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April 28, 2000

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General Counsel

FILED

APR 28 2000

Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

RE: Case No. TM-2000-403

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and fourteen (14) conformed copies of a **STAFF RECOMMENDATION**.

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Bruce H. Bates
Assistant General Counsel
(573) 751-7434
(573) 751-9285 (Fax)

BB/df
Enclosure
cc: Counsel of Record

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

FILED³

APR 28 2000

Missouri Public
Service Commission

In the Matter of the Joint Application of)
GTE Midwest Incorporated and Iowa)
Telecommunications Services, Inc., for)
Authority to Transfer and Acquire Part of)
GTE Midwest Incorporated's Franchise,)
Facilities and System Located in the State)
of Missouri and for Issuance of)
Certificates of Service Authority to Iowa)
Telecommunications Services, Inc., d/b/a)
Iowa Telecom and for Authority for Iowa)
Telecommunications Services, Inc, d/b/a)
Iowa Telecom to Borrow Funds in)
Connection Therewith to Execute a)
Telephone Loan Contract, Promissory)
Notes, and a Mortgage Security)
Agreement and Financing Statement.)

Case No. TM-2000-403

STAFF RECOMMENDATION

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and for its
Recommendation states:

In the attached *Memorandum*, which is labeled *Appendix A*, the Staff recommends that
the Missouri Public Service Commission issue an order approving the *Joint Application* of GTE
Midwest Incorporated ("GTE") and Iowa Telecommunications Services, Inc., d/b/a Iowa
Telecom ("ITS" or "Applicant"), for the reasons stated therein.

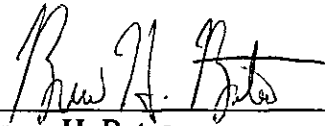
In support of its *Recommendation*, Staff finds that the transfer is not detrimental to the
public interest pursuant to 4 CSR 240-2.060(6)(D). See also State ex rel. City of St. Louis v.

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Public Serv. Comm'n, 73 S.W.2d 393 (Mo. banc 1934) and State ex rel. Fee Fee Trunk Sewer Co., Inc. v. Litz, 596 S.W.2d 466 (Mo. App. 1980). Further, Staff finds that the local and IXC test is in the public interest pursuant to Section 392.430 RSMo (1994). Finally, Staff finds that the financing issue does not appear to be jurisdictional to the Commission, as ITS will be operating in Iowa and Missouri.

Respectfully submitted,

DANA K. JOYCE
General Counsel

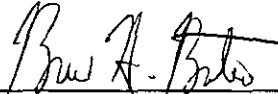


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Missouri Bar No. 35442

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Missouri Public Service Commission
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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel or parties of record as shown on the attached service list this 28th day of April 2000.

A handwritten signature in cursive script, appearing to read "Bruce H. Bates", written over a horizontal line.

Bruce H. Bates

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. TM-2000-403
GTE Midwest Incorporated and Iowa Telecommunications Services, Inc. d/b/a
Iowa Telecom

FROM: William A. Meyer, Project Coordinator *WAM 4/27/2000*
David Broadwater, Financial Analysis Department *DB*
Lisa Mahaney, Telecommunications Department *LM*
David G. Winter, Accounting Department *DG*

William A. Meyer 4/27/2000
Project Coordinator/Date

Wm K. Haas 4/27/00 B7B 4-27-00
General's Counsel/Date

SUBJECT: Staff's Recommendation Concerning Authority to Transfer and Acquire Part of
GTE Midwest Incorporated Franchise and System Located in the State of
Missouri.

DATE: April 26, 2000

On January 4, 2000, GTE Midwest Incorporated ("GTE") and Iowa Telecommunications Services, Inc., d/b/a Iowa Telecom ("ITS" or "Applicant"), filed a joint application ("Application") with the Commission for authority for GTE to sell to ITS part of GTE's franchise, facilities and system located in Missouri. ITS also seeks a certificate of service authority authorizing it to provide telecommunications services, including basic local and interexchange telecommunications services, in the service areas that it is purchasing from GTE. ITS also seeks authority to borrow from Rural Telephone Finance Corporation and Fleet Securities, Inc., or another broker, an amount of money sufficient to complete the proposed transactions. The application was docketed as Case No. TM-2000-403.

Detriment to the Public Interest Standard

Staff utilized the "detriment to the public interest" standard as it is similar in acquisition cases as well as merger cases. If the Joint Applicants fail to show that the proposed sale of certain GTE exchanges to ITS is not detrimental to the public interest in Missouri (i.e., if it is demonstrated that the Missouri public will be harmed by the proposed sale), then the Commission should reject this application and not approve the proposed sale. Staff Counsel has advised that the "not detrimental to the public interest" standard is based on case law generally cited in court opinions such as State ex rel. City of St. Louis v. Public Serv. Comm'n, 73 S.W.2d 393 (Mo. banc 1934); State ex rel. Fee Fee Trunk Sewer Co., Inc. v. Litz, 596 S.W.2d 466 (Mo. App. 1980). Staff

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April 26, 2000
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Counsel also advises that the Commission has incorporated the "not detrimental to the public interest" standard in its rules. 4 CSR 240-2.060(6)(D).

Consistent with Staff's position in other acquisition and merger cases, Staff views the members of the "public" that are to be protected as those consumers taking and receiving utility service from the GTE exchanges that are being sold to ITS in the State of Missouri.

In this case, Staff would define "public interest" as referring to the nature and level of the impact or effect that ITS's acquisition will have on its Missouri customers. There is a fundamental concern in the regulation of public utilities that the public being served will not be impacted adversely or harmed by those responsible for providing monopoly services. Public utilities in Missouri are charged with providing safe and adequate service at just and reasonable rates. If this merger results in adverse or negative impacts to ITS's Missouri customers, then the Commission should not approve the Joint Applicants' Merger Application or, in the alternative, impose conditions sufficient to overcome the detriments of the merger.

SALE OF SYSTEM ASSETS

GTE proposes to sell to ITS all 296 of GTE's local telephone exchanges (280,422 access lines) located in the state of Iowa. Three of those Iowa exchanges include a total of approximately 105 access lines that serve customers physically located in Missouri. Those three (3) exchanges are: the Athens, Iowa exchange which extends into Clark County, Missouri; the Braddyville, Iowa exchange, which extends into Nodaway County, Missouri; and the South Seymour, Iowa exchange which extends into Putnam County, Missouri.

This sales transaction is part of GTE's announced initiative to sell approximately 1.6 million telephone lines or about 8 percent of its domestic telephone network in the United States. It does not affect GTE's long distance, Internet, and wireless services consumers in the State(s) of Iowa or Missouri. The Iowa Utilities Board in Docket No. SPU-99-29 (Attachment 1) approved the sale of GTE's Iowa telephone properties to ITS.

The Commission in Case No. TM-2000-182 (GTE and Spectra Communications Group, L.L.C.) approved a similar type of transaction when it addressed the sale of a portion (107 Missouri exchanges or approximately 120,000 switched access lines) of GTE's Missouri network.

Based on the "Detriment to the Public Interest Standard" discussed above and the conditions as outlined in the "Recommendations" section of this memorandum, the Staff recommends the Commission approve the sale of the Missouri system assets to ITS.

CERTIFICATE, TARIFF AND OTHER ISSUES

The Telecommunications Department Staff has reviewed ITS's request for certificates of authority to provide basic local, local exchange and interexchange telecommunications service. The Application in this proceeding states that "ITS proposes no immediate change in the operation of GTE's properties as a result of the proposed transaction. Moreover, ITS proposes no immediate changes in the rates, terms and conditions of the telecommunications service which GTE currently provides to customers in the exchanges." Based on this statement, the Telecommunications Department Staff believes that ITS will continue to provide the same rates and level of service that has been provided by GTE in the past. ITS proposes to adopt GTE's tariffs for the three (3) exchanges involved in this application or file new ITS tariffs substantially similar to the existing GTE tariffs. ITS requests a waiver of 4 CSR 240-2.060(4)(H) which requires that a proposed tariff with a 45 day effective date be filed with the Application. This waiver is routinely requested and granted in basic local exchange, local exchange and interexchange certificate applications, and it should be granted in this Application.

Further, the Telecommunications Department reviewed the managerial and technical qualifications of ITS. Regarding managerial capability, William P. Bagley serves as the Director and Chief Executive Officer of ITS. He has 43 years of telecommunications experience, including upper-level management positions at Contel Corporation, Fidelity Telephone Company and Iowa Network Services (INS). INS is the majority shareholder and will control and direct the operation and management of ITS. Alan L. Wells serves as President and Chief Operating Officer of ITS. He has many years of managerial experience, including upper-level management positions at Deloitte & Touche, Iowa-Illinois Gas and Electric Company, and MidAmerican Energy Company. Dennis R. Kilburg serves as Vice President of Operations and Engineering and provides extensive technical telecommunications capabilities to ITS. He has over 28 years of telecommunications experience. In addition, approximately 385 GTE employees within Iowa will become ITS employees following the closure of this transaction. These employees currently handle the operation of the GTE network within the State of Iowa. After the transaction closes, these employees will remain in the same or very similar positions.

The Telecommunications Department Staff believes that if the Commission approves this Application, no harm to the quality of service for these customers will result. The Application is in order regarding the certificate of authority from the Missouri Secretary of State, the identification of exchanges in which ITS will offer service, and identification of sufficient technical and managerial resources and abilities to provide telecommunications service. This information is sufficient to support granting ITS' Application for certificates.

Based on GTE's stated intent to discontinue providing telecommunications services in the three (3) affected exchanges, GTE needs to file proposed tariffs to remove from GTE's tariffs any and all references to the provisioning of basic local exchange, local exchange, and interexchange telecommunications service to the exchanges being sold to ITS.

Therefore, the Telecommunications Department recommends the Commission approve ITS' application for certificates of authority to provide basic local, local exchange and interexchange telecommunications service. The certificates should become effective on the same date ITS' proposed tariffs become effective. The Commission should direct ITS and GTE to officially file their proposed tariffs. The proposed tariffs of both Applicants should contain the same proposed effective date.

FINANCING ISSUES

Section 392.430 RSMo Supp. 1999 provides that "...the Commission shall approve an application for a certificate of service authority to provide basic local telecommunications service upon a finding that the grant of service authority is in the public interest. "

Section 392.290.1, RSMo provides that:

The power of telecommunications companies to issue stocks, bonds, notes and other evidence of indebtedness and to create liens upon their property situated in this state is a special privilege, the right of supervision, regulation, restriction and control of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe.

This provision is tempered by Section 392.290.2, RSMo that states:

Notwithstanding any other provision of this chapter to the contrary, no telecommunications company operating in Missouri and one or more other states shall be required to obtain authorization from the commission to issue stocks, bonds, notes or any other evidence of indebtedness; nor shall any such telecommunications company be required to obtain authorization from the commission in order to encumber the whole or any part of its franchise line or system.

As previously stated, ITS is purchasing 296 of GTE's local telephone exchanges located in the state of Iowa of which three local exchanges of approximately 105 access lines extend into the state of Missouri. Since ITS will be operating in Iowa and Missouri, the General Counsel's office has advised Staff that it appears that ITS does not need Commission authorization for the financing proposed in this proceeding.

The Financial Analysis Department concurs in the analysis of the financial capacity of ITS by the Iowa Utilities Board. ITS has more than 99 percent of its operations in the state of Iowa and in the Iowa Utilities Board Order (Attachment 1) approving the sale they found that ITS does have the financial ability to run the company and attract capital at reasonable rates. The Staff therefore believes that ITS will have the financial ability to operate the 105 access lines within the state of Missouri.

ACCOUNTING ISSUES

The sales of the exchanges is considered as a taxable transaction. Taxable acquisitions generally require the recognition of gain or loss by the Seller (GTE) in the year of sale. The buyer of the assets (ITS) does not receive the benefit of any deferred income taxes.

As a taxable asset sale, the deferred taxes attributable to GTE's assets will, in essence, be paid by GTE upon the recognition of the gain on the sale of its assets. This recognition would cause the deferred taxes to be eliminated from GTE's accounting records and rate base. The Staff would consider the loss of GTE's deferred taxes to be detrimental to the public interest and the basis for the Commission to deny authorization for this proposed merger. GTE's regulated customers otherwise would be harmed because they will lose the ratemaking benefit of the deferred taxes offset to rate base and the resulting decrease in revenue requirement associated with this rate base offset.

The Staff recommends as a condition of this transaction that a deferred income tax provision be recognized for the Missouri properties. This provision would ensure that there would be no financial detriment to Missouri ratepayers as a result of the loss of GTE's regulated accumulated deferred tax reserve, as well as deferred tax credits.

RECOMMENDATION

The Staff recommends that the Commission approve the Joint Application with the following provisions:

- 1) ITS shall file new tariffs substantially similar to the existing GTE tariffs;
- 2) The Commission should approve ITS's waiver of 4 CSR 240-2.060(4)(H) which requires that a proposed tariff with a 45 day effective date be filed with the Application;
- 3) GTE shall file proposed tariff sheets to remove from GTE's tariffs any and all references to the provisioning of basic local exchange, local exchange, and interexchange telecommunications service to the exchanges being sold to ITS;
- 4) The Commission should grant certificates of authority to provide basic local, local exchange and interexchange telecommunications service to ITS which should become effective on the same date ITS' proposed tariffs become effective;
- 5) The proposed tariffs of GTE and ITS shall contain the same proposed effective date; and

- 5) The proposed tariffs of GTE and ITS shall contain the same proposed effective date; and
- 6) A deferred income tax provision should be recognized for the Missouri properties. ITS should be ordered to use an additional offset to rate base in any filing for a general increase in telecommunications rates in Missouri initiated in the next five (5) years to compensate for rate base deductions associated with deferred taxes eliminated by this transaction, unless ITS can show that its actual deferred tax reserve is the same as or greater than that reserve would have been taking into account the amortization provided for hereinafter absent the sale of these exchanges. The amount of the offset shall reduce by 20% per year on the anniversary date of the closing of the transaction. This provision would ensure that there would be no financial detriment to Missouri ratepayers as a result of the loss of GTE's regulated accumulated deferred tax reserve, as well as deferred tax credits.

The Staff also concludes that based on the provisions of Section 392.290.2 RSMo, the Commission does not need to authorize: (1) "ITS to borrow from the Rural Telephone Finance Corporation and Fleet Securities, Inc. or another broker" nor (2) to "execute and deliver Promissory Notes evidencing the loans" or "Mortgage, Security Agreement and Financing Statement for the purpose of placing a lien on its assets and securing the loan."

Attachment 1: Iowa Utilities Board Order SPU-99-29

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE:

GTE MIDWEST INCORPORATED AND
IOWA TELECOMMUNICATIONS
SERVICES, INC.

DOCKET NO. SPU-99-29

**ORDER TERMINATING DOCKET, GRANTING WAIVER,
DESIGNATING AS ELIGIBLE TELECOMMUNICATIONS CARRIER,
AND PERMITTING ADOPTION OF PRICE PLAN**

(Issued April 13, 2000)

PROCEDURAL HISTORY

On October 20, 1999, GTE Midwest Incorporated (GTE) and Iowa Telecommunications Services, Inc. (ITS), filed a "Joint Application" (the Application) asking the Board to approve a reorganization and transfer certificates of public convenience and necessity, pursuant to Iowa Code §§ 476.77, 476.20, and 476.29 (1999). GTE proposed to sell all 296 GTE exchanges in Iowa to ITS, including all of the business, property, assets, and rights of GTE relating to those exchanges. The applicants also request transfer of GTE's intraLATA long distance customers to ITS (with a waiver of the Board's anti-slamming rules, if necessary); designation of ITS as an Eligible Telecommunications Carrier; and adoption by ITS of GTE's price plan at the rates in effect on the date the sale is closed.

GTE is a Delaware corporation with its principle offices at 11 Eleventh Avenue, Grinnell, Iowa. GTE is a wholly-owned subsidiary of GTE Corporation and is a public utility providing local exchange and interexchange telecommunications

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service. (Application, p. 1.) GTE provides local service for approximately 222,700 residential and 61,700 business lines for a total of 284,400 access lines in 296 Iowa exchanges. (Tr. 22.) GTE's serving area also includes small portions of cross boundary service area properties extending into the state of Missouri. (Tr. 21.) Approximately 105 customers residing in Missouri receive service from switches located in Iowa. (Tr. 30.) Assets, services, or customers of GTE Communications Corporation (GTECC) and GTE Telecommunications Services, Inc. (GTE TSI), are not included as part of this sale. (Tr. 31.)

ITS is an entity that is majority-owned and controlled by Iowa Network Services, Inc. (INS). INS is joined in this investment by Touch America, Inc. (Touch America). (Tr. 20-21.) ITS was incorporated as an Iowa corporation on May 14, 1999. ITS is governed by a board consisting of six directors, four of whom are elected by INS and two of whom are elected by Touch America. ITS was formed to purchase the Iowa GTE properties. (Tr. 83.)

INS is based in West Des Moines, Iowa, and is owned by 127 Iowa Independent telephone companies that provide local exchange services. INS provides telecommunication services to over 147 independent companies with more than 400,000 customers in some 300 Iowa communities. INS, through a subsidiary, is also a general partner in Iowa Wireless Services, L.P., which is licensed to provide personal communication services (PCS) to residents of Iowa. (Tr. 20-21.) INS provides centralized equal access for the independent companies and their customers. INS also is a provider of Internet services for approximately 40,000 customers in the rural areas of Iowa. (Tr. 83.)

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Touch America is a Montana corporation engaged in the telecommunications business. Touch America is a wholly-owned subsidiary of Montana Power Corporation. Touch America provides long distance, dedicated voice, data, video, and frame relay services. Touch America's equipment services include the design, installation, and maintenance of PBX and key systems. Touch America is located in Butte, Montana, with customers throughout the upper Midwest and western United States. (Tr. 21.)

On October 28, 1999, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an answer and a motion to extend the 90-day review period under Iowa Code § 476.77(2) for an additional 90 days. On November 1, 1999, AT&T Communications of the Midwest, Inc. (AT&T), petitioned to intervene. On November 10, 1999, AT&T joined in Consumer Advocate's motion to extend the review period; on the same day, the Applicants resisted the motion.

On November 29, 1999, Consumer Advocate filed testimony, AT&T filed comments, and Heart of Iowa Communications, Inc. (Heart of Iowa), Winnebago Cooperative Telephone Association (Winnebago), and Forest City Telecom, Inc. (Forest City), collectively, the ILEC intervenors) petitioned to intervene. The next day LTDS Corporation and CommChoice of Iowa, LLC, petitioned to intervene.

On December 1, 1999, the Board issued an order docketing the application, granting AT&T's petition to intervene, extending the review period by 90 days, and setting a procedural schedule. Hearing in this docket was scheduled for February 8, 2000.

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On December 14, 1999, the Board issued an order requiring the Applicants to file additional information in support of their application. The additional information was filed in the form of supplemental testimony on December 28, 1999.

On January 5, 2000, direct testimony was filed by Consumer Advocate, AT&T, and the ILEC intervenors. On January 18, 2000, the Applicants filed rebuttal testimony, and on January 25, 2000, they filed supplemental rebuttal testimony, which was corrected on January 28, 2000.

On January 31, 2000, the Board issued a second order requiring additional information from the Applicants, which was filed as supplemental direct testimony on February 4, 2000.

On February 8, 2000, the ILEC intervenors withdrew their intervention and the hearing was held as scheduled.

The Applicants, Consumer Advocate, and AT&T filed initial briefs on February 18, 2000, and reply briefs on February 25, 2000.

STATUTORY FACTORS

Iowa Code § 476.77(3) lists the following factors that the Board may consider in its review of a proposal for reorganization:

- a. Whether the board will have reasonable access to books, records, documents, and other information relating to the public utility or any of its affiliates.
- b. Whether the public utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is impaired.
- c. Whether the ability of the public utility to provide safe, reasonable, and adequate service is impaired.

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- d. Whether ratepayers are detrimentally affected.
- e. Whether the public interest is detrimentally affected.

The standards for review in section 476.77 indicate some of the important questions are the impacts of the reorganization on the utility's ability to attract capital, the utility's ratepayers, and the public interest generally. The Board will discuss each of the factors separately.

ACCESS TO BOOKS AND RECORDS

In reviewing this reorganization, the Board finds that it will continue to have reasonable access to the books and records of the regulated public utility and its affiliates. All of the books and records relating to ITS will be at the Newton, Iowa, corporate headquarters and will be subject to Board regulation in the same manner as at present. (Tr. 84, 303.) To the extent the records of ITS's majority shareholder or its affiliates may be required by the Board, those books, records, documents, and other information are available at the INS headquarters in West Des Moines, Iowa. (Tr. 83.)

ABILITY TO ATTRACT CAPITAL

Applicants argue ITS will be able to attract capital on reasonable terms in order to acquire the GTE properties in Iowa. Rural Telephone Finance Cooperative (RTFC) has committed to providing the senior debt portion of the financing.

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(Tr. 346-49.) ITS is working with four underwriting firms to prepare a subordinated debt offering. (Tr. 350-54.) Further, ITS will receive equity backing from INS and Touch America, both of which appear to be successful, financially stable telecommunications companies. Because both of these companies will have significant investment in ITS, they will have some incentive to make prudent business decisions with respect to ITS and to make additional equity infusions if needed. (Tr. 134, 375.)

ITS points out it has already arranged for the capital required for the initial purchase and no additional capital is expected to be required in the foreseeable future. Instead, all future capital needs are expected to be met with internally-generated funds. (Tr. 351.)

Consumer Advocate argues ITS will have a debt/equity ratio below the level necessary to insulate itself adequately from an economic downturn. (Consumer Advocate Init. Br. 3.) If there is a general downturn in the economy or for some other reason ITS falls short of meeting its revenue projections, Consumer Advocate believes ITS may be unable to attract additional capital on reasonable terms, which could adversely affect service quality and ITS's ability to provide new or additional services to its customers. (Tr. 489.)

The Board finds that ITS will start with an equity ratio lower than is typical for an Iowa utility. A capital structure of this nature has a relatively higher degree of financial risk associated with it. However, a number of factors offset the concerns that might otherwise be presented by this situation. First, if ITS is able to achieve its revenue projections, then the debt/equity ratio will improve each year. (Ex. 20.)

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Consumer Advocate concedes that the ITS revenue projections appear to be reasonable. (Tr. 489.) ITS's proposed financial statements were reviewed by the RTFC and the underwriters as a part of their due diligence process and those entities found the projections to be fair and reasonable. (Tr. 302-03, 351-54.) Obviously, none of these financial entities can guarantee the accuracy of the projections, but it is significant that they are willing to make investment decisions based upon this information.

Second, both INS and Touch America are financially strong companies with an interest in protecting their investment in ITS. While neither of these parties has made a binding or enforceable commitment to protect the financial integrity of ITS, it is reasonable to believe they will be willing to provide ITS with additional funds if necessary, either directly by equity infusion or indirectly through a third party, in order to protect their own interests. (Tr. 378.)

Finally, if ITS were to face an unusually severe economic downturn, ITS could reevaluate its planned capital expenditures, possibly postponing the addition of new services in order to concentrate resources on maintaining the quality of its existing services. (Tr. 134.) While this is not a preferred solution, it is one possible means of preserving existing service quality in the face of possible future economic difficulties.

Overall, the Board concludes that, if the Board were only looking at the initial financial position of ITS and this specific factor, there would be a serious question whether ITS will be able to attract capital on reasonable terms if additional capital is required in the near future. However, the Board will also consider ITS's financial projections, which indicate ITS is unlikely to need additional capital in the near future

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and that ITS's capital structure will improve each year. Furthermore, the Board will not ignore the fact that ITS is backed by two healthy investors. When all of these facts are considered, the Board concludes that the ability of ITS to attract capital on reasonable terms and its ability to maintain a reasonable capital structure is not unreasonably impaired by the proposed transaction.

Because the Board is relying, in part, on ITS's financial projections, the Board will monitor ITS's financial progress by requiring that ITS file with the Board ITS's year-end balance sheet, income statement, and cash flow statement by March 31 of each year for the next two years, starting in 2001.

SERVICE QUALITY

ITS witness Mr. Bagley, who is Chief Executive Officer of both ITS and INS, testified that ITS intends to apply the telecommunications experience of INS to establish ITS as an efficient, well-managed company that will offer top quality telecommunications services to its customers. (Tr. 83.) ITS is confident of its technical capability to continue to provide the services provided by GTE, in part because ITS will be hiring most of the present GTE employees who currently maintain GTE's switching centers and outside plant in Iowa. (Tr. 86.) ITS also intends to hire approximately 75 to 100 new employees who will be assigned to customer service, engineering, and other corporate areas. (Id.) The transfer of the existing GTE employees and the hiring of new ITS employees should give ITS the technical capability to provide at least the same types of service and the same quality of service currently provided by GTE.

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As a part of this docket, the Board conducted its own review of the existing service quality in GTE's exchanges in Iowa. It is reasonable to use GTE's past performance as an indicator of the performance to be expected from ITS, given that ITS will be using the same employees and equipment to provide the services. GTE's performance comes close to meeting or exceeding all of the service quality measurements specified in 199 IAC 22.6. This performance provides a point of reference for measuring ITS's performance in the future, and the Board finds no reason in this record to believe that ITS will not be able to continue, and even improve upon, GTE's past performance.

Apart from the service quality standards in the Board's rules, the Board is also aware that, according to the latest information available, approximately 57 of GTE's exchanges in Iowa currently lack non-toll access to an internet service provider (ISP). (Tr. 242.) ISPs generally do not provide services that are subject to regulation by the Board, but the services they provide are closely tied to the availability of adequate local exchange services. ITS has developed a plan to offer local-access internet service in each exchange that currently lacks such service by the end of 2000, so long as ITS is able to close its transaction with GTE in the second quarter of 2000 (Tr. 206-10) or, in any event, within six months after the change of ownership of the exchanges. (Tr. 243.) While this is not a regulated service within the Board's jurisdiction, the Board considers expanded local access to ISPs to be one of the public benefits of this proposed transaction.

Another potential service issue concerns pending extended area service (EAS) routes. Pursuant to Board rules, some of GTE's customers in Iowa have

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voted for new EAS routes or are otherwise in the process of obtaining new EAS service. Board rules allow the local exchange carrier up to two years from the date of ballot return to implement the new EAS routes. Currently, there are six GTE routes that have been approved by ballot but not yet implemented, while two more EAS petitions are pending. The Board expects ITS to complete all of these pending EAS proceedings as scheduled.

Overall, the Board finds that the ability of ITS to provide safe, reasonable, and adequate service to the public will not be impaired by the proposed transaction. However, in order to monitor ITS's service quality during the transition period, the Board will require that ITS file quarterly reports for two years after closing to show ITS's compliance with the service standards of 199 IAC 22.6.

WHETHER RATEPAYERS ARE DETRIMENTALLY AFFECTED

GTE currently operates under price regulation, rather than traditional rate regulation, pursuant to Iowa Code § 476.97(11). (Tr. 248.) ITS proposes to adopt GTE's existing price regulation plan, without change. (Tr. 248-49.) ITS does not have any current plans to make any rate adjustments with respect to local telecommunications services. (Tr. 249.) All of ITS's financial projections are based upon the assumption that it will continue to operate under price regulation for the time periods addressed in those projections.

Consumer Advocate expresses concern that it would be unfair for the ratepayers in these GTE exchanges to ever have to pay higher rates just because a

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different company owns the assets being used to serve them. (Tr. 434.) Consumer Advocate argues that changing to a company using the same assets to provide service, but carrying higher debt levels, cannot be anything but a detriment to customers unless there are tangible customer benefits that equal or exceed the additional costs. Consumer Advocate does not believe any such benefits have been shown in this record. (Consumer Advocate Reply Br. 4.)

Consumer Advocate also takes the position that GTE should be required to make a refund to its customers based upon an analysis of certain depreciation reserve deficiencies. (Tr. 436.) Consumer Advocate argues the reserve deficiencies were created by predecessor companies to GTE because depreciation expenses were miscalculated; Consumer Advocate believes any remaining book balances should be written off as losses at retirement, below the line, resulting in refunds to customers. (Tr. 433-38.)

Applicants respond that reserve deficiencies are created when new technology and unforeseen growth result in assets being replaced earlier than expected. Neither traditional rate-making nor mass asset accounting practices require that assets in service that are not recovered during their revenue-producing life must be written off as a loss. (Tr. 69.) Applicants object to Consumer Advocate's proposed refunds.

The Board will not require GTE to make customer refunds based upon the alleged depreciation reserve deficiencies. The issue Consumer Advocate is raising goes to the amount of the depreciation expense that should properly have been included in GTE's rates when GTE was operating under traditional rate regulation.

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The Board in reorganization proceedings has consistently found that rate case issues should be considered in future rate case proceedings, if necessary. See Iowa Resources Incorporated and Midwest Energy Company, Docket No. SPU-90-5, "Order Terminating Docket," p. 5 (July 2, 1990). More recently, the Board said:

The Board will not decide issues relating to any future proposed acquisition adjustment or capital costs in this proceeding. These issues are best left for argument in a future rate case or other appropriate proceeding.

Re: CalEnergy Company, Inc., et al., Docket No. SPU-98-8, "Order" (February 17, 1999). The Board is not persuaded to change this long-held view.

A similar analysis will apply to another issue raised by Consumer Advocate concerning GTE's alleged accumulated deferred income taxes. Consumer Advocate argues that GTE has collected capital contributions from customers based upon accumulated deferred income taxes which, according to Consumer Advocate, should be refunded to GTE's customers. (Tr. 435-38.) Again, the Board concludes that this challenge to GTE's rates, based upon a traditional rate making analysis, is not appropriate for consideration in this proceeding.

Moreover, the Board notes that both of Consumer Advocate's proposed refunds are based upon old information. Consumer Advocate's witness agreed that, to the best of his knowledge, there are no reserve deficiencies in existence today. (Tr. 471.) Both proposals were made on the basis of information from the late 1980s. (Tr. 472.) The Board finds that any attempt to make customer refunds based upon data more than ten years old, and ignoring the fact that GTE is no longer operating under rate of return regulation in Iowa, would be inappropriate.

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The Board will not require that GTE make the refunds proposed by Consumer Advocate. Instead, the Board finds ratepayers will not be detrimentally affected by the proposed sale.

WHETHER THE PUBLIC INTEREST IS DETRIMENTALLY AFFECTED

Finally, the Board must consider whether the public interest will be detrimentally affected by the proposed reorganization. Applicants assert the proposed transaction will benefit the public interest, pointing out that ITS will be a local company with a rural focus (Tr. 23-24, 86) and that ITS will add up to 100 new Iowa employees with an annual payroll of \$2.5 to \$3 million. (Tr. 86, 125-26, 305-06.) Applicants also point out that ITS will bring local internet access to each of the exchanges that currently lacks that service within six months of the closing. (Tr. 242-43.) Finally, applicants state that ITS has agreed to assume and perform GTE's obligations under existing interconnection agreements with CLECs and will maintain existing toll routes and points of interconnection unless changes beneficial to ITS's customers are identified. (Tr. 42, 209-12, 226-27.)

AT&T argues that, prior to approving the proposed sale, the Board should require ITS to provide binding assurances on each of the following points:

1. ITS's provisioning of facilities and routing of traffic will have no negative effects on customers;
2. ITS's proposed increased investment will not be funded by captive ratepayers (i.e., will not be used to increase access charges);

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3. ITS's promise to operate under GTE's price cap with a rate freeze is binding;
4. ITS will honor all existing GTE interconnection agreements and other contracts with other telecommunications companies serving customers in the Iowa exchanges; and
5. ITS will abide by the competitive conditions of the Telecommunications Act of 1996.

(AT&T Init. Br. 7-8.)

Consumer Advocate argues that the public interest in competitive local exchange service is at risk because the telephone companies that are members of INS, and that therefore indirectly own ITS, will have a reduced incentive to compete in these exchanges. (Tr. 111-13, 493.) Consumer Advocate acknowledges ITS's claims that it will compete (Tr. 87-88, 105-06, 115-16), but points out that INS is the majority shareholder in ITS. (Tr. 82, 116.)

In reply to Consumer Advocate's arguments, Applicants assert there is no evidence in the record to support Consumer Advocate's concerns. Instead, the record establishes that ITS will not be captive to INS's services, but instead will be able to shop around for better deals. (Tr. 105-06.) Further, some INS shareholders are already operating as CLECs in some of the GTE exchanges (Tr. 112-13, 181), and there is no evidence to suggest any of those companies have modified their plans to pursue CLEC opportunities.

In reply to AT&T, applicants point out that ITS has offered to assume the existing AT&T-GTE interconnection agreement, even though AT&T does not

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currently offer any retail services under the agreement. (Tr. 222-25, 410.) ITS has also indicated it has no plans to make any immediate modifications in toll routes and would only do so if cost-effective for ITS and after review with the affected customers, including AT&T. (Tr. 226-27.) Further, ITS corrects AT&T's assertion that ITS will be "freezing" its rates, noting that ITS is proposing to adopt GTE's price plan, which may require rate increases or decreases based on future inflation levels.

The Board finds that AT&T's proposed conditions are either not directly related to the proposed transaction or unnecessary. AT&T is concerned, for example, that ITS may change the provision of facilities or routing of traffic, or that ITS may attempt to increase its access charges, or that ITS may opt out of price regulation and seek to raise retail rates, but AT&T has not shown that ITS is any more likely than GTE to do these things. Further, the applicants have agreed to honor existing GTE interconnection agreements, including AT&T's. (Tr. 222-25, 410.) Finally, ITS is already required to abide by the requirements of the Telecommunications Act of 1996, as well as all other applicable laws. A binding assurance that ITS will obey the law will not add anything to this case.

Looking only at the issues that have been raised under the "public interest" heading, it appears the applicants have identified sufficient public benefits to offset the potential public costs identified by Consumer Advocate. It seems likely, for example, that the INS-member telephone companies will be less likely to compete in these exchanges if they are owned by ITS, but that decrease in one area of potential competition is offset by the undeniable benefits associated with the transaction, including local ownership by a buyer who is committed to upgrading service quality

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and increased customer attention from a buyer that does not own any other properties in other states. Some of these benefits are difficult or impossible to quantify, but they are nonetheless real.

The Board finds that, overall, the public interest will not be detrimentally affected by the proposed transaction.

CHANGES TO THE PROPOSAL

The Board is basing its conclusions in this order on the reorganization proposal submitted to it and the evidence in this record. Any material changes in the proposed reorganization may change the basis for the conclusions the Board has reached and may require submission of a revised proposal. Therefore, if there are any material changes to the proposed reorganization prior to closing, applicants will be required to file a copy of those changes with the Board, including an analysis of the impact of the changes. The Board will then determine whether a new proposal for reorganization must be filed.

CONCLUSION

Based upon the testimony and evidence filed pursuant to Iowa Code § 476.77 (1999) and 199 IAC chapter 32, the Board finds the applicants have established the proposed reorganization is not contrary to the interests of ratepayers and the public interest. The Board also finds the other statutory factors are satisfied. Therefore, the reorganization proposed by applicants will be permitted to take place by operation of law and this docket will be terminated.

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OTHER MATTERS

There are three other matters the applicants have asked the Board to address as a part of this reorganization review: transfer of GTE's intraLATA long distance and local customers to ITS (with a waiver of the Board's anti-slamming rules, if necessary); designation of ITS as an Eligible Telecommunications Carrier, and adoption by ITS of GTE's price plan at the rates in effect on the date the transaction is closed. The Board will address each of these matters in turn.

GTE currently provides intraLATA long distance services to some Iowa customers, in addition to its local exchange services. As part of the purchase agreement, GTE intends to transfer these customers to ITS. Board rules normally prohibit making any changes to a customer's preferred local or long distance telephone service provider without first obtaining written or recorded verification of the customer's consent to the change. See 199 IAC 22.23. GTE and ITS request a waiver of that rule to permit the transfer without obtaining and verifying the consent of every single GTE customer in Iowa. ITS further testifies that it intends to serve the GTE "one-plus" intraLATA customers with no change in rates, terms, or conditions. (Tr. 250-51.)

Board rules permit waiver of any rule if the application of the rule would work an undue hardship and if the waiver will serve the underlying purpose of the rule. 199 IAC 1.3. The Board finds that requiring GTE and ITS to obtain verified consent from over 250,000 customers would be an undue hardship, particularly in light of the fact that the Board has reviewed the underlying transaction in detail and is allowing it

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to proceed. Moreover, the purpose behind the Board rule is to prevent unauthorized changes in a customer's telecommunications service, a form of fraud known as "slamming." The transfer proposed by GTE and ITS is not slamming and is not the type of change in service that the Board intended to prevent. The Board will waive 199 IAC 22.23 as applied to the proposed transfer of GTE's intraLATA long distance and local exchange customers to ITS.

GTE is currently designated as an Eligible Telecommunications Carrier (ETC), pursuant to 47 U.S.C. § 214(e), in its Iowa exchanges. ITS requests designation as an ETC for the same exchanges upon the close of the transaction. ITS states in its testimony that it will satisfy all of the requirements and will offer all of the services designated for universal service support in chapter 39 of the Board's rules. No party opposes designation of ITS as an ETC and the Board will grant ITS's request for that designation.

Finally, ITS is asking the Board to authorize ITS to continue to operate under GTE's existing price plan, pursuant to Iowa Code § 476.97(11). ITS states it will accept and adopt all the obligations, requirements, and rates provided by the plan and seeks to maintain the existing GTE rates as of the time of closing. (Tr. 248-49.) No party has objected to ITS's assumption of the GTE price plan, and the Board will authorize ITS to continue to operate pursuant to that plan, beginning with the GTE prices in effect as of the date of closing.

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ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. Docket No. SPU-99-29 is terminated. The joint application for reorganization filed by GTE Midwest Incorporated and Iowa Telecommunications Services, Inc., on October 20, 1999, is not disapproved.
2. Applicants shall promptly file with the Board any material changes to the proposed reorganization that may occur, up to the time of closing. The filing shall include an analysis of the impact of any changes. Any closing shall be delayed by a minimum of five business days to permit the Board and the parties to this proceeding an opportunity to evaluate the potential impact of the change.
3. ITS is directed to file with the Board ITS's year-end balance sheet, income statement, and cash flow statement by March 31 of each year for the next two years, starting in 2001. ITS shall also file with the Board a quarterly report showing ITS's performance with respect to the service standards of 199 IAC 22.6 for the two year period following the date of closing of the proposed transaction.
4. The Board's anti-slamming rule, 199 IAC 22.23, is waived to the extent described in the body of this order.
5. Pursuant to 199 IAC 39, ITS's request that it be designated an Eligible Telecommunications Carrier for purposes of 47 U.S.C. § 214(e) is granted.
6. ITS will be permitted to adopt GTE's existing price regulation plan, pursuant to Iowa Code § 476.97(11), beginning with the GTE prices in effect as of the date of closing.

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7. Motions and objections not previously granted or sustained are denied or overruled. Any argument not specifically addressed in this order is rejected either as not supported by the evidence or as not being of sufficient persuasiveness to warrant comment.

UTILITIES BOARD

/s/ Allan T. Thoms

ATTEST:

/s/ Raymond K. Vawter, Jr.
Executive Secretary

/s/ Diane Muggs

Dated at Des Moines, Iowa, this 13th day of April, 2000.

Service List for
Case No. TM-2000-403
April 28, 2000

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