Verizon NW
Washington Synergy Analysis
Docket No. UT-050814

Synergies are not relevant or applicable to the Commission's decision in this case, but without waiving its objections to the relevancy of such information, Verizon provides the following analysis to avoid any further discovery disputes pertaining to this information. This narrative describes the net cost synergies resulting from the acquisition of MCI that are attributable to Verizon NW's intrastate regulated operations. As the table on page 12 indicates, the estimated net expense effect on Verizon NW's intrastate regulated operations is $300,000 over two years (2006 – negative $100,000; 2007 - $400,000). Matters in California are subject to California law, which is different from Washington law.

The national estimates were prepared based on the synergies that we expect the new company to achieve across various lines of business without regard to service jurisdictions. In total, we estimated that the transaction would generate $7.3 billion of present value arising from new revenues and expense and capital savings, net of costs to achieve those benefits and net of related taxes. This estimate is summarized in the following table below.

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NPV of Synergy / Integration	
Item	($M)

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A. ***Information Technology***

In the area of information technology, we estimated that the acquisition will enable the new firm to achieve cost savings of approximately **[BEGIN PROPRIETARY]** *********, **[END PROPRIETARY]** net present value, and net of the costs to achieve those savings.

MCI, which itself is the result of a series of mergers and acquisitions, operates a large number of information technology systems for various functions. MCI also has an existing plan to develop a unified interface for a number of these systems. The transaction will enable this plan to be accomplished. Once completed, this project will produce cost savings in the future operation of these systems.

B. ***Network***

In the area of network operations, we estimated that the transaction would enable the new firm to achieve cost savings of approximately **[BEGIN PROPRIETARY]** **** billion, **[END PROPRIETARY]** net present value, and net of the costs to achieve those savings.

These savings will be realized in a number of areas. First, Verizon will realize savings by moving a large share of its long-distance traffic onto under-utilized portions of MCI's existing long-haul transport facilities. As a result, Verizon will avoid payments to third parties for such

transport services. Verizon will also realize related savings in avoiding capital costs to build out its own long-haul network. Second, Verizon will be able to use MCI's metropolitan area network facilities in areas outside of Verizon's current franchise territories and thus avoid incurring capital costs to construct or lease such networks. Third, the greater volume of interexchange traffic carried by the new firm will enable more efficient arrangements for the origination and termination of long-distance traffic, reducing access costs. Fourth, higher international traffic volumes will also permit the new firm to enjoy reduced international routing costs. Fifth, the acquisition will enable MCI to benefit from Verizon's economies of scale associated with network equipment purchases. Because MCI's capital spending is much smaller than Verizon's, MCI generally pays higher prices for such equipment. Following the transaction, the new firm will be able to acquire equipment for MCI's operations at the volume discounts that Verizon currently enjoys.

C. ***International and Headcount Reductions***

We estimated synergies in two other categories: International and Headcount reductions.

(i) ***International***

To comply with its noncompete agreement with Canada's TELUS, Verizon will divest MCI's operations in Canada following the completion of the MCI transaction. The divestiture will enable Verizon to avoid costs of approximately **[BEGIN PROPRIETARY]** *********, **[END PROPRIETARY]** net present value, associated with the annual support of those Canadian operations.

(ii) ***Headcount Reductions***

In the area of general and administrative expense, we estimated that the transaction will enable the new firm to achieve cost savings of approximately **[BEGIN PROPRIETARY]**

*****, **[END PROPRIETARY]** net present value, and net of the costs to achieve those savings (severance and integration costs). These cost savings include headcount reductions in the functional areas previously discussed as providing opportunities for synergies, i.e., enterprise markets, mass markets, international and wholesale operations, and information technology. In addition, the transaction will enable the new firm to provide shared services more efficiently, resulting in headcount reductions in areas such as finance, legal, and human relations.

D. ***Revenue Synergies***

Under the California type analysis argued by some parties to be relevant in that state, we estimated that the transaction would produce revenue synergies of **[BEGIN PROPRIETARY]** ********* **[END PROPRIETARY]** of present value, net of the costs of sales, related taxes and the related capital to achieve these additional revenues. We projected revenue synergies for both the Enterprise Solutions Group ("ESG") and the Small and Mid-size Business ("SMB") lines of business.

We estimated two types of revenue synergies associated with ESG. First, we expected the transaction to enhance MCI's ability to retain its existing enterprise customers. MCI has already experienced a reduction in revenue from enterprise customers, and it was assumed that such losses would continue in the absence of a transaction. The financial stability that Verizon's acquisition of MCI will bring to MCI's operations will improve the likelihood that the new firm will retain both revenue levels from existing customers as well as a number of MCI customers who might otherwise have defected to competitors. Second, we expected that the post-transaction company will be able to sell additional services to existing or new customers beyond those that either firm would have been able to sell without the transaction. These incremental

sales are expected to result from the new firm's ability to provide a larger package of services on an integrated basis more efficiently.

We also projected revenue synergies from the SMB line of business. MCI currently has a number of services that it offers to large enterprise customers that should be attractive to smaller business customers as well. Verizon has strong relationships with many of these customers, but currently lacks the ability to offer these services. The acquisition will allow the new firm to combine these capabilities, thus increasing sales to such customers.

E. ***Distribution of Synergies Between Verizon and MCI***

As a first step, we determined how the synergies described above would be distributed between Verizon and MCI. This step is necessary in order to determine how the transaction-related synergies could be attributed to Verizon NW's intrastate regulated operations.

Information Technology: As noted, the transaction will provide additional financial resources that will enable MCI to implement its existing plan to construct a unified interface for various existing MCI systems. The resulting cost savings will accrue to MCI's operations, and we therefore excluded them from the analysis. We likewise excluded the related costs to achieve those savings.

Network: We excluded the procurement cost savings because they will benefit MCI's operations exclusively. As noted, the transaction will enable the new firm to acquire equipment for MCI's operations at the volume discounts that Verizon currently enjoys. Verizon, on the other hand, does not expect to achieve any further reductions in the prices it pays to equipment suppliers due to increased purchasing for MCI's operations.

We included the vendor savings as attributable to Verizon. As noted, these vendor savings relate to payments made by Verizon to other carriers for traffic that can be migrated onto underutilized portions of MCI's network. We did not attempt to separate the remaining cost savings in the network area between Verizon and MCI. As discussed below, these savings are properly excluded from the analysis because they relate to long-distance and out of franchise activities, which are not subject to rate regulation, whether undertaken by Verizon or MCI.

Other (International and Headcount): We excluded the savings associated with international operations because they are attributable to the divestiture of MCI's Canadian operations.

We also analyzed the distribution of cost savings achieved from headcount reductions as between the two companies. **[BEGIN PROPRIETARY]**

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Revenue Synergies: We determined that the revenue synergies that will be realized through retention of existing MCI enterprise customers are attributable to MCI's operations. By definition, these revenues are currently being earned by MCI and would have been lost by MCI in the absence of the transaction. With the transaction, MCI will be able to continue providing service to these existing customers, and would continue to do so without the type of regulation that the Commission exercises with respect to Verizon NW. Accordingly, we adjusted the revenue synergies by eliminating the revenues associated with the retention of MCI's existing customers.

We allocated the remaining revenue synergies between Verizon and MCI in proportion to their respective existing revenues. As noted, these revenue synergies will result from the new firm's ability to combine the capabilities of Verizon and MCI to provide services more efficiently and effectively. Because these synergies result from the combination of the two companies' complementary skills, they cannot be attributed to one firm or the other. We therefore allocated the synergies between the two companies based on their relative revenues from those customer segments currently. Verizon's share of these revenue synergies is approximately 41% for ESG and approximately 70% for SMB. We made corresponding adjustments in the costs to achieve those synergies, including the capital costs related to achieving the revenue synergies. Finally,

we converted these capital costs into an expense, based on prior Commission-approved depreciation and cost of capital rates.

The following table illustrates the synergies that we attributed to Verizon. This table needs to be updated for the errata filing.

[BEGIN PROPRIETARY]

MCI Acquisition – Savings to Verizon (2006 – 2009)	
Item	**Total Verizon**
($'s in millions, nominal)	

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F. ***Transaction Costs***

Although the aggregate synergy estimates described above reflect the implementation costs necessary to achieve those synergies, they do not include the costs of consummating the transaction. Such transaction costs must be deducted from the synergy analysis.

Verizon estimates that its share of the transaction costs will amount to approximately **[BEGIN PROPRIETARY]** ******* **[END PROPRIETARY]** . This includes costs of investment bankers, outside counsel, accountants, and other professionals. We deducted this amount from Verizon's share of the synergies, applying the deduction pro rata against each category of synergies allocated to Verizon.

G. ***Washington Allocation***

We allocated the remaining net transaction-related synergies to Verizon Washington. We allocated cost savings in accordance with cost allocation procedures that Verizon uses in the ordinary course of business. In network operations, we attributed the cost savings associated with avoided vendor costs to Verizon Washington based on a specific identification of circuits. This resulted in an attribution of .37% of those cost savings to Verizon NW. Finally, we allocated 1.38% of the cost savings associated with headcount reductions in the enterprise and wholesale lines of business to Verizon Washington.[1]

We allocated **[BEGIN PROPRIETARY]** **** **[END PROPRIETARY]** of the remaining ESG revenue synergies, and **[BEGIN PROPRIETARY]** **** **END PROPRIETARY]** of the remaining SMB revenue synergies, to Verizon Washington. These allocations are based on the amounts historically earned by Verizon Washington from these customers as a percentage of revenue earned from such customers by Verizon nationwide.[2]

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[1] Theoretically, a portion of the headcount reductions in network could relate to operations in Washington. We did not allocate those savings to Washington, however, because the Verizon headcount reductions relate entirely to long distance and out of franchise activities, which are not conducted by Verizon NW and which are not subject to the type of regulation that the Commission exercises with respect to Verizon NW.

[2] A portion of the revenues that we expect to earn in Washington would be from sales made by Verizon subsidiaries other than Verizon NW. We did not attempt to isolate those revenues at this stage of the allocation process. The revenues earned by entities other than Verizon NW would be non-regulated or interstate and are therefore excluded from the analysis by means of the division of services into those jurisdictional categories, which is discussed below.

The following table illustrates the remaining synergies that we attributed to Verizon Washington.

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	Total Verizon
Item	**WA**
($'s in millions, nominal)	

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H. ***Jurisdictional Split***

We excluded synergies that Verizon NW will realize in operations beyond its intrastate regulated operations. Accordingly, we excluded revenue and cost savings attributable to interstate services regulated by the Federal Communications Commission, unregulated services, and services provided by entities other than Verizon NW.

Network: We excluded 100% of the cost savings from domestic transport, international savings, and avoided costs of constructing Verizon's long-haul network. These costs relate entirely to long-distance services. We excluded 100% of Verizon's avoided capital costs of constructing facilities out of franchise.

We excluded approximately 36% of the vendor savings for private line services because they relate to the costs of interstate services.

Other: With respect to the cost savings resulting from headcount reductions that were allocated to Verizon NW, a portion are properly allocated to non-regulated and interstate services. Based on historical data, this results in an exclusion of 34% of the headcount cost savings allocated to Verizon NW.

Revenue Synergies: We excluded a portion of the revenue synergies allocated to Verizon NW because they relate to unregulated or interstate operations. We examined each of the services that form the basis for the aggregate estimate of revenue synergies to determine their regulatory classification. We excluded services such as interstate long-distance, hosting, IP-VPN services, ATM, and other IP-based services. For revenues synergies that are not based on specific services (e.g., general new customer growth), we allocated the revenues among interstate, unregulated, and intrastate based on historical ratios. We further reduced the revenue amounts by the proportionate cost of sales necessary to achieve the synergies.

The following table illustrates the remaining synergies that we attributed to Verizon NW.

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Annual Synergies For WA Intrastate Operations				
	2006	**2007**	**2008**	**2009**
Item	**VZ-WA**	**VZ-WA**	**VZ-WA**	**VZ-WA**

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NET PRESENT VALUE OF REMAINING SYNERGIES OVER THE LONG-TERM

As a final step in the analysis, we converted the remaining synergies into a net present value of income over four years, using Verizon NW's weighted average cost of capital of 8.68%.

The following table illustrates the net present value of the annual synergies attributable to Verizon NW.

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Verizon-WA Net Present Value Calculation					
Item		**2006**	**2007**	**2008**	**2009**

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