Exhibit No. _____(CRD-3T)
Docket No. UT-050814
Witness: Carl R. Danner

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of **Verizon Communications Inc. and MCI, Inc.** **for Approval of Agreement and Plan of Merger**	)	**Docket No. UT-050814**

REBUTTAL TESTIMONY OF

CARL R. DANNER

ON BEHALF OF

VERIZON COMMUNICATIONS INC.

REDACTED VERSION

October 6, 2005

Confidential per Protective Order in
WUTC Docket No. UT-050814

TABLE OF CONTENTS

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Carl R. Danner. I am a Director with Wilk & Associates/LECG LLC, 201 Mission Street, Suite 700, San Francisco, CA 94105. I filed direct testimony in this proceeding that described my experience and qualifications.

Q. WHAT IS THE PURPOSE OF YOUR REPLY TESTIMONY?

A. In this reply testimony, I address the public policy concerns raised by the testimony of several opposing parties, including the Office of Public Counsel (OPC), the Commission Staff (Staff), XO Communications Services, Inc. (XO), and Covad Communications Company (COVAD). I also offer a broader policy perspective on various issues that are addressed in greater detail by the other witnesses for the Joint Petitioners, Verizon Communications Inc. ("Verizon") and MCI Inc. ("MCI"). Reply testimony is being filed on behalf of Joint Petitioners by Dr. William Taylor, in which Dr. Taylor explains why assertions of competitive harm raised by other parties are unfounded. Mr. Michael Beach of MCI explains why other parties have overstated the significance of MCI's competitive activities in Washington. Ms. Julie Canny of Verizon discusses why Integra's claims reflect only incidental issues that present no systematic problem and need not be addressed in this proceeding. And Mr. Steven Smith of Verizon details the numerous and serious flaws in other parties' synergy analyses.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. As I stated in my initial testimony, the Commission should either declare that it does not have jurisdiction to review this parent company transaction, or, alternatively, it should approve the merger without any conditions. If the Commission does have authority to review a parent company merger, the testimony of the Joint Petitioners demonstrates that this transaction will not cause harm and is in the public interest.

In contrast, opposing parties seek to impose conditions or extract concessions from the Joint Petitioners based on unsubstantiated declarations that such conditions are necessary to mitigate harm caused by the transaction. Opposing parties fail completely, however, to proffer any credible evidence of harm. In the absence of any proof of harm resulting from this merger, there is no basis for considering the purported mitigating measures that the opposing parties demand.

In addition to the lack of support for any finding of harm and any concomitant need for mitigation, many of the conditions sought by the opposing parties are not justified on public policy grounds or are otherwise inappropriate and unreasonable. The proposed conditions address concerns that are not related to nor affected by the transaction, are inconsistent with existing regulatory requirements, are inconsistent with decisions already made by this Commission, the Federal Communication Commission (FCC) and the federal courts, or are completely beyond the jurisdiction of the Commission in any event. Although I am not a lawyer, it is poor public policy for the Commission to embrace proposals that are inconsistent with FCC, Commission and federal court precedent under the Telecommunications Act of 1996 (Telecom Act). In light of these defects in the opposing parties' arguments, I urge the Commission to reject the proposed conditions, and to approve the merger unconditionally.

The reasons why each proposed condition should be rejected are discussed in detail in the testimony which follows, but in summary, the Commission should reject proposals such as the following:

- Covad, through its witness Mr. Gillan, urges the Commission, contrary to the Telecommunications Act, to impose RBOC rules on Verizon's operations in Washington and to price wholesale services in a manner inconsistent with FCC rules;
- Public Counsel, through its witnesses Mr. Roycroft and Mr. King, seeks to impose a host of conditions on the merged entity, while failing to provide any credible evidence that the proposed conditions are necessary. With respect to the various conditions proposed, they are either outside of the state's jurisdiction (*e.g.*, DSL and VoIP regulation), irrational in the current market (*e.g.*, rate regulation of the competitively classified MCI, and demands for various rebates/waivers), excessive, and blatant attempts to extract unwarranted concessions from the Joint Petitioners (*e.g.*, broadband mandates and synergy "sharing" demands) in order to gain regulatory approval that should be based solely on the merits of the case, or are unfair and discriminatory conditions that would be applied only to the Joint Petitioners (*e.g.*, service quality "enhancements") and not to other service providers in Washington.

- Commission Staff, through witnesses Ms. Roth, Mr. Wilson and Ms. Folsom, also demand certain conditions that are not related to the transaction and are not justified. (For example, customers for long distance and local service already freely switch carriers and need no new incentives to do so.) Staff's proposed conditions are discussed in greater detail below.

The arguments of the opposing parties are at best distractions from what should be the narrow focus of this proceeding. As an initial matter, this is a merger involving the parent companies of the regulated utilities operating in Washington, and as such, the Joint Petitioners continue to stress that there is no need for the Commission to review this transaction at all.[1] To the extent that the Commission has deferred resolution of that issue and has chosen to undertake this review, its review should be focused solely on whether this transaction will cause any harm or adversely affect rates and/or service quality in Washington.

At worst, the demands of opposing parties demonstrate that they view this proceeding as an opportunity to obtain private gain or to extract unwarranted conditions. The implicit suggestion contained in all of these demands, however, is that Verizon and MCI must pay a "toll" for merger approval, however inappropriate and otherwise unjustifiable such demands may be. Indeed, many of the conditions that opposing parties advocate as essential "mitigation" to the harms allegedly caused by this proposed transaction are demands that the parties sought and lost in prior proceedings and/or separate venues. As

[1] See Joint Petition of Verizon Communications Inc. and MCI, Inc., paras. 18-31.

set out in more detail below, these matters are uniformly unrelated to the impact of the transaction at issue, have been or will be considered by this Commission or the federal authorities in separate, more appropriate proceedings, are beyond this Commission's jurisdiction and/or would not benefit the very customers on whose behalf they purportedly are proposed. To the extent that the Commission decides to exercise jurisdiction over this parent company transaction, it should adhere to its precedents and limit its analysis to whether the transaction will cause "no harm," and is otherwise in the public interest, as the statute requires.

Q. OPPOSING PARTIES ASSERT THAT THE MERGER WILL CREATE HARM AND THAT THEIR PROPOSED CONDITIONS WOULD MITIGATE SUCH HARM. WHY ARE THEY WRONG?

A. These parties offer no facts that substantiate their blanket allegations of harm. In contrast, the Joint Petitioners have offered – and provide more detail in this round of reply testimony – proof that the transaction will not cause harm in Washington, nor will it adversely affect rates or service quality. The allegations of potential harm proffered by opposing parties are designed not to inform the Commission with relevant data, but rather to support demands for alleged mitigation remedies that favor the interests of those parties or their constituencies. As is discussed below and in the testimony of other witnesses for the Joint Petitioners, there is no potential harm that will be caused by this transaction and no opposing party has proffered genuine evidence of such harm. In the absence of such evidence, there is no reason for the Commission to impose any conditions on this merger.

Q. HOW DO JOINT APPLICANTS REBUT OPPOSING PARTIES' ALLEGATIONS OF POTENTIAL HARM TO COMPETITON RESULTING FROM THIS MERGER?

A. Our rebuttal is extensive and provides considerable Washington-specific information that was lacking, for the most part, from opposing parties' testimony. First, the testimony of Dr. Taylor discusses the complementary nature of the assets and business activities of Verizon and MCI. As Dr. Taylor explains, there is no economically significant overlap of customers or of facilities in Washington. Second, as both Mr. Beach and Dr. Taylor also discuss, there is no competitive harm to mass market customers because of the current state of MCI's mass market business. The facts demonstrate that even absent this merger MCI is not now and will not be in the future a competitive force in the mass market. Third, as Dr. Taylor and Mr. Beach discuss, there is no competitive harm in the enterprise market in Washington because MCI's and Verizon's subsidiaries do not compete for the same customers in providing services to enterprise customers. Fourth, given the limited overlap of facilities and MCI's inability to constrain Verizon's pricing for special access services, the transaction will not harm competition for special access services. Finally, there is no factual support for the opposing parties' speculation about the merger's effect on rates and service quality. As was made clear in the Joint Petition and as reiterated in the reply testimony, the merger agreement does not call for any change in the operations of the Verizon and MCI subsidiaries in Washington, nor in the rates, terms and conditions of the regulated services of those subsidiaries. Thus, there is no basis for Public Counsel's presumption that MCI customers will become Verizon customers (or vice versa) and certainly no basis for Public Counsel's presumption that

MCI, a competitively classified carrier, should be subject to traditional rate regulation. There is ample record evidence that both the mass market and the enterprise market are competitive in Washington and that such competition will continue after the merger. MCI's rates will continue to be determined by that competitive environment. And even if the Commission is not convinced that competition alone will discipline Verizon's rates, the Commission retains regulatory authority to exert such discipline itself, if necessary, at an appropriate future date. Thus, in the absence of a credible and substantiated showing of any harm, there is simply no reason for the Commission to consider the various "remedies" proposed by opposing parties.

Q. WILL THE PUBLIC INTEREST BE HARMED IF THE OPPOSING PARTIES' CONDITIONS ARE IMPOSED?

A. Yes. There can be significant and damaging public interest consequences from engaging in such regulatory "taxation" when companies seek to merge, particularly where, as here, there is no nexus between the concessions or costs demanded and the facts of the case. As in this case, corporate mergers are often pursued to create synergies, that is, to increase business efficiencies and maximize cost savings. Companies may also seek to create more attractive products for customers by banding together than either of them could create as stand alone enterprises. Certainly these are the primary motivating factors for this merger. When government is urged to react to such business restructuring by extracting a fee from the merging companies just because opposing parties recognize that the agency has leverage at that moment, the result can be to decrease, deter or delay the benefits of the merger and deprive consumers of some portion of benefits that the transaction promises. Where, as here, there is no demonstration of harm, it would be more prudent for the Commission to forego conditions that themselves could be damaging.

Q. ASSUMING THE COMMISSION HAS JURISDICTION TO REVIEW THE MERGER, DO APPLICANTS NEED TO DEMONSTRATE THAT THE COMMUNICATIONS SERVICES MARKET IS COMPETITIVE IN ORDER TO SATISFY THE PUBLIC INTEREST STANDARD?

A. No. This is not a case where Verizon Northwest is seeking competitive classification of its regulated intrastate services, and therefore Joint Petitioners need not prove that any particular level of competition exists for all communications services. Competition in the market only becomes relevant if there is a credible showing that the merger will cause anti-competitive harm. Where, as here, there is no such showing, there is no burden on the Joint Petitioners to demonstrate the degree of competition in the market. As the Joint Petitioners' testimony shows, any changes resulting from this transaction will have no adverse impact on customers or on competition in Washington, particularly with regard to regulated services under this Commission's jurisdiction. For example, as Mr. Beach discusses, the steps that MCI has taken to manage the decline of its mass market business include increasing retail rates, decreasing sales efforts, substantially reducing the work force devoted to mass market selling and fundamentally maximizing the remaining revenue stream from its mass market products. MCI has taken these steps in Washington and nationally. As a result, MCI's mass market business does not now and would not in the future constrain Verizon's prices for services provided to mass market customers, without regard to the merger. Further, since MCI focuses primarily on the largest business customers in its enterprise efforts, both in Washington and nationally, there is no harm to enterprise customers, which will continue to be served by a host of providers and which are not significant purchasers of Verizon's services in any event. What the evidence does demonstrate is that the combination of Verizon and MCI will create a more robust competitor for targeting enterprise customers, creating a tangible benefit for such customers.

Q. YOU MENTION THAT MCI HAS A NATIONAL FOCUS FOR BOTH ITS MASS MARKET BUSINESS AND THAT VERIZON HOPES TO BECOME AN EFFECTIVE NATIONAL ENTERPRISE COMPETITOR. WHY ARE THOSE FACTS RELEVANT TO THE COMMISSION'S DELIBERATIONS?

A. As the Joint Petitioners have stated consistently, the primary purpose of the merger is to enhance their abilities to compete and serve enterprise customers in a marketplace that is national and increasingly global in scope. Given the breadth of the companies' operations, the merger is appropriately being reviewed by the FCC and the Department of Justice, each of which will evaluate the public interest and competitive effect of the merger on a nationwide basis. Notably, some of the parties participating in the proceedings before this Commission (including XO and Covad) have made their views known at the federal level and have raised some of the same issues that they raise here. While this Commission has a responsibility to consider the effects of the merger in Washington, it should recognize the broader context in which the transaction is occurring, and limit its review to matters properly within its authority. It should not accept the invitation of some opposing parties to stray beyond its jurisdiction and to take action in this proceeding that conflicts with federal policy, decisions, rules, or legislation. While these parties may disagree with the merits of current federal law or rules – which are the product of extensive debate and litigation – this is not the proceeding or forum in which to address those grievances. The Commission should ignore attempts to interject such extraneous issues and arguments in this proceeding, and focus only on the transaction at hand. To the extent any of those issues has merit – which is doubtful – the federal authorities will address them. The Washington Commission does not need to deal with those concerns.

Q. HAVE OTHER REGULATORY AUTHORITIES EITHER APPROVED THE MERGER, OR DECLINED TO ASSERT JURISDICTION TO REVIEW IT?

A. Yes. MCI and Verizon combined operate in every jurisdiction in the country, but only approximately half of those jurisdictions have any legislative authority to review a parent company transaction such as this one. Of those, the transaction has either been affirmatively approved or the commission has declined to review it in 18 jurisdictions.[2] Proceedings to review the transaction are still open in 11 states and the District of Columbia. Of all the states that have rendered a decision to date, no substantive conditions have been imposed on the merger.[3]

---

[2] States that have either affirmatively approved the transaction or declined to act on it are Colorado, Connecticut, Delaware, Georgia, Hawaii, Louisiana, Maryland, Minnesota, Mississippi, Missouri, Nebraska, New Hampshire, Nevada, North Carolina, Oklahoma, Tennessee, Utah, and Wyoming.

[3] Notably, Covad's witness, Mr. Wood, cites only to staff analyses in two jurisdictions, analyses that have not been adopted in any Commission order. Wood Reply at 21-22. Joint Applicants suggest that the decisions *actually rendered* by other state commissions are more relevant and compelling. *See, e.g.*, *Order Approving Transfer of Control*, State of North Carolina Utilities Commission, Dkt. Nos. P-19 Sub 487 and P-474, sub 16, issued April 27, 2005, at 3: "Based upon the foregoing Findings of Fact and the entire record in this proceeding, the Commission concludes that the request to transfer control of MCIMetro through the acquisition of MCI by Verizon is justified by

Q. HOW DO YOU ELABORATE ON THE PUBLIC POLICY ISSUES IN THE REMAINDER OF YOUR TESTIMONY?

A. In the remaining sections of my reply testimony, which complements the reply testimony of Dr. Taylor, Mr. Beach, Ms. Canny, and Mr. Smith, I rebut the arguments of the opposing parties as follows:

- First, an accurate assessment of this merger demonstrates that Washington will obtain economic benefits from the transaction.
- Second, as Dr. Taylor demonstrates in his testimony, the opposing parties have not successfully demonstrated any harm that could arise from this transaction and, therefore, the imposition of proposed "mitigating" conditions would be bad public policy. Thus, regulatory mandates to cut rates, change service quality requirements, provide incentives for customers to switch to other carriers, or to provide unwarranted benefits to competitors are unnecessary and counter productive.
- Third, the particular proposed "mitigating" conditions are unwarranted, and in some cases outside of the Commission's authority to adopt. In particular, drawing on the discussion of synergy savings in Mr. Smith's testimony, I discuss the policy implications of the demands by Public Counsel and Staff that the

---

the public convenience and necessity for several reasons as set forth in the Application and generally described above and should be approved pursuant to G.S 62-111(a)." *See also*, Order of the Public Utility Commission of Hawaii, Decision & Order No. 22023, issued September 12, 2005, at 16-17: "The Proposed Merger appears to be a union of two (2) complementary companies that that can more effectively and efficiently provide services to their customers as a merged entity rather than on a stand-alone basis. Verizon's financial strength should stabilize MCI and assure MCI customers that they will continue to be served by a strong telecommunications provider. The Proposed Merger should provide growth opportunities for both subsidiaries of Verizon and MCI. Among other things, Verizon will have access to MCI's Internet backbone, while MCI shall have the opportunity to integrate a full range of wireless services into its line of offerings. Applicants' customers should benefit since they will be assured communications services through providers with a strong parent company and should have access to new product lines and services. For these reasons, we find the Proposed Merger to be reasonable and in the public interest."

Commission mandate the way in which synergies benefit customers of the combined company.

II. THERE ARE SUBSTANTIAL ECONOMIC BENEFITS THAT WILL ACCRUE TO WASHINGTON CUSTOMERS

Q. WILL THE MERGER CREATE ECONOMIC BENEFITS FOR WASHINGTON?

A. Yes, as the Joint Petitioners have already testified, the merger will capitalize on the complementary assets of Verizon and MCI and create new competitive options for enterprise customers nationwide and in Washington.

Q. HOW WILL ENTERPRISE CUSTOMERS BENEFIT FROM THE MERGER?

A. As discussed in the testimony of Dr. Taylor and in my initial testimony, enterprise customers (which include large business customers, as well as government customers and institutions) are among the most sophisticated consumers of communications services. They typically require services at multiple locations, and often require customization of network functions and systems. These customers generally purchase complex, integrated packages of voice and data services through competitive procurement practices (such as bidding and Requests for Proposals) or individually negotiated contracts. Under such contracts, voice is just one of many applications that ride over the networks deployed to serve these customers. Although Verizon has been working to increase its enterprise business for several years, it still has a relatively small share of this business in its operating territories and even less presence outside its operating territories. By joining Verizon's and MCI's complementary assets and experienced sales forces, the transaction will make the post-transaction company more competitive across the enterprise segment than either company would be alone. Verizon's local and regional presence and its substantial wireless investment, coupled with MCI's enterprise sales expertise and innovative product offerings, will allow the new firm to provide enterprise customers with a suite of products and services capable of addressing the full range of these customers' needs.

As a result of the merger, enterprise customers in Washington will benefit from the creation of a stronger competitor with the network reach and financial resources to compete effectively with other enterprise service providers, including Qwest, in this technologically intensive and highly competitive segment. Government customers will benefit and national security will be enhanced by the planned investment in the national and international communications infrastructure that is relied on by the Departments of Defense and Homeland Security, as well as other federal and state agencies. The fact that Verizon has already committed to a $2 billion investment in MCI's network and information technology platforms is strong evidence of the benefits that Verizon's financial strength can bring to important MCI assets.

Relying on the complementary network assets of Verizon and MCI will also bring substantial benefits to enterprise customers. Verizon has an extensive network with substantial local fiber within its region and Verizon Wireless has one of the most advanced and extensive wireless networks in the country. MCI has a global fiber optic long-distance network and global data capabilities employing private line and packet-switched data services such as ATM and Frame Relay. In addition, one of MCI's most valuable assets and core strengths is its extensive IP-based backbone network and related expertise. This combination of network assets will benefit customers by enabling them to obtain all of these capabilities in a single transaction, and at the competitive pricing permitted and encouraged by the more efficient operation of these networks. The transaction also will allow Verizon to utilize MCI's ISP connectivity services (such as e-mail, web hosting, and others) in ways that will enhance its capabilities in a segment in which Verizon is a small provider at present.

The Verizon/MCI combination of product offerings will provide a stronger, and geographically broader, converged solution for enterprise customers. Verizon currently has strong IP-based offerings, but they have limited reach within its area footprint, and Verizon is not a major provider of IP-based services. As noted above, one of MCI's core strengths is its global Internet backbone, which provides global IP connectivity today, and will be able to provide next-generation VoIP and other IP-based services worldwide tomorrow. The combined company will thus be able to offer converged IP-based solutions to enterprise customers with national and global needs, and so will be able to grow its application services on a broader scale.

Of particular significance in Washington, Verizon Northwest currently has only a limited ability to compete for enterprise customers within Qwest's service territory because of the limited reach of the Verizon network. MCI, by contrast, has backbone facilities and local points of presence in Qwest's service area that will enable the combined company to compete successfully for many enterprise accounts – both business and government – that neither could obtain independently.

Q. HOW WILL THE MERGED COMPANIES BETTER BE ABLE TO COMPETE AGAINST QWEST TO SERVE ENTERPRISE CUSTOMERS IN WASHINGTON?

A. At present, Verizon Northwest has only a limited ability to compete "out of franchise" in Washington (i.e., within Qwest's service area) because of the limited reach of its network. MCI, for its part, is a strong competitor in the enterprise space but will also gain strength in Washington through the addition of Verizon Northwest’s local facilities, and Verizon Wireless. The opportunities the combined companies will be better positioned to serve include, for example, Washington statewide enterprise customers, and customers with a number of locations spread across Verizon Northwest and Qwest service areas.

As one case in point, the State of Washington operates a statewide network that serves state agencies and educational institutions from elementary school through college levels. Qwest currently provides the overwhelming majority of these facilities and services through contracts that generally expire in 2006, and which will be ripe for rebidding at that time. With the combination of their assets, Verizon Northwest and MCI may be able to win some of this business by offering the State more attractive services, prices, and/or terms. Whatever the outcome, the state likely will benefit from a robustly competitive procurement process. As another example, there are a number of regional medical operations that have multiple facilities in western Washington. These facilities have multi-locational network requirements for imaging and large data file transfers that Verizon and MCI will be better positioned to meet through the use of Verizon Northwest's in-region network and MCI's points of presence and other facilities inside Qwest's local serving area. Once again, these enterprise customers will gain economic benefits from the superior services, prices, and/or terms that Verizon and MCI would have to offer to win such business.

Finally, to help illustrate how Verizon and MCI will complement each other's facilities for serving enterprise customers in Qwest's territory, Mr. Beach has included two confidential maps as attachments to his testimony. The first shows how MCI's existing fiber, points of presence and lit buildings within Qwest's territory complement Verizon's local service area and facilities in the Seattle-Tacoma-Bellevue area. The second map shows the downtown Seattle area (all within Qwest's territory), and highlights similar MCI facilities at a more detailed level. These maps provide a visual, intuitive confirmation of the advantages the merged companies will gain for competing against Qwest.

Q. WHY ARE BENEFITS SUCH AS COSTS SAVINGS AND IMPROVED COMMUNICATIONS SERVICES FOR ENTERPRISE CUSTOMERS IN THE PUBLIC INTEREST?

A. Washington-based enterprise customers include a wide range of businesses, such as retail store chains, banks, government agencies, educational institutions, major software companies, and aerospace firms. Such entities provide employment for Washington residents and the costs that such enterprises incur matter a great deal (note, for example the widespread concern about the impact on the national economy of rising fuel costs to businesses). Moreover, residents of Washington and institutions operating on their behalf (such as pension funds) invest in securities offered by these enterprise customers to build wealth and security for retirement. As a result, if communications services can be provided at reduced costs or services can be improved as a result of this transaction, these benefits to enterprise customers have a positive effect on the state's economy as a whole.

.

As well, specific technologies developed for enterprise customers may provide benefits to consumers in their use of the products and services that enterprise customers offer. In addition, some technologies originally developed for industrial and commercial use ultimately are used directly by mass market customers. The Internet itself is a classic example of such a development, as it was originally intended for use by the Defense Department and for university research purposes. Finally, an enhanced backbone network will continue to be used both by enterprise customers and mass market consumers.

Q. WHY IS IT IN THE PUBLIC INTEREST FOR VERIZON AND MCI TO BE BETTER POSITIONED TO COMPETE WITH QWEST?

A. The Commission has long endorsed the value of competition and it should embrace this transaction because it will better facilitate competition. Energizing stronger competition against the largest carrier in the state will inevitably result in more competitive pricing and services and improved service quality for customers, ultimately benefiting the state's economy as well. Moreover, the combined Verizon/MCI will pose a competitive alternative to Qwest's local facilities and high-capacity broadband backbone network, again resulting in competitive pricing and services to customers. For these reasons, failure to approve the merger, or imposing undue financial burdens upon it, would actually be anticompetitive and would harm the public interest. Indeed, as Dr. Taylor and Mr. Beach discuss, the competitive reality is the opposite of the scenarios advanced by those parties that suggest that Verizon and MCI might refrain from competing with other ILECs. There is no evidence of past collusion of the type they suggest and no rational economic reason for such collusion going forward.[4]

Q. DR. ROYCROFT SUGGESTS THAT SOME OF THESE BENEFITS COULD ACCRUE WITHOUT THE ACQUISITION. FOR EXAMPLE, RATHER THAN ACQUIRE MCI, VERIZON COULD SIMPLY PURCHASE BACKBONE SERVICES FROM MCI UNDER CONTRACT. (ROYCROFT, PAGE 25) WHY IS THE MERGER PREFERABLE?

---

[4] In a formal opinion recommending approval of the Verizon-MCI transaction, the California Attorney General succinctly summarized the absurdity of the opposing parties' arguments on this point:

> "[T]he opportunity costs of pursuing such a strategy would be enormous and would have little chance of success. Verizon states that it is pursuing this merger to acquire MCI's national and global customer base, and the facilities required to serve them. The majority of these customers require a comprehensive network – like MCI's – that extends well beyond the Verizon region and into the service territories of SBC and other ILECs. The combined company will be ceding these customers to the many competitors in the enterprise market, along with much of the multi-billion dollar investment in MCI, if it limits the scope of its operations to the Verizon territory it currently serves. Furthermore, through its investment in Verizon Wireless, Verizon competes directly with SBC and other ILECs for wireless customers in many of the country's largest MSAs, highlighting the inaccuracy of the charge that Verizon and SBC have historically refused to compete in each other's territories."

In the Matter of the Joint Application of Verizon Communications Inc. and MCI, Inc. to Transfer Control of MCI's California Utility Subsidiaries to Verizon, before the Public Utilities Commission of California, No. 05-04-020, Opinion of the Attorney General on Competitive Effects of the Proposed Merger of Verizon Communications Inc. and MCI, Inc., filed Sept. 16, 2005, at 17-18.

A. Leasing of network capacity does not provide the same degree of operational and quality control over an asset as does the ownership that will occur through this merger, which brings the service providers under the same corporate umbrella. Unified management permits more effective provisioning of services and better quality control of the resulting network (including a better ability to diagnose and repair network faults or problems that do not need to be traced between multiple providers). These operational improvements facilitate more reliable service to customers. Dr. Roycroft's analysis also overlooks the fact that in addition to purchasing MCI's extensive network facilities, Verizon is obtaining MCI's experienced account teams, who have long-standing relationships with enterprise customers. These human assets will better enable Verizon to compete in the global market for enterprise customers and are not a capability that could be obtained from another company on a contract basis.

III. OPPOSING PARTIES FAIL TO DEMONSTRATE ANY HARM RESULTING FROM THE MERGER

Q. DO OPC AND STAFF IDENTIFY ACTUAL CONSUMER HARM THAT WILL STEM FROM THEIR CLAIMS OF ENHANCED MARKET POWER FOR VERIZON NORTHWEST?

A. No. Neither Dr. Roycroft nor Ms. Roth identifies how Verizon Northwest might be able to raise prices or disadvantage customers with regard to the intrastate services Verizon Northwest offers in Washington. Dr. Roycroft repeatedly asserts that the merger will result in increased market power for Verizon Northwest, but never identifies anything specific that would occur except to speculate on some scenarios that might unfold in the absence of regulation. (Roycroft, pages 77-78) As explained above, the transaction will have no incremental adverse effects, as MCI does not, and would not absent the merger be able to, constrain Verizon's pricing of intrastate services. On behalf of Staff, Mr. Wilson performs HHI calculations and Ms. Roth states that the results show increasing concentration and market power – but neither identifies any specific adverse consequences for customers.[5]

Q. WHAT IS STAFF WITNESS FOLSOM'S CONCLUSION REGARDING THE FINANCIAL EFFECT OF THE MERGER?

A. She states that, based on her review of broad financial indicators, "it does not appear likely the merger will be harmful." (Folsom at 29). The Joint Applicants agree.

IV. THE PROPOSED CONDITIONS SHOULD NOT BE IMPOSED

A. SYNERGY SAVINGS AND CUSTOMER BENEFITS

Q. PLEASE CLARIFY WHAT IS MEANT BY THE TERM SYNERGIES IN THE CONTEXT OF THIS MERGER.

A. In this context, "synergies" are either added revenues from the increased sale of services, the retention of current revenues that would otherwise be lost to competitors, and cost savings that the merger is expected to generate by reducing expenses that the companies would otherwise incur. The Public Counsel and Staff have attempted to calculate their own synergy analysis, but they have erred. Mr. Smith's testimony addresses the errors in

[5] The other specific allegations of competitive harm that these witnesses make relate to the absence of MCI as an independent competitor,– points that Dr. Taylor and I address elsewhere. I address concerns about special access services, below.

their calculations; my testimony addresses the related policy issues raised by the Staff's and Public Counsel's recommendations.

Q. WHY SHOULD THE COMMISSION NOT ACCEPT PUBLIC COUNSEL'S AND STAFF'S PROPOSALS FOR THE FLOW THROUGH OF MERGER SYNERGIES?

A. First, their calculations of the merger synergies are wrong, as explained by Mr. Smith. For that reason alone, they cannot be relied upon for purposes of Commission decision-making. Second, the other parties ignore the fact that merger benefits will flow through to customers without such explicit mandates. As explained more fully below, the projected merger synergies represent economic gains that will benefit customers of the merged company via competition, without any need for regulatory-driven, mandated outcomes. Third, even if one assumes (erroneously) that competition will not pass through synergies to customers, the Commission has the power to address this issue in a subsequent rate case. Staff's and Public Counsel's arguments on synergy flow-through fail to recognize that Verizon Northwest is subject to rate-of-return regulation. Under this form of regulation, the Commission must examine Verizon Northwest's intrastate operations in total and provide the company an opportunity to earn a reasonable rate of return. Thus, contrary to Staff's and Public Counsel's arguments, the Commission cannot (and should not) reduce Verizon's overall revenue requirement in piecemeal fashion.

Q. PLEASE EXPLAIN HOW COMPETITION WILL ENSURE THAT CONSUMERS BENEFIT FROM THE MERGER.

A. Given the powerful market forces driving the communications industry today, as discussed in the testimony of Dr. Taylor, the Commission need not explicitly allocate economic benefits to customers. Rather, the Commission can rely upon market forces to ensure that an equitable share of such benefits flow to customers. The methods proposed by Public Counsel and Staff, in contrast, are not appropriate for achieving anything in particular except extracting a payment, in effect, for merger approval.

This is particularly true, for example, in examining cost savings resulting from this merger. As Mr. Smith discusses, there are likely to be headcount reductions and network cost savings that affect the enterprise and long distance lines of business. In keeping with the actions of its rivals (who are also working to achieve efficiencies), the combined firm will be compelled by market forces to flow through savings in the form of lower prices for the services that face the most competition – long distance and enterprise alike. Competition will not permit the combined companies to retain any "windfall" profits.

Since, as Dr. Taylor discusses, the communications market in Washington is characterized by vigorous competition today, customers will reap the benefits of this transaction in various ways. The competitive process of which this merger is a part will continue to deliver more competitive prices, improved quality, newer, better, and more advanced service offerings, and increased investments. Customers will benefit from the consumption of the new services that the firm may be able to provide due to the transaction. The extent of such competition is evident. For example, Qwest just announced a partnership with Microsoft to offer VoIP-based services to small businesses,[6] an initiative that presumably will place added competitive pressure on the combined Verizon and MCI in Washington. As another example, America Online intends to leverage its brand name to offer its own VoIP service, beginning this month, to anyone with a broadband connection (not just AOL customers).[7] Comcast has begun its rollout of "Digital Voice" telephone service in western Washington, to include interconnection with existing home phone jacks and wiring.[8] All of these service offerings will integrate phone service with advanced computer and Internet features such as email and instant messaging. In order to compete in this market, Verizon and MCI will need to compete on price and quality, which the synergies from this transaction will help them to do. All of the services I mentioned are good examples of the competitive pressures that will result in economic benefits from the merger synergies, without any compulsion by the Commission.

Consumers and producers both benefit from market transactions and this is one of the fundamental bases of our market economy. For instance, as discussed in Mr. Smith's testimony, revenue synergies will result from expanding the product line and offerings to enterprise customers, as well as to smaller businesses. While it is anticipated that improved revenue from these new offerings will accrue to both MCI and Verizon, the businesses purchasing these new services will also gain from access to new

---

[6] "Qwest, Microsoft Team to Offer Small Firms Web-Phone Service," Wall Street Journal, September 21, 2005, page A25.
[7] "AOL to Launch VoIP Service," Wall Street Journal, September 20, 2005.
[8] "Comcast to deliver web phone service soon," Seattle Times, September 23, 2005. (http://seattletimes.nwsource.com/html/businesstechnology/2002514348_comcast23.html, accessed 9/29/05)

communications functionalities. Although the amount of such consumer benefit cannot be quantified with certainty, it clearly exists, otherwise businesses would not purchase these new services. In other words, the projected revenue synergies only exist to the extent that customers have *already* benefited from new services by purchasing them. There is no reason for the Commission to engineer an explicit flow through when customer gains will occur as a natural outcome of this merger.

Q. ASSUMING FOR SAKE OF ARGUMENT THAT COMPETITION WOULD NOT PROVIDE BENEFITS TO CUSTOMERS FROM SYNERGIES, HOW WOULD THESE SYNERGIES BE TREATED IN THE USUAL COURSE OF REGULATION OF VERIZON IN WASHINGTON?

A. First, the Commission does not regulate Verizon, but rather its subsidiary, Verizon Northwest Inc. Verizon Northwest is still subject to traditional rate of return regulation (ROR). Under ROR regulation, the Commission determines an authorized rate of return on the regulated firm's allowed investment and then sets rates that are expected to yield that return. (This ratemaking approach is consistent with RCW 80.28.020, which states that the Commission "shall determine the just, reasonable, or sufficient rates.") In Washington, the Commission relies upon a historic test year to determine the investment, earnings and authorized return. That is, it looks at the actual investment, expenses and revenues of the regulated firm during a recent twelve month period in order to set new rates designed to yield the authorized return. The firm operates under the resulting authorized rates until either it believes another rate case is necessary to address low earnings, or until the Commission initiates a formal review of the firm's earnings.

Under ROR regulation, therefore, if any retained synergies or financial benefits of the transaction (in excess of merger implementation costs) were to increase Verizon Northwest's earnings above its authorized ROR, notwithstanding all the changes in other costs and competition that will occur in the mean time, the Commission could initiate a rate case to adjust its rates.[9] Of course, there is no assurance what the combined financial impact on Verizon Northwest will be of factors such as increased competition, technological change, new investments, innovative service offerings that may occur, and increases in the company's costs. But, even if it were reasonable to conclude (incorrectly) that the effects of competition would not pass through any Washington-specific synergies to customers, the Commission has the authority to address the issue in a rate case if it chooses.

It is also worth noting that ROR regulation cannot justify a rate reduction if earnings are low, as they are now for Verizon Northwest. Currently, even a substantial reduction in Washington-jurisdictional costs would not increase Verizon Northwest's earnings above their authorized level.

Q. IS IT REASONABLE TO DEMAND THAT RATES BE ADJUSTED NOW TO REFLECT POTENTIAL NET SYNERGIES THAT WILL NOT OCCUR FOR SEVERAL YEARS?

A. No. It is inconsistent with the entire ROR methodology and practice to demand that savings projected to occur several years from now must be reflected in rates immediately.

[9] While the recent settlement of Verizon Northwest's rate case included a moratorium on filing any new rate case until 2007, the projected financial impact of the merger is not expected to be positive before that date.

It is therefore unfair, inappropriate and plainly arbitrary for OPC and Staff to single out one trend that is projected to be positive – *two or more years from now* – and insist on compensation for it *today*. Arguing that Verizon Northwest should take into account such amounts far in advance of the time these positive benefits are expected to accrue is also inconsistent with the historical test year basis for ratemaking traditionally used by the Commission.[10]

Q. MR. KING STATES THAT THE COMMISSION DECISION AUTHORIZING THE GTE / BELL ATLANTIC MERGER WAS A PRECEDENT FOR "IMPOSING FINANCIAL AND RATE-RELATED CONDITIONS" FOR MERGER APPROVAL. (KING, PAGE 4) PLEASE COMMENT.

A. I disagree with Mr. King. The 1999 order to which he refers settled an earnings review and an access charge complaint in addition to approving the Bell Atlantic/GTE merger. That proceeding is thus dissimilar to the current situation and does not provide a basis for seeking new rate reductions in connection with this merger. In fact, the Commission's order in the Bell Atlantic/GTE merger proceeding supports my position that the Commission cannot reduce Verizon's current earnings in piecemeal fashion. There, the Commission examined Verizon's overall earnings and rates and concluded, "The rates, charges, and revenues produced under the terms of the Settlement Agreement are just,

[10] The projected synergy savings are distinguishable from the type of "known and certain" changes that are usually taken into account in a rate case. Adjustments are made for such known and certain costs (or earnings), such as labor rate increases from a union contract, and generally fall within the year following the test year in the case.

reasonable, and sufficient. RCW 80.28.020."[11] The Commission did not, as Mr. King suggests, engage in piecemeal ratemaking.

Furthermore, this decision was the result of a negotiated settlement among the various parties, with each compromising on their initial positions; it should not be treated as though it were precedent for this case.

Q. IS IT SOUND PUBLIC POLICY TO MANDATE THE SHARING OF REVENUE SYNERGIES WITH CUSTOMERS THAT DO NOT CONTRIBUTE TO THE SYNERGIES?

A. As Mr. Smith discusses, the projected revenue synergies are expected to be earned from increased sales to enterprise, medium-sized and small business customers. Moreover, because most synergies relate to MCI's operations, which are focused on the largest enterprise customers, savings realized in those operations should not be shifted to the mass market. There is no public policy basis for attempting to reflect those synergies in rate reductions for regulated mass market services.

Q. MR. KING STATES THAT IT WOULD BE "OVERCHARGING" TO "DEPRIVE RATEPAYERS OF THE BENEFIT OF THE LOWER REVENUE REQUIREMENT RESULTING FROM MERGER SYNERGIES" AND THAT HAD THE MERGER SYNERGIES BEEN KNOWN DURING VERIZON'S RECENT RATE CASE, THE ANTICIPATED SAVINGS COULD HAVE BEEN

[11] Fourth Supplemental Order at 27, Conclusion of Law #4, Docket Nos. UT-981367, UT-990672, and UT-991164 (WUTC Dec. 1999).

REFLECTED IN VERIZON'S REVENUE REQUIREMENT AND RATES. (KING, PAGES 5-6). PLEASE COMMENT.

A. Mr. King distorts rate case principles in his effort to justify the Public Counsel's proposal for mandating flow through of synergy savings. His argument is simply wrong. First, Verizon Northwest is not currently earning its authorized rate of return in Washington.[12] Thus, any synergy savings that might accrue to the benefit of Verizon Northwest's operations (net of merger implementation costs) could potentially offset to some degree its poor financial results. Second, the recently concluded rate case relied upon a 2002-2003 test year and would not have included any cost savings that are not due to accrue until several years in the future. Under traditional ROR ratemaking principles, there is no way these savings, even if known, would have affected a determination of the appropriate revenue requirement. Simply put, there is no principled ratemaking basis or other public policy justification for Mr. King's proposal.

Q. WHAT DOES MR. KING ASSERT ABOUT AN ALLOCATION OF HEADCOUNT SAVINGS BETWEEN THE TWO COMPANIES? (KING, PAGES 12-16).

A. Mr. King argues that the targeted functions – primarily corporate functions that presently exist in both companies – should result in savings to both Verizon and MCI if the anticipated headcount reductions are achieved. He asserts that the Joint Petitioners have not properly allocated the synergies from headcount reductions across both companies and have thereby failed to reflect in Verizon's Washington-specific synergy estimate the

[12] With an authorized ROR of 8.68%, VZ-NW's most recent earnings report showed annual earnings in the range of 1% when impacts of the rate case (UT-040788) and the depreciation case (UT-040520) are included.

savings that should accrue to Verizon Northwest based on these headcount reductions. Based on his own calculations and an allocation of corporate expenses derived from Washington regulated earnings, he argues that the Commission should mandate a rate reduction immediately to reflect future savings from such headcount reductions.

Q. WHY IS MR. KING'S ANALYSIS IN ERROR?

A. The problems with his synergy calculations are addressed by Mr. Smith. As a policy matter, however, Mr. King's argument is yet another example in which he seeks immediate rate reductions based on projections of a favorable trend (in only some costs) several years out. This is not the way in which traditional ratemaking is conducted. The normal process seeks to relate expectations of overall earnings with the rates that are set. By focusing on one cost factor and excluding all other considerations, Mr. King's approach violates the basic precepts of ROR regulation. For example, even if Verizon Northwest's share of centralized costs shrinks, that fact alone would not allow a regulator to determine whether an actual decrease in its intrastate regulated expenses had occurred. That is why none of the merger synergies should be reflected in immediate rate reductions in a ROR environment.

Q. MR. KING STATES THAT SAVINGS ATTRIBUTABLE TO MCI ARE EQUALLY RELEVANT TO A MERGER SAVINGS CALCULATION BECAUSE POST-MERGER, "MCI'S INTRASTATE OPERATIONS WILL BE REGULATED TO THE SAME DEGREE AS VERIZON'S." (KING, PAGE 13) PLEASE COMMENT.

A. Mr. King is wrong. There is nothing about this transaction that changes the competitive nature of MCI's Washington operations. All MCI Washington subsidiaries have been competitively classified by the Commission and are not subject to rate of return regulation. Because it operates in a competitive environment, MCI's prices are set by market forces, not on the basis of company-specific cost factors. Imposing a mandatory flow-through requirement on MCI – and not on its competitors – would be fundamentally unfair and inconsistent with the long-standing "hands off" approach the Commission has taken with respect to the pricing of competitive services.

Q. MR. KING DISCUSSES WHAT HE CALLS A "BROADER VIEW" OF SYNERGY SAVINGS IN WHICH HE URGES THE COMMISSION TO TREAT ALL MERGER SYNERGIES AS APPLICABLE TO WASHINGTON, ARGUING THAT "MERGER SYNERGIES ARE FUNGIBLE." (KING, PAGE 21). IS HE CORRECT?

A. Absolutely not. He argues, for example, that cost savings resulting from the sale of operations in Canada should be presumed to flow back to the regulated rates for services in Washington. (King, page 21). Similarly, he argues that savings from reduced network costs that benefit interstate, interexchange services should be treated as though they are savings applicable to the regulated services in Washington.

Such extreme views expose the weakness of Mr. King's position. Under no form of traditional ROR ratemaking is it appropriate to adjust the costs of providing intrastate, regulated service to reflect savings experienced by the utility's corporate parent that are not properly allocated to the regulated entity, or by an affiliate conducting interstate or international operations. Accordingly, Mr. King's inclusion of so-called "broader view" synergies is an improper attempt to confiscate funds from Verizon and MCI operations across the country (and beyond). His analysis is untenable and should be rejected out of hand by the Commission; and his proposal to account for such savings in intrastate regulated rates in Washington should be disregarded in its entirety.

Q. HOW DOES STAFF JUSTIFY ITS PROPOSALS TO MANDATE A PASS THROUGH OF SYNERGY SAVINGS?

A. Staff rests its argument on an assertion that a mandated pass-through is required to offset the "potential harm to competition" that it alleges will result from the transaction. (Roth, page 2). But as discussed in detail in Dr. Taylor's testimony, there will be no harm to competition and no mitigation measures are appropriate. Further, Staff's testimony does not make the requisite nexus between the anti-competitive harm it fears and the remedies it suggests. As a result, the list of remedies it recommends is arbitrary and its proposal as a whole is not justified by the evidence.[13]

In addition, Staff's proposal to extend the rate cap on Verizon Northwest's local rates for two additional years is not supported by any evidence that links such a plan to any harm resulting from the merger. (Roth, page 29) While Staff does not articulate a specific rationale for its proposal, its justification appears to be based on a change in MCI's status

[13] For example, Staff's line extension proposal (Roth, page 24-25) has no relationship to the merger; Staff does not try to link its proposed expansion of certain extended calling areas to the merger (Roth, pages 25-26); and Staff's proposal to cut Verizon Northwest's special access prices is not supported by the evidence as mitigation for any potential harm. (Roth, page 28-29).

from a competitor to an affiliate of Verizon Northwest. However, since MCI is not now nor would it in the future discipline Verizon Northwest's prices for mass market services, the change in MCI's status does not provide a basis for extending the "stay out" period (i.e., from July 1, 2007, to June 30, 2009).[14] In any event, Verizon Northwest would not be able to change its local rates without Commission approval, a fact that is not changed by the merger.

Q. ARE MS. FOLSOM'S CONCERNS CONSISTENT WITH STAFF'S POSITION ON MANDATED FLOW THROUGH OF MERGER SYNERGIES?

A. No. Ms. Folsom notes that Verizon was placed on "CreditWatch," with "negative implications," by Standard and Poors, due to concerns about the investment costs required to achieve merger synergies. (Folsom, page 12). She recommends that the impact of any related debt downgrade of Verizon be excluded from any subsequent Verizon Northwest rate case. (Folsom, page 13). This recommendation seems incompatible with Staff's simultaneous demand that Verizon Northwest be compelled to disgorge any synergy savings now. Although Staff expresses concern about the financial risks inherent in the transaction, it asks the Commission to disallow the expense incurred to attain the savings, thereby placing all the risks of actually achieving synergy savings on Verizon Northwest. At the same time, by seeking to get immediate rate reductions for projected synergy savings, Staff seeks to appropriate for consumers all potential benefits derived from those savings. These positions are unbalanced, unfair, unreasonable and inconsistent.

[14] There can be a variety of reasons why changes in basic rate levels are not necessarily harmful or even may be beneficial, particularly if existing rate levels are below cost. Nevertheless, Verizon is not proposing any changes in rates, or in the regulation of basic services as a result of the merger.

Q. IS PUBLIC COUNSEL'S TIME FRAME FOR MANDATING FLOW THROUGH OF SYNERGY SAVINGS REASONABLE?

A. No. In making his own synergy calculations, Mr. King projects the savings well into the future - as far out as 2014. (King at 22). Based on these synergy analyses, Mr. King seeks rate cuts that would continue indefinitely. His open-ended proposal ignores all the fundamental precepts of ROR regulation and should not be accepted. It is arbitrary to demand rate reductions based on forecasts that extend well beyond a presumed ratemaking cycle in Washington (the current moratorium on initiating a rate case expires in mid-2007), and beyond a time period in which reasonable predictions about the industry and its finances can be made with confidence given the rapid changes in technology and markets that Dr. Taylor has documented.[15] By contrast, as described above, Commission ratemaking deals only with historic test years and limited adjustments based on "known and measurable" factors.

Q. IS THERE ANY OTHER IMPORTANT FLAW IN PUBLIC COUNSEL'S PROPOSAL FOR SYNERGY SHARING?

A. Yes. Mr. King recommends that the Commission appropriate the *entirety* of what he considers to be merger synergies that he allocates to Verizon Northwest's regulated operations. (King, Exhibit CWK-7HC). By seeking to deny Verizon Northwest the ability to retain *any* of the synergy benefits, Mr. King's approach would render the notion

[15] Many of the dramatic changes and developments that have occurred in the telecommunications industry since passage of the 1996 Act, and that are described by Dr. Taylor, could hardly have been predicted by Dr. Roycroft or anyone else at the time. This recent experience demonstrates the hazards of predicating rate making decisions on futuristic projections, as Dr. Roycroft would have the Commission do here.

of "sharing" meaningless. As with his other proposals, this one is so extreme that it cannot be given serious consideration.

B. OTHER CONDITIONS

Q. DO THE PARTIES PROPOSE CONDITIONS IN ADDITION TO THE SYNERGY-RELATED CONDITIONS YOU JUST DISCUSSED?

A. Yes. Staff, Public Counsel, Covad and XO propose a number of additional conditions. As I discuss below, these conditions are unnecessary and are completely unrelated to the Verizon-MCI parent company transaction.

Q. MS. FOLSOM RECOMMENDS THAT IF VERIZON'S DEBT RATING IS DOWNGRADED AS A RESULT OF THE MERGER, AN ADUJUSTMENT TO VERIZON'S COST OF DEBT SHOULD BE MADE (FOLSOM AT 29). IS THIS APPROPRIATE?

A. No. Whenever the next rate case takes place, the Commission will look at then current financial market information to determine an appropriate cost of debt for Verizon Northwest. It is neither necessary nor appropriate to speculate now on how that future review will proceed, to assume that the merger will cause a particular adverse impact, or even to guess how such an impact (whether positive or negative) could even be measured at that time. Because the merger will make Verizon companies more effective competitors, it also may be more likely to help improve their financial situation over time, especially after the initial investments to achieve synergies have occurred. But as I explained above, the correct response is to wait and see what financial circumstances exist whenever the next rate case occurs.

Q. PLEASE DISCUSS STAFF'S PROPOSALS REGARDING RETAIL SERVICE QUALITY.

A. Staff witness Roth states that the Commission should "emphasize the importance of Verizon maintaining its service quality" post-merger. (Roth at 35). She notes that Staff reviewed Verizon's monthly service quality reports; that Verizon was out of compliance with the Commission's rules only once during the last six months; and that Verizon had the second-lowest percentage of service quality-related complaints during that period. (Roth at 33-34). Verizon agrees that retail service quality is important, and Verizon will continue to meet the Commission's service quality standards. No additional conditions are needed.

Q. PUBLIC COUNSEL WITNESS ROYCROFT STATES THAT VERIZON NORTHWEST SHOULD BE SUBJECT TO "ENHANCED" RETAIL SERVICE QUALITY REPORTING, E.G., QUARTERLY REPORTING OF INVESTMENT, QUARTERLY HEADCOUNT REPORTING, AND ANNUAL SERVICE QUALITY REPORTS TO CUSTOMERS. (ROYCROFT AT 120-122). PLEASE COMMENT.

A. Joint Petitioners object to this proposal, because it is wholly unrelated to the merger. Dr. Roycroft assumes that Verizon Northwest will allow its retail service quality to degrade as a result of the merger. This assumption, however, is not based on any evidence related to the transaction. Indeed, if Dr. Roycroft's concern is that financial pressures due to cost-cutting might threaten service, it is worth noting that the high service quality Verizon Northwest has achieved (as Ms. Roth documents) has occurred during a period of low earnings by Verizon Northwest. Moreover, his proposal ignores the fact that (1) this Commission has comprehensive retail service quality standards that Verizon Northwest must follow (see, e.g., WAC 480-120-401, et seq.), (2) Verizon must report these standards every month (WAC 480-120-439); and (3) the Commission enforces these requirements and can impose penalties upon carriers that violate them (WAC 480-120-019). Also, the Commission can, and does, monitor and contact companies to discuss any downward trends in service quality. Given this, and given Verizon's current good service quality performance, there is no basis for Dr. Roycroft's speculation about Verizon Northwest's service quality.

Q. PUBLIC COUNSEL WITNESS ROYCROFT STATES THAT "COMMISSION RULES DO NOT SPECIFY THAT MERGING COMPANIES MUST NOTIFY CUSTOMERS THAT A MERGER IS AFFECTING THEIR CHOICE OF SERVICE PROVIDER," (ROYCROFT AT 27), AND ARGUES THAT VERIZON NORTHWEST AND MCI SHOULD BE REQUIRED TO GIVE NOTICE AND TO WAIVE ALL CHARGES FOR CUSTOMERS WHO CHOOSE TO SWITCH FROM MCI. PLEASE RESPOND.

A. Joint Petitioners disagree with this proposal. Here, too, Dr. Roycroft's proposal fails to recognize that existing Commission rules already require notice where a subscriber's service provider is being changed. For example, if an MCI operating company decides to stop providing a particular telecommunications service in Washington, under WAC 480-120-083, the company must first provide 30 days' written notice to the Commission, its customers, and the state 911 program, among others. Also, the Commission's rules specifically require customer notice when telecommunications companies transfer customers as a result of a merger, purchase of a company, or purchase of a customer base (WAC 480-120-147(7)). In this situation, however, MCI's customers will continue to be served by the same operating company following the merger. There will be no transfer of customers between telecommunications companies, because the transaction only involves a merger of the parent companies.

The existing rules provide a comprehensive scheme for customer notification. Verizon Northwest and MCI will follow these procedures if and when customers are transferred from one operating company to another, but that will not occur as a result of this transaction. Accordingly, no additional notice requirements are necessary or should be imposed.

Q. STAFF AND OPC PROPOSE TO REQUIRE THAT PRICE BREAKS BE OFFERED TO MCI CUSTOMERS WHO DECIDE TO SWITCH TO ANOTHER CARRIER. WHAT IS YOUR REACTION TO THESE PROPOSALS?

A. Staff witness Roth proposes (at 22) that Verizon waive its switching charge for any local service customer that currently subscribe to MCI's long distance service who decides to switch long distance providers after the merger. In a similar vein, OPC proposes that Verizon rebate all service establishment charges for current MCI (presumably local) customers who decide to switch their service to a different CLEC. (Roycroft at 112). Neither proposal makes sense, and neither of these conditions should be imposed. As Joint Petitioners have explained, MCI will operate its existing mass market businesses in the same manner after the merger as before. Its customers will receive the same services at the same prices as they would have obtained from an independent MCI.[16] MCI does not charge termination fees to its mass market customers, so they will be able to switch carriers (if they choose to do so) as easily as before the merger. Perhaps in recognition of these facts, OPC and Staff appear to rationalize these proposals on the theory that some MCI customers might desire to switch providers solely because of a change in the ultimate ownership of their service provider, rather than because of any tangible concerns they may have about the services they receive. It is as if OPC and Staff assume that MCI's services will acquire a kind of tarnish as a result of the transaction.

The Commission should not presume that the transaction will create an ill-defined intangible harm for which there is no evidence. It would be inappropriate and discriminatory for MCI and Verizon to be saddled with regulatory obligations – and the corresponding costs of compliance -- that do not apply to any other competitors in the marketplace. The proposed conditions do not presume that there is a problem with MCI's services (otherwise, disgruntled customers would already have switched to a different service provider).

[16] These prices and terms of service will continue to be subject to possible modification, as they are now for MCI and for every other provider that is competitively classified.

Q. OPC PROPOSES THAT VERIZON BE REQUIRED TO OFFER STAND-ALONE DSL SERVICE. (ROYCROFT, PAGES 88-90) PLEASE COMMENT.

A. I understand that Verizon already permits Washington customers with existing DSL service to port their numbers to a facilities based carrier and retain their DSL service while canceling their Verizon telephone service. By the end of the year, customers served by CLECs who use Verizon's commercial replacement for UNE-P (Wholesale Advantage) should also be able to obtain Verizon DSL service. Verizon is also working on resolving technical and systems issues that currently do not accommodate these stand alone DSL products for the relatively small proportion of customers served by remote terminals. So while the Commission should not order any conditions related to DSL because the service has been deemed an interstate service by the FCC, Verizon's business decision to offer stand-alone DSL help to address this concern.

Q. OPC ASKS THAT VERIZON MAKE AVAILABLE IN WASHINGTON AN OPERATIONAL PLATFORM THAT FACILITATES E-911 SERVICE TO VOIP PROVIDERS. (ROYCROFT, PAGES 86-88). PLEASE COMMENT.

A. As is indicated in the Verizon data response that Dr. Roycroft references, provision of E-911 services to VoIP providers is more than a matter of unilateral actions by Verizon or by state authorities. E-911 for VoIP is a national issue on which the FCC has taken the lead. There are on-going negotiations and collaboration among various service providers to meet the deadlines set by the FCC. Regardless of the merits of OPC’s recommendation, it is completely unrelated to the merger, is being addressed by the FCC, and so is not an appropriate topic for consideration as part of this proceeding.

Q. OPC ASKS THAT THE COMMISSION PREVENT VERIZON FROM AVOIDING TARIFF OBLIGATIONS BY OPERATING MCI AS A "SHELL CORPORATION." (ROYCROFT, PAGE 91-92) PLEASE COMMENT.

A. This suggestion is vague and should not be adopted. Dr. Roycroft offers no explanation of his alleged concern. MCI will remain a competitively classified affiliate of Verizon following the merger. However, hypothetically, if MCI were to succeed in attracting customers through attractive service offerings following the merger, the Commission should regard the results as positive because they would reflect customers getting a better deal than before.

Q. OPC RECOMMENDS THAT VERIZON BE REQUIRED TO DEPLOY BROADBAND SERVICES TO CERTAIN CUSTOMERS ON A SCHEDULE SUGGESTED BY DR. ROYCROFT. (ROYCROFT, PAGES 94-96). PLEASE COMMENT.

A. The broadband services referred to are deregulated information services that the Commission does not regulate. The FCC has made a national policy determination that consumers will best benefit if the market drives the deployment of these services, not regulatory mandates. Because MCI does not have any facilities devoted to mass market broadband service in Washington, the merger could not have any adverse impact warranting remedial action by the Commission. There is no nexus between the suggested condition and the proposed merger, and Dr. Roycroft does not even attempt to establish one. This proposal is not justified, exceeds the Commission's jurisdiction to order, and should be denied.

Q. MR. GILLAN PROPOSES TO IMPOSE SECTION 271 OBLIGATIONS ON VERIZON NORTHWEST. PLEASE COMMENT.

A. Mr. Gillan admits that Section 271 of the federal Telecommunications Act, by its terms, does not apply to the Verizon Northwest operations. He describes this circumstance as an "historical anomaly" (Gillan, page 4) but cannot escape the fact that Congress passed a law that specifically does not apply to Verizon in this state. His efforts to rationalize a different outcome on policy grounds are to no avail. This Commission cannot override federal law. Accordingly, the Commission must reject his suggestion that Verizon Northwest should be compelled to conform to Section 271 requirements as a condition of merger approval. Insofar as Mr. Gillan's proposed regulatory approach for setting UNE prices is predicated on his theory that Section 271 obligations should be imposed on Verizon Northwest (Gillan, pages 20-42), those recommendations must be rejected as well.

Q. MR GILLAN ALSO ASKS THE COMMISSION TO SET UNE RATES FOR VERIZON AND REGULATE THESE RATES VIA A "PRICE CAP" PLAN. (GILLAN AT 32-38). PLEASE COMMENT.

A. Here, too, Mr. Gillan ignores the federal Telecommunications Act, which explains how UNE rates are to be set. Also, Mr. Gillan appears to be unaware of the fact that this Commission recently completed a review of Verizon's UNE rates and established new rates in Docket No. UT-023003.

Q. STAFF PROPOSES THAT VERIZON'S INTRASTATE SPECIAL ACCESS RATES BE REDUCED TO EQUAL VERIZON'S HIGH-CAPACITY UNE RATES (ROTH AT 27). XO AND COVAD PROPOSE THAT VERIZON BE REQUIRED TO PROVIDE MORE HIGH CAPACITY UNES THAN IS REQUIRED BY FEDERAL LAW. (WOOD AT 85). PLEASE COMMENT.

A. These proposals should be rejected. They are premised on the assumption that the FCC's recent actions in the TRRO limiting an incumbent provider's obligation to provide high-capacity circuits are somehow unlawful or anti-competitive. In short, these parties simply disagree with the law. Their proposals, therefore, conflict with federal law and are unrelated to this transaction.

Also, Staff's proposal to reduce intrastate special access rates ignores the fact that Verizon Northwest's rates are already priced below their equivalent services in Verizon Northwest's interstate tariff. And for DS-1 and DS-3 loops, Verizon Northwest's intrastate rates are the same as Qwest's.

Finally, these proposals fail to recognize that even under the FCC's new rules, Verizon must continue to provide high-capacity UNEs throughout most of its Washington territory. As a practical matter, Verizon Northwest continues to provide most DS-1 and DS-3 UNEs at the same TELRIC–based rates as before the adoption of the TRRO, as the FCC's criteria for impairment had minimal effect in the state. As a result, CLECs continue to have access to such facilities at [****BEGIN CONFIDENTIAL****] **

****
***[**END CONFIDENTIAL**]**

Q. BOTH STAFF AND MR. GILLAN DISCUSS AN IMBALANCE OF BARGAINING POWER DUE TO MCI'S BEING REMOVED FROM THE REGULATORY ARENA. IS THIS A GENUINE CONCERN FOR THE COMMISSION?

A. No. As is evident from the participation in this proceeding, there remain strong competitors in Washington with the resources to challenge the incumbents in regulatory proceedings. More important, however, is that the communications market has changed dramatically and the industry players that choose to participate in regulatory, legislative and other public policy forums will reflect that change as well. Wireless, VoIP, cable and other intermodal challengers do not necessarily need to take part in regulatory proceedings in order to be effective competitors, but they clearly have the right and opportunity to participate in such processes, if they find it is in their interests to do so.

Q. WITH REGARD TO DR. ROYCROFT'S CHARACTERIZATION OF VoIP SERVICES (ROTCROFT, PAGES 59-61), DO YOU HAVE PERSONAL EXPERIENCE WITH VONAGE SERVICE?

A. Yes, I have had Vonage service since March. It was easy to install, requiring only that the router and telephone be plugged into my Internet connection. I have found the service to function well and provide high sound quality on virtually all calls I have made, both domestically and internationally. I pay only about $17/month for 500 minutes of calling, vertical services and voice mail, and some features that landline services do not provide. My personal experience with Vonage does not comport with Dr. Roycroft's expressed concerns about third-party VoIP service.

Q. DOES THIS CONCLUDE YOUR REPLY TESTIMONY?

A. Yes.