entity from offering any telecommunications service. This means that local markets in all states, some previously closed to all but monopoly LECs, are now legally open to competition.
Finally, the Act changed, or implied change, for the nature of regulation and the

relationship between state and federal regulators.

Congress realized that you cannot create competition merely by passing legislation to remove legal barriers to competition. Decades of law and regulatory practice had affirmed the correctness of the local exchange monopoly. The belief that local service was most efficiently provided by a monopoly is deeply ingrained in the legal system, in state and local laws and in the consciousness of today?s local monopolies. In addition, there are substantial practical difficulties that competitors face as they try to compete with a ubiquitous local exchange network. Congress recognized that it was necessary to take strong, affirmative steps to make it possible for new entrants to gain a foothold in local exchange markets.

Thus, Congress acted boldly to end monopoly control of local telecommunications markets. To ensure that new entrants are able to enter local markets in spite of the substantial market power of the incumbent local exchange companies, Congress fashioned requirements (?duties?) for the LECs:

- ? DUTY TO NEGOTIATE
- ? INTERCONNECTION
- ? UNBUNDLED ACCESS
- ? RESALE
- ? NOTICE OF CHANGES
- ? COLLOCATION
- ? NUMBER PORTABILITY
- ? DIALING PARITY

? ACCESS TO RIGHTS-OF-WAY

? RECIPROCAL COMPENSATION

It is instructive to compare the approach taken by Congress in the 1996 Act with the approach taken in the divestiture fourteen years earlier. The MFJ imposed a structural change from *without*, separating ?competitive? and ?monopoly? services. While there were duties imposed on the surviving local exchange providers (e.g., equal access) the MFJ relied on a traditional antitrust technique: divestiture. Competition in the long distance industry was enabled by removing the opportunity for anti-competitive behavior, excluding the local monopolies from participating. In the 1996 Act, Congress is relying on two other techniques to create and enhance competition: imposing duties (e.g., access to monopoly network elements) and permitting today?s monopolies to enter other markets (e.g., cable television and, eventually, interexchange service).

The duties imposed in the 1996 Act, especially the requirements to provide access to network elements and resale opportunities, will create competition and price pressures from *within* the existing monopolies. In many ways, the approach in the 1996 Act can be as successful as divestiture in its effects, assuming state commissions follow through to make network elements and resale available at prices such that entry by competitors is economically rational and feasible. Making these elements available to competitors will inexorably lead to an elimination of the monopoly, with new entrants getting into the market and winning customers.

Q. How are these considerations relevant to the Commission?s consideration of the merger proposal?

A. The New York PSC is a partner, together with other states and the FCC, in changing the model for the provision of telecommunications service in the United States. The State of New York is one of only a few states with jurisdiction over the merger. Because of its size and the significance of telecommunications markets in this state, New York is also among the foremost jurisdictions in the amount of telecommunications revenues its decisions affect. That means that decisions made in New York will have influence elsewhere. For reasons I establish below, consumers in New York and the entire Northeast region will be best served by an activist approach by this Commission in considering the merger. The Commission? decision in this merger case will influence, directly or indirectly, the development of local competition, not just in New York, but across the region and the country.

I think the Commission should be very concerned about the effect this merger will have on telecommunications competition in New York and the implications for regional markets outside of New York as well. Recognizing the far-reaching influences of the merger, CPI suggests that the New York PSC not view the merger application like it would view a simple antitrust case, but rather as a benefit/cost analysis in which the Commission can affect the benefits and the costs. As I will argue below, the New York Public Service Law gives the Commission the authority, indeed the duty, to ensure that the merger does not negatively affect competition. For New York? consumers, the Commission has the opportunity in this case to ensure that consumers receive the long-term benefits of competition while also receiving a fair share of any short-term financial benefits which the merger may produce. Thus, this case is more than merely the consideration of a merger application. This case affords the Commission with the opportunity, and the duty, to

move local competition forward, consistent with its policy of relying on competition to produce choices and equity for consumers.

Q. **Please discuss the setting in which this merger is being considered.**

A. CPI is deeply concerned about the rapid consolidation of major players in the telecommunications marketplace. The landmark Telecommunications Act of 1996 passed the Congress by overwhelming majorities earlier this year because the Act contained the right balance between deregulation and competition. The substantial loosening of ownership regulations contained in that legislation was accompanied by equally strong measures to allow the growth of competition.

Unfortunately, the mergers of several key industry players may upset the balance against the interests of competition and consumers. Since passage of the Telecommunications Act, the concentration of ownership in the communications industry has developed much faster than the growth of competition. If this industry consolidation continues unchecked, the pro-competitive goals that Congress endorsed in the 1996 Act may not be achieved, and consumers may end up paying higher rates for lower quality service.

Of the several major announcements over the past year, the proposed merger of Bell Atlantic and NYNEX, as well as the proposed merger of SBC and PacTel, are of particular concern to consumers. First, these mergers eliminate potential competitors in the market for local telephone service. Whether or not the companies planned to compete before the merger announcements, the market forces intended to be set into motion by the Telecommunications Act of 1996 would have driven them to compete with each other in

the future. There can be no doubt that each of the mergers eliminates one of the strongest and most experienced potential competitors for local telephone service. At this early stage of local telephone competition, it is too soon to say which potential competitors will be successful in making local telephone markets reasonably competitive. Mergers that eliminate some of these competitors (while simultaneously increasing the strength of the monopoly incumbents) must be considered significant.

Second, the mergers essentially double the size of two companies (Bell Atlantic and SBC) that have substantial market power in most of the markets in which they operate. The proposed mergers will create companies that will each have significant market power and over 20% of the nation?s access lines. This increase in size comes at exactly the time that the FCC and the States, through the process set out in the Telecommunications Act of 1996, are attempting to open up these very markets to competition. This increase n size also makes state regulation more difficult and potentially less effective.

The mergers increase the ability and incentives of the carriers to engage in anti-competitive behavior. The substantially larger size of these companies means that they can muster greater *resources* to spend to retard the development of competition if they choose to do so.[1] Further, the merged companies will have stronger *incentives* to thwart the development of competition, since they will each have more revenues at risk. Lastly, the mergers raise the stakes for consumers by doubling the number of consumers who will be

[1]One of the benefits cited by the applicants in this merger is the strengthening of NYNEX, today?s monopoly provider in New York. But this is a two-edged sword. The ?benefit? of a stronger NYNEX in New York means that competition which can open up the local exchange to competition faces an even stronger incumbent. The solution is not to weaken NYNEX--instead regulators must redouble their efforts to open local markets.

at risk from any anti-competitive behavior on the part of the new merged company or from the damage done to competitive markets by this concentration.

My primary concern about these two large RBOC mergers is their timing. It is not coincidental that the mergers have arisen at exactly the time that these companies are due to face competition in markets that have been traditional monopolies for many decades. The development of local competition is at a very formative and fragile stage, if I can use that term when discussing Fortune 50 companies. The effect of the federal legislation and state legislative and regulatory changes on the development of competition for local telephone service is just beginning to be felt. The FCC only recently released its initial set of rules governing how competitors may interconnect with the networks of the incumbent local telephone companies. The pricing provisions of the order have been stayed by the Court of Appeals. Developments are quite unsettled: even one of the nation?s largest LECs, GTE, has asked to be considered as a rural telephone company in some of its service areas and to be exempted from the new unbundling rules. While there are some hopeful signs that at least some States are following through on the pro-competitive thrust of the pricing provisions of FCC?s Interconnection Order, I stress that all of this development is still in its infancy. The major industry re-alignments represented by this merger could have a very detrimental effect on the early development of competition.

Competitors to the incumbent telephone companies are growing but are far smaller than the incumbent telephone companies. According to one industry analyst, competitors to the local telephone companies brought in less than 1% of the total revenues for local telephone service in 1995. Moreover, these competitors tend to be very much smaller

than the LECs with whom they are beginning to compete. But another way to judge the scope of competition for local telephone service is to examine the consumer perspective. Frankly, I do not know one residential consumer who has a choice among alternative providers of local telephone service today. Under these circumstances, I think regulators should view mergers like the Bell Atlantic/NYNEX merger very warily.

Section 2 ? Costs and Benefits of the Proposed Merger

Q. What are the Commission?s duties and prerogatives in reviewing this proposed merger?

A. The New York PSC, like many state utility regulatory commissions, has broad authority over the supervision of telephone corporations. The Commission is generally tasked with the requirement of maintaining just and reasonable rates. Also, like most other commissions, the New York PSC has a variety of tools with which to accomplish this task. The commission regulates an industry affected with the public interest; this is the reason that the commission has the authority to approve (or deny) a proposal to transfer plant of a telephone company. In light of the authority granted the Commission under the statute, I suggest that the commission has three duties: 1) to ensure that the interests of ratepayers are served by the transfer of the NYT system; 2) to ensure that the Commission can continue effectively to regulate; and 3) to determine what conditions on the transfer are needed to serve the general policy goals of the Commission, especially the development of competition in the local telecommunications market.

In the balance of my testimony, I will concentrate on three issues 1) whether the merger

produces more benefits than costs for ratepayers; 2) whether the merger adversely affects competition; and 3) how the merger affects the capacity of the Commission to regulate effectively. I will conclude with recommendations designed to ameliorate some of the adverse consequences which may result from this merger.

Q. What are the claimed benefits of the merger?

A. The merger of NYNEX and Bell Atlantic is a merger of two firms approximately in the same business, although serving different (geographic) markets today. In their application, NYNEX and Bell Atlantic allude to the benefits of the merger as being cost savings and certain other ?soft? benefits. To get more detail on the claimed benefits, we may consider the ?Reply of Bell Atlantic and NYNEX to Comments in Opposition? filed at the Federal Communications Commission[2] I have also reviewed the Applicants? discussion of merger benefits in filings in other states, including Vermont and Maine. From all these sources, we can piece together a claim that there are three classes of benefits that derive from the merger.

[2]See, for example, the affidavit of Richard Schmalensee and William Taylor attached to the Reply of Bell Atlantic and NYNEX to Comments in Opposition. Federal Communications Commission, Tracking No. 96-0221.

The first claimed benefit is one that is usually asserted about such mergers: increased efficiencies and financial benefits. To the extent that a single larger firm can produce the same output at lower total cost than two separate firms, there is a cost savings and an increase in productive efficiency. The Joint Application in this case also suggests that the merger will result in a company which is financially stronger, presumably resulting in lower capital costs. The applicants sketch the estimates of these benefits in their filings at the FCC and in the testimony of Mr. William Heitmann, Vice President-Merger Implementation for NYNEX, presented in Maine and Vermont.[3] Here the annual benefits flowing from increased efficiency, elimination of duplicate functions and change in financial strength are estimated to be $900 million beginning in the third year.

The second class of alleged benefits relates to the creation of a large new global competitor. In Maine and Vermont, NYNEX? witnesses reason that bigger is better on the international scene. Obviously, this strategic decision on the part of the boards of NYNEX and Bell Atlantic depends on their analysis of the future of these global markets. But I would note that mergers aren? always beneficial to a management? business plan, even when they appear to be so initially. An example of a major failed acquisition in recent years was the purchase of NCR by AT&T.

Finally, the applicants assert that the combination of the two firms will result in greater choices and competition in New York telecommunications markets, with the attendant

[3]See, for example, the testimony of William F. Heitmann before the Public Utilities Commission of the State of Maine, Docket No. 96-388.

benefits of lower prices in these markets. The implication of this argument is that the merger will enhance competition in the markets in New York. As discussed below, I think this is a very generous assumption and strongly suggest that the Commission not take it at face value.

Q. If the direct benefits of the merger are shown to exist, do you think that New York consumers will realize these benefits?

A. Unless the Commission acts to ensure that tangible benefits of the merger actually accrue to consumers in New York, I am concerned that ratepayers will not receive the forecasted short and long-term benefits. Instead, these direct benefits will be denied to consumers or at least or substantially delayed. To make it more likely that ratepayers will actually see the net benefits, regulators must do two things: 1) take affirmative regulatory steps to ensure that any benefits arrive by requiring a flow-through of an equitable share of the merger benefits in rates; and 2) act to increase local competition so that its pressure will tend to force flow-through of these savings in the form of lower rates.

There are several reasons to think that net benefits may not otherwise flow to ratepayers. To begin with, some of the estimates of benefits are overly optimistic and rely on assumptions that may not materialize. Second, because of regulatory structures now in place, there is no guarantee that even the claimed direct benefits of the merger will find their way to consumers. The combination of incentive regulation plans, price freezes and a lack of immediate competition means that companies can continue to pocket savings derived from restructuring today. This is one area where active regulatory supervision remains appropriate, at least until competition arrives. Third, the assumptions about

increased competition might be reversed: instead of increasing competition in New York, the merger may well delay or reduce the amount of competition in New York, turning the applicants?alleged large benefit into a very large cost for consumers.

Q. Why do you think that some of the claimed benefits are speculative?

A. The efficiencies inherent in combining operations will be difficult to detect and measure. Without a doubt, there will be operational changes at NYNEX driven by this merger. But it will be difficult to sort these out from operational changes which would have happened anyway; all telecommunications firms now have to reduce costs in anticipation of future competition. We must also note that these efficiencies generally translate into reduced labor costs from combining operations, a threat to continued employment levels in New York and possibly to the quality of service goals of the Commission and NYNEX.

The enhancement of the global position of NYNEX and Bell Atlantic is similarly difficult to measure and even more difficult to relate to consumers in New York. Experience with global activities of domestic telecommunications carriers is hardly uniformly positive. The possible outcome is that management?s attention may be drawn to exciting oversees ventures at the expense of the core business at home. I?m not suggesting limits on these activities: I am merely questioning whether these are benefits to New York *per se* to increasing NYNEX?s global reach. It seems more likely that this ?benefit?should viewed by the Commission as a challenge to ensure that New York gets its share of the new company?s attention. As I will develop below, ultimately the only sure way to achieve this result is by subjecting NYT to competition at home. In this way, any lapse of attention could result in the loss of a customer.

Q. Are there costs to the proposed merger for New York?

A. Yes. While the claimed benefits of the merger may be speculative, there are costs which could be harmful to consumers. The Commission must examine both sides of the balance sheet and determine whether the costs are offset by the benefits and in what way the costs could be mitigated.

First, the merger may reduce the future competitiveness of telecommunications markets in New York. The merger eliminates a likely future competitor in New York telecommunications markets at exactly the time that state and federal policymakers are attempting to open markets to competition. In many ways, the timing of the merger could not be worse for the development of local competition in New York. The merger strengthens a company which today has durable market power in important markets while eliminating one of the largest telecommunications firms in the country as a future competitor. I will discuss this issue in greater detail below.

A second set of costs relates to the Commission?s ability to continue to effectively regulate utility operations in the state. If the merger is approved, ownership of NYNEX will reside with a much larger holding company. Although it is now difficult to judge the extent of the control that will be exerted by Bell Atlantic, we should assume that NYNEX?s policies will be subordinated to Bell Atlantic?s policies. Differences in philosophy and tactical approaches between these two companies will affect the Commission?s ability to achieve its regulatory goals. The Commission should also recognize that decisions of the New York Public Service Commission will affect a relatively much smaller share of Bell Atlantic?s business post-merger than of NYNEX?s

business today--all things being equal, the merger will lessen the PSC?s ability to command the attention of the post-merger company.

An observation about public utility regulation is relevant here. A public utility commission regulates both directly and indirectly. Direct regulation determines rates for specific services, the exact wording of particular rules, and effectuates legal requirements. Indirect regulation refers to the ability of commissions to achieve results and compliance with its policies through influence and suasion. In my experience, this second form of regulation is often as important as the first. It relies on good communications between regulators and the firms they regulate and relies generally on a shared vision of all the stakeholders of the role of regulation and the course of the industry. Closely related is the observation that regulation works well only with the cooperation of the regulated firm.

The New York Public Service Law focuses on the commission?s authority to regulate NYT in traditional ways: access to books and records, authority to set rates, etc. While such continued authority is critical, especially in the intermediate term, the Commission must also make this statute, crafted in a strikingly different telecommunications environment, work for telecommunications regulation in 1996. State regulation must change fundamentally. Competition, compared to regulation, can produce superior results in the areas of customer choice and equity in pricing. Harnessing local competition to the task of regulation is as important an outcome as the Commission can hope to achieve in this merger docket. To put this succinctly, **the Commission?s ability to regulate NYT effectively in the future depends directly on the Commission?s ability to trigger effective competition in New York now**.

Section 3 ? Analysis of the Applicants

Q. Please comment on the analysis of the effects of the merger on competition included in the Joint Application.

A. At page 23 of the Joint Application, NYNEX and Bell Atlantic sketch an antitrust argument that claims there are no anticompetitive effects caused by the merger. This is essentially a ?lite? version of arguments presented by Bell Atlantic and NYNEX in filings at the FCC and in other state proceedings. For example, Dr. Richard Gilbert, in testimony filed at the FCC[4] and Dr. William Taylor in testimony filed in Maine and Vermont[5], essentially predict whether the facts of the merger would trigger an antitrust investigation by the Department of Justice: i.e., whether the merger violates the ?merger guidelines? issued by the DOJ. They conclude that 1) Bell Atlantic is not an actual competitor to NYNEX in local and long distance markets today, so that the merger does not eliminate an existing competitor; and 2) Bell Atlantic is not an actual potential competitor to NYNEX so that the elimination of Bell Atlantic as a future competitor does not pose a threat to competition developing in New York; 3) even if Bell Atlantic is an actual potential competitor, there are enough other potential new entrants that competition will

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[4]Declaration of of Richard J. Gilbert attached to the Reply of Bell Atlantic and NYNEX to Comments in Opposition. Federal Communications Commission, Tracking No. 96-0221.

[5]Testimony of William E. Taylor, before the Vermont Public Service Board, Docket #5900.

not be harmed.

The first conclusion, that Bell Atlantic is not a competitor to NYNEX today, is not surprising. NYNEX, like every other local exchange carrier in the country, has faced only trivial amounts of competition in local markets. There are and have been legal and practical barriers to competition in local markets in virtually every state, something that the New York PSC and Congress understood when they began to open local markets. It is important to realize that Bell Atlantic?s absence as a competitor to NYNEX historically (like the absence of AT&T, BellSouth, MCI, or Time Warner) is not evidence of its future intention. Competition in local markets simply had not been an option until incumbent LECs opened their markets, provided interconnection, permitted access to bottleneck functions, allowed resale, provided number portability, etc.

The second conclusion, that Bell Atlantic is not an actual potential competitor to NYNEX rests on a premise (that Bell Atlantic would never become a competitor to NYNEX) that is difficult to accept. It is a very generous assumption. We are asked to believe that a company which is interested enough in entering the New York market to buy the incumbent local carrier would not have considered entry into this market through another route. We pose this question: if Bell Atlantic were ever going to enter telecommunications markets outside of its region, would it rule out the Northeast corridor, including New York? That seems highly unlikely. The claim that Bell Atlantic would never have entered the NYNEX markets is tantamount to saying that Bell Atlantic

would never have ventured outside its region.

The applicants in this case provide a very interesting, if inadvertent, confirmation of this fact in the application filed in this case. In the Joint Application, NYNEX and Bell Atlantic state:

> The proposed merger will join two corporations that currently serve adjacent <u>parts of one natural market</u> ? that is, the Northeast corridor from Maine to Virginia.[6]

This admission, that the Northeast is a natural market, leads immediately to these questions: If Maine to Virginia is a natural market, shouldn? Bell Atlantic and NYNEX both be expected to vie for customers in this natural market? Why would Bell Atlantic not attempt to extend its reach to the Northeast, while NYNEX extended its service into New Jersey, Pennsylvania, Washington and Virginia? In other words, **if this is a natural market, aren? Bell Atlantic and NYNEX natural competitors?**

This description of the region also bears on the third conclusion of the antitrust analysis of the applicants. They would deny that Bell Atlantic has any special advantages over other potential entrants in the NYNEX region. Once again, such an assumption strains credulity. The experience of Bell Atlantic in providing local exchange service, its physical proximity to the NYNEX region, its sharing the market area, especially in northern New Jersey, and its regional presence through its cellular operations argue strongly that Bell Atlantic would be among the first, certainly among RBOCs, to enter the NYNEX region,

[6]Petition, Docket 96-C-0603 dated July 2,1996. (Emphasis added; parenthetical note omitted.)

but for the merger.

The Commission should be unmoved by the claims that these carriers never had designs on each other?s territories. It is a new world in telecommunications, demonstrated by the lengthy recitation of alliances and strategic moves detailed by Dr. Taylor in his testimony in Maine. These examples really stand for this proposition: the new telecommunications world created by the 1996 Act requires large telecommunications companies, like AT&T, Bell Atlantic and LDDS to learn to be more flexible and mobile. Bell Atlantic?s action in this merger demonstrates how quickly a carrier can move when it wants to. It is unacceptable to assume that Bell Atlantic could not have entered the NYNEX region except through a merger.

There are several routes to the NYNEX territory and New York besides buying NYNEX. Bell Atlantic could have pursued other market strategies in New York: joining other facilities-based competitors already present in New York; reselling local exchange services of NYNEX; extending facilities from Bell Atlantic?s existing switched network into lucrative markets in New York City, etc. Other technologies, such as the LMDS (Local Multipoint Distribution Services) licenses about to be auctioned at the FCC would provide a wireless entrepreneur like Bell Atlantic the ability to establish a presence in voice and broadband delivery in competition with NYNEX. Finally, Bell Atlantic and NYNEX are each exercising out-of-region prerogatives to enter long distance markets quickly through resale. Long distance resale would provide Bell Atlantic with the opportunity to increase its identification in New York as it built a local market entry strategy. There simply is no credible reason to assume that these very same entry strategies would not have been used

by each company against the other, except for the implicit pact that developed as soon as merger discussions began.

Q. Does the antitrust argument of the applicants show that this merger will not negatively affect the future of competition in New York?

A. No. There are three ways in which this argument is not useful. First, the argument proves too much. Various witnesses for the applicants conclude that the elimination of Bell Atlantic as a competitor to NYNEX would not harm competition in New York. They reason that, since other potential competitors are able to enter the markets in New York (IXCs, CAPs, and Cable) the merger of Bell Atlantic and NYNEX would not harm competition. Here is the problem with this analysis: it would apparently arrive at the same conclusion if used to examine a proposal to merge all seven RBOCs into a single local exchange company owned by Bell Atlantic. Consider this argument: none of the RBOCs are today competing in each others?territories; presumably each would swear it has no intention of entering another?s territory; and, besides, MCI, AT&T, TCI, TCG, GTE and others would still be available to enter local markets of the RBOCs. This means that the analysis could justify the re-assembling of the seven RBOCs.

Second, this analysis is a relatively narrow antitrust analysis, not a public interest analysis. The PSC must conduct a broader examination of the effects of the merger on consumers in New York. Importantly, the analysis should study the effects of the merger on the Commission?s ability to effectively regulate. As I stated earlier, this should include how the concentration of carriers in the region will affect the Commission?s ability to regulate NYT.

Third, I am concerned that the antitrust tools are less useful in an environment that is changing as quickly as the telecommunications marketplace. In short, reliance on the Antitrust Division?s merger guidelines may yield too static an analysis since so little is known about the possible future activities of these firms in telecommunications. Further, while the merger guidelines might function well in the analysis of a merger in a market with some degree of competition, what we have here is an ultra-concentrated market. For example, the 1984 Merger Guidelines describes situations where the Herfindahl-Hirschman Index (HHI) for a market is in the range of 1000 to 1800. A market having an HHI of 1000 or less is described as unconcentrated; a market with an HHI greater than 1800 being highly concentrated. In the case of local exchange markets today, the index is probably greater than 8500. There simply are no competitors to speak of.

Given the early stage of competition in local telecommunications markets, it is implausible to conclude that the merger of Bell Atlantic and NYNEX would have no effect on competition in the New York markets. I agree with Dr. Taylor that the industry is in a state of flux and that many firms are attempting to identify strategic partnerships. I must also agree with Dr. Taylor that it is difficult to estimate the effect of mergers on the future concentration in the market. But the existence of an independent Bell Atlantic, able to compete with NYNEX in New York through alliances with providers not having market power would lessen concentration in the New York markets and improve the future prospects of local competition, compared to Bell Atlantic?s entry through this merger. Such an arrangement would be far preferable, from the standpoint of consumers and competition, than the purchase of NYNEX by Bell Atlantic.

Q. Would you comment on the testimony that NYNEX has provided elsewhere in support of this merger?

A. Yes. Mr. William Heitmann is Vice-President for merger implementation for NYNEX. In testimony in Maine and Vermont, Mr. Heitman discusses the projected financial costs and benefits of the merger from the perspective of the merging companies. He reports that the merger is expected to save the combined companies up to $900 million annually ($600 million in expenses, $250-300 million in capital) by the third year, while one-time initial costs of $700-900 million will be experienced over the first three years. This means that the merger, based on Mr. Heitmann?s analysis, will net the combined companies approximately $2 billion in net present value savings over the first six years.

The Commission should be concerned that there is no mention of any flow through of a reasonable portion of this savings to ratepayers in New York. From the company?s silence, I assume that there are no plans to share an equitable portion of this savings with ratepayers. In the absence of such an equitable sharing, ratepayers are denied what may be the only direct benefit of the merger.

Section 4 ? Mitigating the Negative Effects of the Merger

Q. How can the Commission mitigate the negative effects of the merger on New York

consumers?

A. The Commission has available to it several tools to offset some of the negative effects of this merger:

Application of ?271 of the Telecommunications Act of 1996 ? Section 271 of the Telecommunications Act of 1996 contains a ?competitive checklist?which measures the degree to which an RBOC has opened its network to competition. The New York PSC could ?borrow?the checklist and make it a precondition for approval of the merger. In that way, the twin negative effects of eliminating a competitor and strengthening the incumbent could be partially offset by making local competition more likely.

Implementation of ?251 of the Telecommunications Act of 1996 ? Now that parts of the FCC? interconnection rules have been stayed by the Court of Appeals, implementation of the pricing provisions of the 1996 Act has moved to the states. The New York Commission will affect the competitiveness of local telecommunications markets by its decisions on the pricing of unbundled network elements and terms and availability of services for resale. By adopting pro-competitive rules and requiring strict compliance by the State? carriers to comply with those rules, the Commission can enhance entry and help mitigate detrimental effects of the merger on competition.

Flowthrough of Merger Benefits ? If the Commission agrees that its job is to decide whether the merger represents a net benefit for consumers, then it must consider whether ratepayers should receive some of the direct benefits of the merger. The PSC should require NYNEX to quantify any benefits of the merger and to flow an equitable portion of

the savings through to ratepayers in the form of rate reductions or rebates. Unless and until NYNEX faces competition in New York for today?s monopoly services, regulation must act to force the flow through of these benefits.

Q. How can ?271 of the Telecommunications Act of 1996 be used by the Commission to offset adverse competitive effects of this merger?

A. As discussed above, the Bell Atlantic/NYNEX and SBC/PacTel mergers may upset the balance in favor of concentration of ownership before competition for local telephone service has begun to be effective. In other words, these mergers increase the risk that competition will not develop for local telephone service. I recommend that this risk be counter-balanced by measures to make competition more likely for all consumers.

The Commission should recognize that the pressures of the merger toward concentration must be accompanied by additional pressure to encourage competition. One way to address this imbalance is to require the merging companies to satisfy the competitive checklist in Section 271 of the Telecommunications Act of 1996 before the merger can be considered for approval. Section 271 of the 1996 Act requires that each RBOC must open and unbundle its network to competitors for local telephone service in a state before being allowed to provide long distance service in that state.

Requiring the carriers to unbundle their networks would mitigate somewhat the risks to competition that are posed by the merger. The unbundling requirements are essential to the development of local competition. Therefore, consumers are more likely to realize the benefits of competition -- greater choices and lower prices -- once the carriers comply with the competitive checklist, even if the merger goes forward.

Here are the terms of the checklist from the Telecommunications Act of 1996:

(B) COMPETITIVE CHECKLIST- Access or interconnection provided or generally offered by a Bell operating company to other telecommunications carriers meets the requirements of this subparagraph if such access and interconnection includes each of the following:

(i) Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1).

(ii) Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).

(iii) Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224.

(iv) Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services.

(v) Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.

(vi) Local switching unbundled from transport, local loop transmission, or other services.

(vii) Nondiscriminatory access to--

(I) 911 and E911 services;

(II) directory assistance services to allow the other carrier's customers to obtain telephone numbers; and

(III) operator call completion services.

(viii) White pages directory listings for customers of the other carrier's telephone exchange service.

(ix) Until the date by which telecommunications numbering administration guidelines, plan, or rules are established, nondiscriminatory access to telephone numbers for assignment to the other carrier's telephone exchange service customers. After that date, compliance with such guidelines, plan, or rules.

(x) Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.

(xi) Until the date by which the Commission issues regulations pursuant to section 251 to require number portability, interim telecommunications number portability through remote call forwarding, direct inward dialing trunks, or other comparable arrangements, with as little impairment of functioning, quality, reliability, and convenience as possible. After that date, full compliance with such regulations.

(xii) Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).

(xiii) Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).

(xiv) Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).

Q. The checklist was developed originally as a precondition to the RBOCs?entry into interLATA markets. Are you recommending that the mergers be delayed until the companies are approved to enter interLATA markets?

A. No. I am simply suggesting that one of the preconditions, that networks be fully opened to competition, also be applied in the case of the mergers. This suggestion does not require the companies to be approved to enter long distance markets before the merger can proceed. In my view, Section 271 of the Telecommunications of 1996 provides regulators with a useful benchmark as to whether this predicate has been fulfilled. Regulators should merely ?borrow?the requirement.

By requiring the carriers to satisfy the ready-made conditions of the Section 271 checklist, the New York PSC would not have to make a determination of the carrier? market share or market power. Nor would this suggestion involve the Commission in interpreting a new set of standards. Instead, this suggestion would rely upon the checklist already

included in the legislation enacted by Congress. This precondition would simply rely on a decision that is going to be made anyway--whether an RBOC has met the competitive checklist. As a result, this standard would not involve any increase in administrative resources by the New York PSC.

Similarly, this suggestion does not impose added burden on the carriers. Repeatedly, these companies have described the incentives each has to meet the checklist requirements. In response to those who might argue that fulfilling the checklist requirements would delay approval of the merger, the answer is that the length of time it will take to comply with the checklist is in the control of the carriers themselves. The sooner that they meet the checklist requirements, the sooner the merger could be approved. The precondition of ensuring that the RBOCs meet the Section 271 checklist is simply an added safeguard to ensure that the merged entity does its part to allow competition to develop.

Finally, CPI thinks that the New York PSC has the legal authority to attach this precondition to approval of the merger under the New York statute. This flows from the broad general authority of the Commission to supervise the activities of telephone corporations operating in New York and from the Commission?s prerogative to approve the transfer of operations only if the Commission?s ability to regulate is not impaired.

Q. **How should the Commission decide whether this precondition has been met?**

A. There are two options for the Commission. First, the Commission could condition approval of the merger on the finding of the FCC that the checklist has been met. Second, we should recall that each state commission will be conferring with the FCC on the status

of the checklist implementation in its state. The New York PSC could use its recommendation to the FCC as the basis for its conclusion whether the checklist requirements have been met for purposes of this merger.

Q. Does this recommendation mean that the New York Public Service Commission would yield its jurisdiction over this merger approval to the FCC?

A. Not at all. I am simply recommending that the New York PSC link consideration of this merger proposal to an external measure of how fully NYNEX and Bell Atlantic have opened their networks to competition. The effect of this recommendation is to synchronize this merger, which has the potential to limit competition, with another event designed to increase local competition: implementation of the 1996 Act and RBOC compliance with the competitive checklist. Under this approach, the New York Commission retains full jurisdiction to approve or deny the merger proposal--the New York PSC would simply use the ?271 process as a benchmark for whether sufficient steps have been taken by these companies to limit the damage the merger could do to competition.

Q. Has CPI made a similar proposal concerning the mergers of Bell Atlantic and NYNEX and of SBC and PacTel?

A. Yes. CPI recommended this approach recently in testimony before the Antitrust Subcommittee of the Senate Judiciary Committee. Further, CPI has filed a ?Petition to Impose Conditions? at the Federal Communications Commission asking the FCC to adopt compliance with the ?271 checklist as a precondition to considering the Bell Atlantic/NYNEX merger proposal. That request is now pending at the FCC. I also made

this recommendation to the Public Utilities Commission of Maine in a hearing on the proposed merger. CPI filed testimony before the California Public Utilities Commission recommending this approach in that commission?s consideration of the SBC/PacTel merger. Finally, CPI is making this same recommendation in *ex parte* comments filed at the FCC in the agency?s review of the proposed SBC/PacTel merger.

Q. Please summarize this recommendation.

A. There are two ways that the New York Public Service Commission should link approval of this merger to the applicants?compliance with ?271 of the 1996 Act.

First, the Commission should require that NYNEX to meet the competitive checklist throughout New York as a precondition to approval of the merger. While compliance with the checklist is not equivalent to the existence of effective competition, it will help ensure that NYNEX has opened its local market to a substantial degree before the merger proceeds.

Second, the Commission should insist on strict adherence to the terms of the ?271 competitive checklist by NYNEX when the FCC confers with the New York Commission pursuant to the 1996 Act. Section 271 of the Telecommunications Act of 1996 requires the FCC to confer with the States to determine whether a Bell Operating Company has met the terms of the checklist in a given state. Although the State?s role is consultative, the FCC has indicated its willingness to work closely with the states on this issue and has expressed its intention to give substantial weight to the advice of the states in this matter. The New York PSC should issue clear language in the order in this case about its

expectations for judging checklist compliance.

In line with this, I also recommend that the Commission require NYNEX to comply with the list of ?Best Practices?developed by the National Association of Regulatory Utility Commissioners (NARUC) when preparing its application for certification of the checklist. A copy of the list of ?best practices?is attached as Appendix C.

In summary, I recommend that the New York PSC include the following requirements in any order concerning the merger:

? Before the merger is allowed to go forward, NYNEX and Bell Atlantic must have satisfied the ?competitive checklist?in ?271 of the Telecommunications Act of 1996.

? The New York PSC will insist on strict adherence to the terms of the checklist when performing its consultative role at the FCC.

? NYNEX should comply with NARUC? ?Best Practices?when applying for certification that it has met the competitive checklist.

Q. How does the Commission? implementation of ?251 of the Telecommunications Act of 1996 relate to the proposed merger?

A. As I discussed before, Congress sought to enable and stimulate the development of local exchange competition by imposing ?duties?on the Regional Bell Operating Companies. These duties relate to the inter-carrier transactions necessary for a competitor to begin competing with incumbent monopoly companies. Chief among them are requirements to interconnect, to make services available for resale and to provide access to unbundled

network elements of the incumbent providers.

States are mid-way through implementation of the local competition provisions of the Telecommunications Act of 1996. The New York Commission is now considering arbitration requests for interconnection terms. There is an obvious close relationship between the likelihood of competition and the prices for intercarrier transactions: the level of prices for unbundled network elements and resale discounts which this Commission approves will determine the likelihood that new entrants (resale, facilities-based and hybrid carriers) will provide competition to the incumbent LECs. The New York PSC has substantial discretion over those terms and price levels. The Commission should recognize the special importance which those decisions will have for New York consumers, especially in light of this merger application. I am not suggesting that the Commission be pro-competitor in these decisions, but pro-competition.

Here is the bottom line: if the Commission approves the merger of Bell Atlantic and NYNEX, it should also redouble its efforts to ensure that local competition policies are set in way to make vibrant local competition a reality in New York.

Section 5 ? Summary of Recommendations

Q. Mr. Binz, would you summarize your recommendations?

A. The proposed merger of Bell Atlantic and NYNEX may work against the interests of New York consumers unless the Commission acts to mitigate the negative consequences of the merger and capture an equitable portion of the potential benefits of the merger for consumers. Only if the Commission acts in this way will the benefits of the merger exceed its costs for ratepayers. I recommend that the New York PSC take the following steps:

1. Require NYNEX to meet the ?competitive checklist? of Section 271 of the Telecommunications Act of 1996 as a precondition of the merger.

2. Recognize that the New York PSC?s implementation of the pricing policies of Section 251 of the Telecommunications Act of 1996 must be pro-competitive to compensate for damage to competition which may result from the merger.

3. Require that any benefits of the merger be quantified by the applicants and adopt mechanisms to ensure that an equitable portion of these benefits are delivered to New York ratepayers.

Q. Does this conclude your testimony?

A. Yes.

This**Testimony of Ronald J. Binz** was prepared by Ronald J. Binz and is respectfully submitted to the Public Service Commission of the State of New York on this 25th day of November, 1996.

(signed)

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