BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

In the Matter of the Joint Application of VERIZON COMMUNICATIONS, INC. and MCI, INC. For Approval of Agreement and Plan of Merger	DOCKET NO. UT-050814 BRIEF OF COMMISSION STAFF ON THE PROPOSED SETTLEMENT AND ON THE MERITS

1 Commission Staff submits this post-hearing brief in support of the Commission's acceptance of the Multiparty Settlement Agreement in resolution of all contested issues in this proceeding. Staff has submitted a separate brief on the question of the Commission's jurisdiction.

I. INTRODUCTION AND SUMMARY OF POSITION

2 If accepted by the Commission, the Settlement would protect Verizon Northwest consumers against the possibility of an increase in the company's rates through July of 2009, while at the same time passing on benefits to consumers and resolving controversies regarding expansion of local calling areas and extension of service to unserved areas.

3 The Settlement also would mitigate the effects of losing MCI as an independent competitor in the market for intrastate long-distance within Verizon Northwest's service territory by removing barriers for Verizon local service customers who chose MCI as their long-distance carrier to switch to a different long-distance provider. The effect of MCI's

loss as an independent competitor in local exchange markets would be lessened by improving the wholesale performance metrics that are designed to ensure that Verizon meets parity requirements when providing unbundled network elements to its remaining competitors in Washington. Potential anti-competitive effects also would be addressed by a requirement that Verizon offer to competitors the same commercial agreements for access to its network that it provides its new MCI affiliate.

4 Finally, the Settlement would establish a baseline of retail service quality to ensure that Verizon's customer service does not decline as a result of the merger.

5 Taken together, these conditions should assure the Commission that the proposed merger of Verizon Communications, Inc. and MCI, Inc. is consistent with the public interest within the Commission's scope of authority.

II. BACKGROUND OF THE TRANSACTION AND PROCEEDING

A. Description Of The Transaction

1. The Applicants

6 Verizon Communications, Inc. (Verizon) is a corporation with headquarters in New York. The Company provides "telecommunications services on a regulated and unregulated basis in 29 states, Puerto Rico, and District of Columbia, serving 52 million access lines."[1] Verizon Northwest Inc. (Verizon NW), Bell Atlantic Communications Inc. d/b/a Verizon long-distance, Verizon Avenue Corp, and Verizon Select Services Inc. are wholly-owned subsidiaries of Verizon Communications, Inc. registered to provide service in Washington.[2]

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[1] Joint Petition at 3.
[2] Roth, Ex. 101T-HC at 6.

7 In Washington, these Verizon companies offer local exchange telephone services to residential and business customers, intraLATA and interLATA toll services, access services, local private line, voice and data services, and Centrex. Verizon serves approximately 825,000 access lines in Washington and has annual intrastate operating revenue of $ 377 million.3

8 MCI, Inc. (MCI) is a corporation with its headquarters in Ashburn, Virginia. MCI's wholly-owned subsidiaries that are registered in Washington to provide telecommunications services are MCImetro Access Transmission Services LLC; MCI WorldCom Communications, Inc.; MCI WorldCom Network services, Inc.; Teleconnect Long-distance Services and Systems Co. d/b/a/ Telecom USA; and TTI National, Inc. MCI, Inc.'s subsidiaries offer services to residential, business, and enterprise customers in Washington ranging from local and long-distance services to data, Internet, Sonet private line, and a whole range of high speed dedicated services.[4]

9 The services provided by the individual subsidiaries of Verizon Communications, Inc. and MCI, Inc. within the state of Washington are described more particularly in the Staff's separate brief on jurisdiction.

2. The Proposed Transaction

10 Verizon and MCI state that the proposed merger will result in a net present value of approximately $7 billion in synergy benefits company-wide by eliminating 7,000 jobs, reducing information technology costs, avoiding future costs for expanding out-of-region

[3] *Id.*
[4] *Id.* at 6, 7.

network, and achieving economy of scale for purchasing costs.[5] This level of synergies is actually quite small in relation to the operations of the two companies, which combined, had operating expenses of $72 billion in 2004. The same net present value of savings/synergies could be achieved by reducing operating expenses of the companies by less than one percent per year.[6]

11 The merger will be effectuated as follows: MCI, Inc. will merge into ELI Acquisition, LLC, which is wholly-owned by Verizon and was created solely to facilitate the transaction. ELI Acquisition, LLC will be the surviving company in the merger, and Verizon Communications, Inc. will be its parent corporation after the merger. Verizon intends to rename ELI Acquisition, LLC "MCI, LLC."[7]

12 The Joint Petition states: "[a]fter the transaction is completed, MCI will be a subsidiary of Verizon. MCI's regulated subsidiaries in Washington will remain as subsidiaries of MCI, LLC."[8] Thus, all of the WUTC-regulated subsidiaries of Verizon and MCI will be owned by a common parent, Verizon Communications, Inc.[9]

13 Verizon has indicated that Verizon Communications, Inc. would likely be the issuer of any future common stock offerings and that Verizon Global Funding Corp., an affiliate company, would likely be the issuer of any debt offerings for all affiliates of the merged company, including those MCI entities registered in Washington. [10] This is consistent with

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[5] *Id.* at 9.
[6] *Id.* at 9-10.
[7] Folsom, Ex. 150T-HC at 6, 7.
[8] Joint Petition at 7; MCI WorldCom Communications, Inc. is to be renamed MCI Communications Services, Inc. and MCI WorldCom Network Services, Inc. is to be renamed MCI Network Services, Inc., *Id.* {Folsom, Ex. 150T-HC} at 5.
[9] Folsom, Ex. 150T-HC at 5.
[10] *Id.* at 6.

Verizon's current practice with regard to Verizon NW's capital needs. Verizon NW does not issue debt in its own name; instead its capital needs are met through intra-company transactions with Verizon affiliates.[11]

14 The main strategic reason for the merger is to join Verizon and MCI's assets and sales forces in a way that will make Verizon more competitive across the "enterprise" market segment than either merging party would have been alone.[12] "Enterprise" customers are the Fortune 1000 companies, federal government agencies, large state agencies, and similar sized institutions, all of whom buy complex, integrated packages of voice and data services through competitive procurement or individually negotiated contracts. Verizon asserts that the transaction will benefit this customer group with better, more competitively priced services.[13]

B. Summary Of Proceeding

15 On May 27, 2005, Verizon and MCI filed a Joint Petition requesting a declaration that the Commission lacks jurisdiction, or in the alternative, expedited approval of the proposed transaction that will result in MCI becoming a wholly-owned subsidiary of Verizon.

16 Following the entry of a protective order, all parties began serving formal data requests on Verizon and MCI. Verizon and MCI filed their testimony, and discovery continued.

17 Staff, Public Counsel, XO, and Covad filed testimony on September 9. The filing of opposing testimony had the effect of framing the contested issues. It also showed that all

[11] *Id.*
[12] Smith, Tr. at 238:2-3; Danner, Ex. 21T at 16-19.
[13] Danner, *Id.*

parties would be advocating approval of the merger, but with conditions designed to reduce or eliminate potential harms to the public interest or to pass on savings to customers.

18 The parties met for two settlement conferences on September 23 and 27.

19 On October 21, 2005, the Petitioners, Commission Staff, and intervenor Integra Telcom of Washington filed a multiparty settlement agreement for the purpose of resolving all contested issues in the docket. The Commission held a hearing on November 1 and 2 for the presentation of the settlement and for cross-examination on the merits of the non-settling parties' proposed conditions.

III. THE PROPOSED SETTLEMENT

A. Are the Settlement Conditions in the Public Interest?

20 This brief will first address each of the conditions contained in the proposed settlement individually, and then address why, as a whole, the settlement is in the public interest.

1. Extension of Service to UT-050778 Complainants

21 Over the years, Staff has been dealing with the issue of areas where people reside with no access to basic telephone service. These unserved areas are, in many cases, adjacent to the service area of a local telephone company. The cost of serving the area and who should bear the cost is often controversial.[14]

22 There is presently before the Commission a complaint against Verizon by residents on the Index-Galena Road in Docket UT-050778. Staff recommends that the Commission require Verizon to use a portion of its Washington jurisdictional merger savings to offer

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[14] Roth, Ex. 101T-HC at 24.

telephone service to those complainants. While we are in an era of rapid technology development, promoting competition and consumer choice, we should not forget to achieve the fundamental goal of universal service.

23 The cost of this line extension will not be borne by ratepayers in the usual way that such line extension costs are recovered—through an addition to the terminating access charges that interexchange (long-distance) carriers must pay Verizon for completing calls over Verizon's local exchange network. Instead it will be borne by the company. Neither the individual residents on the Index-Galena Road nor the other customers of Verizon will pay for the costs of this service extension. Verizon has voluntarily agreed to absorb the cost as a condition of approval of the MCI acquisition.

24 Public Counsel may argue that this provision is of little benefit because the Commission might have ordered the same thing following the complaint proceeding. This argument is incorrect for two reasons: First, it fails to consider the costs that the Commission and Verizon would incur if the case is litigated. Regardless of how that case turned out, the litigation approach would be expensive. Those costs would likely be borne by utility ratepayers in this state–Verizon's costs being a part of its operating expenses and the Commission's and Public Counsel's costs being paid from the Public Service Revolving Fund. Second, it fails to account for the cost recovery mechanism that would be available to Verizon in the litigation approach. Assuming the Commission did decide to order a service extension, Verizon NW would be entitled to recover the full cost of the extension through an increase in its terminating access charges.[15] Through this resolution, the company agrees

[15] WAC 480-120-071.

not to recover its expenses through either terminating access charges authorized by WAC 480-120-071(4) or through the charge that covers the cost of trenching or pole supports on the customers' property under WAC 480-120-071(4). Only the charge that applies to any customer initiating service will apply.

25 At hearing, Commissioner Oshie raised the issue[16] of consistency between this proposed line extension and those that the Commission decided not to require in the Taylor/Nelson case, UT-011439.[17] While the two results–extension of service in one case and denial of service in the other–appear to be opposite, they are not contradictory. The Commission decided in the Taylor/Nelson case that Verizon should not be compelled to extend service in those circumstances.[18] In doing so, it was applying a rule that required companies to extend service or seek a waiver. WAC 480-120-071(7) sets out standards to be considered when a company does not voluntarily extend service; the rule does not prohibit a company from extending service when it is willing to do so. Therefore, the Commission was not presented in the Taylor/Nelson case with the question of whether Verizon could voluntarily extend service, as it is doing here. The Commission never said that it was contrary to the public interest for the Taylor and Nelson families to have telephone service or for a telephone company to provide that service, and it is hard to imagine a circumstance where it would make such a finding. Only if the Commission had done so might it be inconsistent to accept Verizon's offer here.

[16] Tr. at 601-607.
[17] In the Matter of the Petition of Verizon Northwest, Inc. for Waiver of WAC 480-120-071(2)(a), Twelfth Supplemental Order (April 23, 2003).
[18] *Id.* at ¶¶ 63-70.

While there is no conflict between this settlement provision and the line extension rule or the Commission's interpretation of that rule in the Taylor/Nelson case, Staff recognizes that the Commission may not be satisfied that the proposal to extend service to the Index-Galena Road is the best use of this money. Therefore, if the Commission is not satisfied of the value of this condition, neither Staff nor Verizon would object if the Commission decided that the $325,000 committed to this line extension should be spent another way, provided that approval of the settlement is not delayed.[19]

2. Rate Center Consolidations and EAS Adder Elimination

27 Staff has identified three areas served by Verizon where it would be reasonable to improve the scope of the local calling area offered to customers. These changes would benefit the local customers by enabling them to make local calls that today are charged as long-distance calls. In addition, the changes would benefit all customers in the state by allowing telephone number resources to be used more efficiently and delaying the need for another area code in Western Washington.[20]

28 As with the line extension provision, the Commission has questioned the consistency of one of the calling area expansions with a prior interpretation of an agency rule. At hearing both Commissioner Oshie and Chairman Sidran raised the issue[21] of whether the Skagit County calling area change met the standards in the Commission's local calling area rule. There is no conflict between the proposed calling area change and the rule, because the

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[19] The Commission could convene a hearing for the purpose of considering alternative proposals from Staff and the company in the same manner that was contemplated in the event the company could not complete the work within the $325,000 allowance under the settlement. This approach would enable the Commission to approve the settlement without further delay.
[20] Roth, Ex. 101T-HC at 25, 26; Tr. at 609.
[21] Tr. at 607-609; 615-616.

rule does not set standards that apply when a company voluntarily expands the scope of customers' local calling area. The rule, WAC 480-120-265, specifies considerations that will apply when the Commission is asked to decide whether it will order an expansion of a local calling area. In the typical situation covered by this rule, a mandated change in local calling area will either cause an involuntary reduction in revenues to the company or cause an increase in local rates to customers, some of whom may place no value on the expanded calling scope. These standards do not apply when a company voluntarily provides a larger calling scope. In other words, the standards do not require that the Commission break down existing calling areas to the minimum size necessary for customers to reach essential community services; if they did, a call from Beacon Hill to Capitol Hill in Seattle, for example, might have to be a toll call.

29 Staff acknowledges that, if a formal complaint were brought against Verizon under the local calling area rule, the Commission would likely decide not to order Verizon to implement the Skagit County calling area change. It does not follow that the voluntary expansion of calling scope—with no increase in local rates—is not in the public interest. To the contrary, it is clear that county-wide local calling in Skagit County will produce public benefits. Customers on one side of the county making calls to the other side of the county will no longer pay toll charges. Customers who move from one community to another within the county will be able to keep their telephone number. Verizon and every other telecommunications company competing in Skagit County will be able to use telephone numbering resources more efficiently.

30 This condition would benefit [redacted] percent of Verizon's residential local service customers and [redacted] percent of business customers (using lines as a proxy of customers), Ex. 528, and would reduce Verizon's revenue by [redacted] annually, or [redacted] (in nominal dollars) in the first four years.[22] This condition also would eliminate all of the premium adders that Verizon presently charges; these are substantial monthly charges for customers who want the benefits of a larger local calling area—$15 for residential customers and $30 for business customers.[23]

3. Local Services Rate Cap or "Stay Out"

31 A key provision of the settlement is that Verizon cap its local service rates at the levels that are set in the settlement agreement in its last rate case from July 1, 2007, to June 30, 2009, a period of two years. During this period, Verizon could propose to reduce its local service rates and make other rate changes on a revenue neutral basis.[24]

32 This condition provides a benefit to consumers by giving them rate stability. It is potentially worth a great deal to consumers, particularly if this change in the financial status quo results in an increase in Verizon's costs, rather than the predicted decrease. This condition also addresses concerns regarding any negative impact on Verizon's debt rating, raised in Staff witness Folsom's testimony,[25] by sheltering consumers from a degrading of the Company's financial indicators after the merger for an additional two years.

33 It is difficult to calculate with certainty the revenue impact of this particular condition, because the value depends when Verizon would otherwise propose rate increases

[22] Ex. 502 (Narrative, Confid. App. A).
[23] Roth, Tr. at 588:20-24.
[24] Roth, Ex. 101T-HC at 29.
[25] Ex. 150T-HC at 4, 5.

for its basic local exchange services and file a rate case to request a revenue increase.[26] Without this condition, it would be possible for Verizon to file a rate case as early as July, 2007, and to make the claim that Verizon NW has a revenue deficiency in excess of $[redacted].[27] The additional two year rate cap would shelter rate payers from potential rate increases.

4. Wholesale Performance Metrics

34 Staff argued in its testimony that an incentive will exist once MCI becomes a Verizon affiliate for Verizon to gain a competitive advantage by providing better wholesale service (i.e., for interconnection and provision of unbundled network elements) to MCI than it provides to unaffiliated competitors.[28] Staff, therefore, argued that the Commission should require Verizon to guarantee that its wholesale service quality performance will be as good for other competing carriers as for MCI.[29]

35 Verizon already is required by law to provide its competitors with a level of service with respect to interconnection and provision of unbundled network elements that is generally at parity with the level of service it provides to its own customers.[30] Additionally, Verizon today measures its service performance for many aspects of its service. Some of

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[26] Roth, Ex. 101T-HC at 30.

[27] This is a real possibility based on the second quarter Surveillance Report filed by Verizon with the Commission, which reflects the Company's financial condition for the twelve months ending June, 2005. *See* Danner, Ex. 23T-C at 28, fn. 12; The Commission may take official notice of this report, which is on file with the Commission. The size of the deficiency that Verizon could *claim* (which is not to say *prove*) can be estimated by multiplying the percentage of deficiency in the Surveillance Report by the company's rate base, also in the Report.

[28] Roth, Ex. 101T-HC at 21.

[29] *Id.* at 22.

[30] 47 U.S.C. § 251(2)(C) and (3); 47 C.F.R. §§ 51.311, 51.313.

the standards, for example, are Operational Support System (OSS) Response Time, Order Confirmation Timeliness, Installation Quality, and Missed Repair Commitments.[31]

36 Consistent with Staff's concerns, intervenor Integra Telecommunications, a facilities-based competitive local exchange carrier that relies on Verizon for unbundled loops and other unbundled network elements, presented testimony explaining why it is important to its continued competitiveness to have improved service quality reporting.[32]

37 Generally, the Joint Partial Settlement Agreement (JPSA) standards with which Verizon has committed to comply are much more detailed and stringent than the current wholesale standards set out by the FCC for the Bell Atlantic/GTE merger, which have, in fact expired. [33] Staff will have access to the reports through Verizon's Wholesale Internet Service Engine (WISE) system.[34]

38 As discussed in section V.A., below, the proposed merger will reduce the number of competitors in Verizon's service territory and will also potentially negate the benefit that the remaining competitors previously enjoyed by having MCI as a powerful bargainer on the CLEC side of the table. It is therefore vital that after the merger, Verizon is not allowed to compound these injuries to competition by providing poor wholesale service to its remaining competitors. For this reason, it is in the public interest for the Commission to adopt the settlement provision that requires Verizon to adopt improved wholesale service quality performance standards. The standards will deter the type of discrimination described in

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[31] Roth, Ex. 101T-HC at 21.
[32] Koenders, Ex. 201T-C at 4.
[33] Roth, Tr. at 610-611.
[34] *Id.*

Staff's testimony[35] and will also help to overcome the difficulties for CLECs as described in Integra's testimony.

5. Retail Service Quality

39 The Commission believed it was imperative to monitor quality of service performance and network maintenance as a part of its consideration of the Bell Atlantic/GTE merger in 1999.[36] The Commission issued an order approving and adopting a settlement agreement that set out additional commitments for GTE Northwest to improve its baseline level of consumer complaints, held orders, installation appointments, and trouble reports.[37] The settlement also included a remedy plan if GTE failed to meet the standards.[38]

40 Some, but by no means all, of the conditions that lead the Commission to require service quality conditions in prior merger cases are present in this case. Some of the merger synergies are to be generated through cost cutting, work force reduction, and consolidations of operational centers. This causes Staff some concern about the possibility of deteriorating service quality. On the other hand, it is apparent that cost-cutting is generally focused on the MCI side[39] and there is not likely to be much change in the structure of Verizon NW's local exchange company operations. Staff financial analysis shows that the merger is unlikely to adversely affect Verizon's finances, including its ability to meet debt obligations and pay for operations and capital investments.[40]

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[35] Roth, Ex. 101T-HC at 21, 22.
[36] *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for an Order Disclaiming Jurisdiction or, in the Alternative, Approving the GTE Corporation-Bell Atlantic Corporation Merger*, Docket No. UT-981367, Fourth Supplemental Order Approving and Adopting Settlement Agreement, Granting Application, Subject to Conditions (Dec. 1999) ("GTE/Bell Atlantic Merger Order").
[37] *Id.*, App. A (Settlement Agreement), at 7-9.
[38] *Id.*
[39] Folsom, Ex. 150T-HC at 8.
[40] *Id.* at 16.

41 In both the GTE/Bell Atlantic and US West/Qwest[41] mergers, the local exchange company was the company being acquired. In this case, the parent of the local exchange company will remain the same, so there is less reason to be concerned regarding a change in the status quo with respect to service quality.[42] Because the merger involves Verizon acquiring MCI, there will be no change in Verizon's management. The company's operation is still under the control of the same management team.

42 Additionally, having reviewed Verizon's monthly service quality reports for the last six months and similar data from MCI, Staff is generally satisfied with both companies' service quality.[43] When Verizon's service quality reports are compared with reports filed by other incumbent companies, Verizon is within the range of performance indicators of other companies, if not better on average.[44] Staff did not see a need to impose additional reporting requirements because the Commission already has a strong set of service quality rules in place to ensure that the Companies' performance is measured and reviewed. Since the time those mergers were approved, the Commission has adopted more comprehensive and rigorous service quality standards and reporting requirements.[45]

43 As a condition of the merger with MCI, the Commission should emphasize the importance of Verizon maintaining its service quality, and acknowledge Verizon's commitment to continue to meet service quality standards. Staff does not believe, however,

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[41] In re Application of US WEST, Inc., and Qwest Communications, International, Inc., for an Order Disclaiming Jurisdiction, or in the Alternative, Approving the US WEST, INC.—QWEST COMMUNICATIONS, INC. Merger, Docket No. UT-991358, Ninth Supplemental Order Approving and Adopting Settlement Agreements and Granting Application (June 2000) ("US West/Qwest Merger Order").
[42] Roth, Tr. at 569, 570.
[43] Roth, Ex. 101T-HC at 33-34.
[44] Public Counsel's Ex. 48 regarding Verizon's service quality performance as compared with that of other carriers is misleading because Verizon reports the number of missed appointments within a four hour window, while other companies report within a twenty-four hour window.
[45] *See* Docket No. 990146, General Order No. R-507 (filed 12/12/02, effective 7/1/03).

that there is cause to require service quality measures above and beyond those already required by the Commission's rules, as advocated by Public Counsel. If Verizon's retail service quality deteriorates (as compared with the baseline established by Staff review for this case), the Commission may address rule violations with penalties. It is important to note that, by operation of law, when MCI merges with Verizon, MCI's local exchange company subsidiary (MCImetro Access Transmission Services) will be required to file service quality reports.[46] MCI's local exchange carrier (which was previously exempt from service quality reporting requirements because, together with its affiliates, it served less than two percent of the access lines in the state) will now be subject to service quality reporting requirements.[47]

6. LPIC Credits

44 Staff's market analysis shows that the market share of Verizon's residential long-distance service will increase significantly. *See* Sec. V.A.2, below. Those Verizon local service customers that have MCI as their intrastate long-distance carrier could have chosen Verizon as their long-distance provider, but chose instead to use a competing provider. Their choice not to use Verizon effectively will be thwarted by this transaction in that MCI will become a Verizon affiliate.[48] To address this concern, given that long-distance services have been classified as competitive services, it is consistent with the public interest for Verizon to provide its customers who have selected MCI as their long-distance carrier with notice that there will be no switching charge from Verizon (i.e., no LPIC change charge) if a

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[46] WAC 480-120-439(2); 480-120-034(3)(" For purposes of classifying a company as Class A or Class B, the number of access lines served by the local exchange company includes the number of access lines served in this state by any affiliate of that local exchange company.")
[47] Roth, Ex. 101T-HC at 35.
[48] *Id.* at 22.

customer wishes to switch long-distance carriers within 60 days after the merger. The charge is between $4 and $5.[49]

45 Verizon has agreed to this condition, which Staff advocated in its testimony, and will, in addition, extend the same waiver of charges to customers switching their *interstate* long-distance carrier from MCI if the customer makes that request.

46 Public Counsel proposes similar conditions that go considerably farther. *See* Sec. V.C.1.c, d, and e, below.

47 First, Public Counsel would require Verizon to waive any service establishment charges for current MCI customers who, after the merger, decide to take service from Verizon.[50] This condition can't be justified based on the rationale that customers who do not want to take service from Verizon have had their choice to switch away from Verizon (or a Verizon affiliate) thwarted by merger. Presumably, the MCI customers who place a high value on not having Verizon as their carrier would not switch back to Verizon in any event. Moreover, such a requirement would create a perverse incentive to switch back to the incumbent rather than to another competitive provider.

48 Second, Public Counsel would require Verizon to reimburse service establishment charges for current MCI subscribers who decide to switch from MCI (apparently for either long-distance or local exchange service) to another CLEC.[51] This goes a great deal farther than the condition advocated by Staff (which was accepted by Verizon in the settlement).

49 When a customer decides to change his or her presubscribed interexchange carrier, that customer's local carrier charges a certain amount (the "LPIC charge") to cover the cost

[49] Roth, Tr. at 555.
[50] Roycroft, Ex. 371T-HC at 91.
[51] *Id.* at 91.

of facilitating that change. (There is no analogous charge when the customer switches local exchange carriers.) In Staff's view, because the LPIC charge represents a barrier to customers changing long-distance carriers, and it is a charge over which Verizon has control, Verizon should waive that charge for a period of time after the merger. The customer would still have to pay whatever service establishment charges are required by the CLEC to whom the customer is switching.

50 Public Counsel would, in effect, require the merged company to pay Verizon customers to switch to a different carrier. This is different than waiving an administrative charge over which the Verizon has control. Staff believes Public Counsel's condition goes too far and is not warranted by the evidence of potential harm to competition. Although MCI is providing local exchange service in Verizon territory, the change in market concentration in the local exchange market from Verizon acquiring MCI is very minimal.[52] MCI will continue to provide service under the terms of its currently filed price list after the merger.[53]

7. Commercial Agreements Availability

51 Staff argued in its pre-filed testimony that Verizon should be required, as a condition of approval, to make the same rates, terms, and conditions available to other carriers that it makes available to MCI in contracts and commercial agreements.[54] In its Triennial Review Order[55] and its subsequent Triennial Review Remand Order,[56] the Federal Communications Commission (FCC) removed certain unbundled network elements, including line sharing

[52] Roth, Tr. at 557.
[53] *Id.* at 557, 558.
[54] Roth, Ex. 101T-HC at 20.
[55] 18 F.C.C.R. 16,978 (2003), *vacated in part, U.S. Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004).
[56] 20 F.C.C.R. 2533 (2004).

and the unbundled network element platform (UNE-P) from the list of elements[57] that incumbent local exchange carriers must provide to competitors subject to § 251 of the Federal Telecommunications Act of 1996.[58] These were elements that were widely used by competitors. UNE-P was, in fact, MCI's sole vehicle for competing in the mass market for local exchange services.[59]

52 The FCC encouraged incumbents to enter into commercial agreements (as distinguished from regulated interconnection agreements) for the continued provision of these elements. Verizon has entered into such commercial agreements with its competitors. However, as this Commission determined in its order on commercial line sharing agreements,[60] such agreements do not have to be filed with the Commission for review through the process described under § 271 of the Act.[61] Neither, therefore, does the company have to allow other CLECs to opt-in to the same agreement.[62]

53 The potential exists, therefore, for Verizon to discriminate among CLECs in the provision of de-listed network elements. After the merger, there will be every incentive for Verizon to offer its affiliate, MCI, more favorable terms for access to such elements than the company offers to unaffiliated competitive local exchange carriers. To mitigate this economic harm, it is in the public interest for the Commission to require Verizon to make

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[57] 47 C.F.R. § 51.319.
[58] 47 U.S.C. § 251.
[59] Beach, Ex. 60T-HC at 8:166-9:173.
[60] *In the Matter of Multiband Communication LLC for Approval of Line Sharing Agreement with Qwest Corporation Pursuant to Section 252 of the Telecommunications Act of 1996*, Docket No. UT-053005, Order No. 02, Dismissing Petition (April 19, 2005).
[61] 47 U.S.C. § 271.
[62] *See Multiband, supra*. at fn. 32.

available the same rates, terms and conditions in its contracts and/or commercial agreements with MCI to other requesting carriers.[63]

54 Public Counsel may argue that this condition is not worth much because MCI's and Verizon's local exchange operations may be combined (i.e., that they will not remain separate affiliates). This is contradicted by Verizon and MCI's petition.[64] And, as Ms. Roth notes, MCI today has on file with this Commission both interconnection agreements and commercial agreements with Verizon and those agreements have effective dates of between three and five years.[65]

8. Special Access Rates

55 The main reason Verizon wishes to obtain MCI is MCI's strength in the enterprise market.[66] Recent changes in FCC rules, as announced in the TRRO,[67] will impact the ability of Verizon's remaining competitors to contest the market for business/enterprise class local exchange services. The changes that will potentially make it more costly for the remaining competitors to serve that market are (1) the elimination of CLEC's right to obtain high capacity loop facilities in certain wire centers, (2) the elimination of CLEC's right to obtain transport facilities on certain routes between wire centers, and (3) numerical caps on the number of such facilities that a CLEC may obtain where they are still available on an unbundled basis.[68]

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[63] Roth, Ex. 101T-HC at 20, 21.
[64] Joint Petition at ¶¶ 16, 17.
[65] Roth, Tr. at 553, 554.
[66] Smith, Tr. at 238:2-3; Danner, Ex. 21T at 16-19.
[67] 20 F.C.C.R. 2533 (2004).
[68] 47 C.F.R. § 51.319.

56 A CLEC's alternative is to either build its own facilities or to purchase the same functionality (that of the high capacity loop and transport UNEs) from the ILEC as a finished retail service called special access.[69] Special access service is a permanent, dedicated private-line type of connection between an individual subscriber and the interexchange carrier's point of presence.[70] Verizon offers special access at retail to business customers, but it can also be purchased by competitors as a means of obtaining a connection between the CLEC's facilities and the customer's premises in lieu of a high capacity loop and high capacity dedicated transport.

57 In pre-filed testimony, Staff advocated for the Commission to condition its approval of the merger on Verizon reducing its current rates for intrastate special access to the level of its functional equivalent unbundled network elements as determined by the Commission in the generic cost docket. Staff stated that reducing Verizon's special access rates would mitigate the potential competitive harm of the merger when the high capacity loops and transport will no longer be available as UNEs.[71]

58 In the proposed settlement, Verizon has agreed that if the FCC required it to reduce interstate special access rates as part of the FCC's review of the merger, Verizon would support a review by this Commission to determine whether any changes to Verizon's intrastate special access rates should be made. Staff was willing to compromise on this issue for two reasons: (1) Staff learned that within Verizon NW's Washington service territory only one transport route for DS3 between two central offices meets the criteria for Verizon to be relieved of its obligation to provide its competitors with UNE transport and

[69] *See* TRRO, 20 F.C.C.R. 2533 at ¶ 142.
[70] Roth, Ex. 101T-HC at 26.
[71] *Id.* at 28.

loops[72] and (2) the Commission is not precluded from taking up this issue at a later time in a different docket.[73] The settlement agreement in the general rate case expressly allows the Commission to initiate and resolve a proceeding to reduce Verizon's intrastate special access rates.[74]

59 The FCC announced its approval of the Verizon/MCI and SBC/AT&T mergers on October 31, 2005, the day before hearings began in this matter.[75] The FCC's announcement indicated that Verizon had agreed, as a condition of approval, to certain conditions related to pricing and provision of interstate special access services, but not to a reduction in rates. Instead, Verizon committed not to increase the rates set forth in its interstate tariffs for special access services for a period of 30 months.[76] It appears that this condition has therefore become moot.

60 Another condition of the merger approval may further alleviate concerns that lead Staff to its recommendation concerning special access rates. As part of the "voluntary commitments" of the merging parties, Verizon will recalculate—after excluding MCI collocations—to determine which wire centers and transport routes qualify for "delisting" of unbundled high capacity loops and transport.[77]

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[72] Roth, Tr. at 576.
[73] Roth, Tr. at 599.
[74] *See* Roth, Ex. 101T-HC at 28.
[75] "FCC Approves SBC/AT&T and Verizon/MCI Mergers," Corrected FCC News Release (Oct. 31, 1995).
[76] In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Memorandum Opinion and Order, App. G (conditions) (November 17, 2005).
[77] *Id.*

B. Does the Settlement, as a Whole, Assure that the Merger Meets the Standard for Approval?

61 In order to show why the settlement conditions, as a whole, assure that the merger meets the standard for approval, it is helpful to group the conditions according to the potential harms or issues they address: competitive harms, potential savings, and retail service. When considered in light of the concern they each address, and when contrasted with different or additional conditions proposed on the same topics by other parties, it is clear that the settlement conditions strike an appropriate balance to ensure that the merger will not harm the public interest.

1. Competitive Conditions

62 To address the harms to competition identified by Staff's analysis as described in Sec. V.A., below (which is largely consistent with the analysis of Public Counsel witness Dr. Roycroft[78]), the settlement includes four conditions: (1) Verizon will offer competing carriers the same inputs to intrastate services that it makes available to MCI and other affiliates (settlement term 7), (2) Verizon will maintain parity for its wholesale performance measures between its own affiliate, MCI, and other competing carriers (term 4), (3) Verizon will offer its local exchange customers who selected MCI as their long-distance provider a chance to switch to another, unaffiliated carrier without incurring a charge from Verizon to do so (term 6), and (4) in the event the Federal Communications Commission had required Verizon to reduce its interstate special access rates, Verizon would support this Commission

[78] Ex. 371T-HC.

undertaking a review of the level of Verizon's rates for intrastate special access services (term 8).[79]

63 As discussed in Sections V.C.1 and 2, below, to the extent that Staff and Intregra propose additional (or different) conditions for blunting the anti-competitive effects of the merger, they tread into matters of federal jurisdiction that are beyond the scope of this Commission's public interest review.

64 The settlement's competition-related conditions are consistent with the public interest and should be accepted by the Commission in resolution of all of competitive issues raised by the parties to this proceeding.

2. Synergy/Savings-related Conditions

65 To ensure that consumers enjoy at least some benefit from the predicted savings/synergies, and that they are not harmed in the event that savings do not come about, the settlement would require Verizon to satisfy three conditions: (1) to improve service in rural areas by extending service to an unserved area that is the subject of a case currently pending before the Commission (term 1), (2) to extend the benefits of flat-rate local calling in certain areas by increasing local calling areas (term 2), and (3) to cap its local service rates at the level that was set by the Commission in the last case for an additional two years past the two year "stay out" contained in the rate case settlement (term 3).[80]

66 One of Public Counsel's chief criticisms of the proposed settlement will likely be that it does not go far enough to pass on predicted savings or synergies to consumers. Public Counsel may criticize terms one through three of the settlement as collectively costing

[79] *See* Roth, Ex. 101T-HC at 18, 19.
[80] *See Id*. at 24.

Verizon significantly less than Staff's estimation of the synergies allocable to Verizon NW. What this argument fails to recognize is that the question before the Commission is whether the transaction is likely to harm customers or the public. The consequences of a merger, whether positive or negative, are difficult to forecast, and the Commission should be skeptical about promised benefits and cautious about potential harms. It should not approve a transaction unless it is clear that there will be no harm to the public. That approach, however, does not require that all or any specific portion of the expected benefits of a transaction flow to the benefit of customers. With the conditions proposed in the settlement, Staff believes that it is reasonable to conclude that the transaction will not harm customers. It is not necessary to pass through the full amount of estimated future savings for the transaction to pass the public interest test.

67 The Commission must also bear in mind that no rate complaint has been filed against Verizon, and even if it had, estimated savings do not meet the "known and measurable" test for a pro forma adjustment to test year results of operations.[81]

68 Public Counsel tries to rely on *settlements* in previous merger cases as precedent for requiring Verizon to reduce rates to which it would otherwise be entitled. Even setting aside the fact that voluntary undertakings in a settlement are not precedent for the Commission to *require* such a condition in this case, Public Counsel misconstrues the previous settlements. In the Qwest/US West Merger Order, the settlement adopted by the Commission did not require a rate reduction even though Qwest claimed very substantial synergies.[82] Although

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[81] Danner, Ex. 23T-C at 26, fn. 10; King, Tr. at 528:24—529:11.

[82] *US WEST/Qwest Merger Order, supra*, at ¶ 58 ("Dr. Blackmon testified that based on the ongoing review the Commission staff undertakes with respect to U S WEST's financial performance, there being no rate reduction as a part of the Retail Settlement Agreement is a reasonable outcome.")

the Commission did adopt a settlement that required certain rate reductions in the GTE/Bell Atlantic merger, that is because GTE was, contemporaneous to the merger application proceeding, also under an earnings review and the settlement was an opportunity to resolve not only the merger issues but also the potential of a rate complaint that had been raised in the earnings review with regard to the company's (then) *current* level of earnings.[83]

69 Staff's approach (as reflected in the settlement) is more cautious on the issue of the merging companies' estimated savings.[84] While the settlement would pass real public benefits on to customers (terms 1 and 2) in recognition of the savings estimated to be achieved by the merger, it also—perhaps more importantly—guards consumers against the possibility that the merger will have negative effects on Verizon NW's financial picture by extending the existing two year "stay out" for rate filings for two more years until 2009 (term 3). Public Counsel's approach provides no such insurance against negative consequences.

70 The settlement's synergy related conditions are in the public interest and should be accepted by the Commission in resolution of all synergy/savings issues.

3. Retail Service Quality Condition

71 Finally, to address the potential that Verizon's retail service quality could deteriorate as a result of the merger, the settlement provides that Verizon will commit to comply with Commission service quality rules (term 5). Staff's review established a baseline of the

[83] *GTE/Bell Atlantic Merger Order*, *supra*, at pp. 1,2 and 22 ("Until July 1, 2002, Staff, Public Counsel, and the Commission will refrain from initiating, and will not support a third-party request to initiate, and complaint proceeding regarding the overall revenue or earnings of GTE Northwest.").
[84] *See*, Public Counsel witness King, Tr. at 527 ("Q. Is it a possibility that things could turn out worse than predicted by the companies? A. They could turn out worse, turn out better. I have no idea.")

company's performance over the last six months, which can be used to check this commitment.

72 As discussed in Section III.A.5, above, Staff believes that Public Counsel's additional service quality conditions are unwarranted because Verizon's existing service quality is good, there is little evidence that it will change, and the Commission's existing service quality rules are thorough and comprehensive.

73 The settlement's retail service quality provision is in the public interest and the Commission should accept it in resolution of all retail service quality issues raised in this docket.

IV. IF COMMISSION REVIEW AND APPROVAL OF THE TRANSACTION IS REQUIRED, WHAT IS THE STANDARD FOR APPROVAL?

74 WAC 480-143-170 states "If, upon examination of an application and accompanying exhibits, or upon a hearing concerning the same, the Commission finds that the proposed transaction is not consistent with the public interest, it shall deny the application."

75 In the US West/Qwest Merger Order, the Commission stated:

> There is no bright line against which to measure whether a particular transaction meets the public interest standard. As we observed in another recent merger case, "the approach for determining what is in the public interest varies with the form of the transaction and the attending circumstances."
>
> As in prior merger cases, we must be concerned here with whether the transaction might distort or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service. Applicants contend through their application and supporting material that the proposed transaction is procompetitive. Applicants state that the merger will provide "substantial benefits" to Washington consumers. The Settlement Agreements would establish conditions to our approval of the merger application that the Parties assert are sufficient to ensure such benefits are realized in a fashion that is consistent

> with the public interest. We turn now to a review of what is proposed, mindful that the transaction, if approved, should strike a balance among the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available telecommunications service to Washington consumers.

Citing *In Re PacifiCorp and Scottish Power PLC*, Docket No. UE-981627, Third Supplemental Order on Prehearing Conference (April 2, 1999), p. 3.

76 The Commission has applied the public interest standard in at least the two most recent telecommunications company mergers, the U S West/Qwest Merger (UT-991358) and the GTE/Bell Atlantic merger (Docket No. UT-991367). In both cases, the Commission approved the mergers by adopting settlement proposals that included conditions to protect the public interest.

V. ABSENT THE SETTLEMENT, DOES THE TRANSACTION MEET THE STANDARD FOR APPROVAL?

A. Will the Transaction Create Adverse Effects for Competition or in Other Areas?

77 The impact of the merger on competition should be one of the paramount considerations in determining whether the merger is in the public interest.[85] This is because the long-standing policy of this state for the telecommunications industry is to promote competition by creating a competitive environment with ease of entry for multiple suppliers of telecommunications services.[86] If there is a finding that the merger increases concentration in any of the regulated markets, the Commission should establish (or accept in settlement) specific remedies to offset the anticompetitive harm.

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[85] Roth, 101T-HC at 13.

[86] *Id*; RCW 80.36.300(5) (declaring the policy of the state to promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state); *see also* RCW 80.36.310 through 330 (establishing a process for competitive classification and reduced regulatory oversight of telecommunications companies and services in the presence of "effective competition").

78 Plainly, the merger decreases the number of suppliers in certain segments of the market and, to that extent, runs counter to the public policy of promoting competition.[87] The merger has the potential to harm the public interest by reducing competition and customer choice in areas where Verizon is the dominant provider of telecommunications services.[88]

79 The Applicants claim that "[t]here will be no anti-competitive effect of this transaction in Washington or nationally because each company provides different market strengths."[89] They assert that the combination of their respective strengths will bring long-term benefits to consumers in this state.

80 In general, Staff's analysis is that Verizon already dominates most of the markets in which it offers service, and the acquisition of MCI will increase its market power.[90] Staff analyzes market concentration in local exchange, intrastate long-distance, and special access/high capacity loop markets within Verizon's historic service territory to determine whether the merger will affect consumer choice and/or reduce the level of competition in those markets.[91]

81 Staff's analysis employs the Hirfindahl-Hirschman Index ("HHI"), a method of quantifying and labeling the degree of concentration in the supply for a service in a given geographic area. A high HHI number indicates a greater degree on concentration. A high HHI can be due to a scarcity of competing suppliers, or to the dominance of one supplier. A significant increase in the amount of market concentration is cause for concern and, under

[87] Roth, 101T-HC at 13.
[88] *Id*. at 6.
[89] Joint Petition at 18.
[90] Roth, 101T-HC at 11.
[91] *Id*. at 14.

the Department of Justice's Horizontal Merger Guidelines, can be a basis for opposing a merger or for imposing conditions to prevent or mitigate the competitive harm.[92]

82 Based on its analysis of the market data, Staff concluded that the overall effect of the proposed merger on competition will be negative for business and residential customers in areas where Verizon is the incumbent local exchange provider. There will be both direct and indirect negative effects on customer choice. The direct harm is that customers will lose MCI as an alternative to the services offered by Verizon. The indirect harm is that other telecommunications companies that provide retail service using the wholesale or network services of other carriers will no longer have MCI has a supplier in competition with Verizon.[93]

83 Staff's market concentration analysis focuses on Verizon NW's 103 historic incumbent local exchange operating areas in Washington.[94] Due to limitations on the ability to gather data from non-parties, and on the fact that intermodal forms of competition are all rather nascent,[95] Staff's analysis of intrastate special access and local exchange markets is restricted to CLECs competing against Verizon in the market for local exchange services using unbundled network elements. Staff's analysis did, however, also include data regarding purely facilities based competition (where the competing carriers do not rely on

[92] *Id.* at 15; Horizontal Merger Guidelines, U.S. Department of Justice and Federal Trade Commission, Sec. 0.1 (1992).
[93] Roth, Ex. 101T-HC at 16.
[94] Wilson, Ex. 121T-HC at 3.
[95] *Id.* at 9.

the incumbent for any UNE inputs)[96] but did not include intermodal forms of competition (such as wireless, cable and VoIP services).[97]

1. Will the Transaction Adversely Affect Mass Market Local Exchange Services?

84 Staff's analysis shows that the market for residential local exchange service is already very highly concentrated in the geographic areas where Verizon operates. Verizon competes with 36 CLECs in 86 of its 103 wire centers and enjoys an average 98.5 percent market share that varies from a high of 100 percent to a low of 96.5 percent with very little variation in market share across wire centers.[98] Verizon's acquisition of MCI will eliminate its largest single competitor, but the effect of the merger on market concentration is negligible because Verizon's market share before the merger was already so dominant.

> MCI is Verizon's number one competitor with [redacted] percent market share and virtually no market power. MCI serves about [redacted] residential local exchange lines in the relevant market than the [redacted]. MCI's growth in residential local exchange lines has been [redacted] from 2003-2004.[99]

The harm to competition is largely prospective, in that there will no longer be the possibility of greater competition from MCI.[100]

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96 *Id.* at 12, 13.
97 *Id.* at 5.
98 *Id.* at 14.
99 *Id.* at 14.
100 Roth, 101T-HC at 17.

2. Will the Transaction Adversely Affect Mass Market Long-distance Service?

85 MCI and Verizon residential long-distance market shares (for presubscribed intrastate toll calling) are approximately [redacted] percent and [redacted] percent respectively.[101] Verizon's share in this market would, thus, increase significantly with the acquisition of MCI.[102]

3. Will the Transaction Adversely Affect Competition for Enterprise Services?

86 Staff did not specifically analyze the enterprise market as distinguished from the business market, which includes all business class customers without distinction based on the size of the business.[103]

87 The market for business local exchange service is highly concentrated in the geographic areas where Verizon operates. Verizon's acquisition of MCI will increase concentration by a measurable amount.

> Verizon provided [redacted] business local exchange lines in 104 wire centers in 2004. The average number of business local exchange lines that Verizon serves in a wire center is [redacted]. The maximum number of business local exchange lines served by Verizon in 2004 in any wire center was [redacted], and the minimum is [redacted]. Verizon's maximum wire center market share for business local exchange lines was 100 percent, and the minimum was 24.9 percent. Verizon's average market share for business local exchange service was 69.7 percent. Verizon enjoys very high overall market power as measured by the HHI.
>
> Thirty-eight CLECs provide business local exchange services in 89 Verizon wire centers. The average CLEC provides 2,488 business local exchange lines across Verizon territory, the largest provides [redacted], and the smallest provides one line. The most wire centers that any CLEC is in competition to provide business local exchange lines is 60, and the largest market share for any CLEC is [redacted] percent. The average market share for a

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[101] Wilson, Ex. 121T-HC at 19.
[102] Roth, 101T-HC at 17.
[103] *See* Wilson, Ex. 121T-HC at 5, 6.

> CLEC providing business local exchange services in Verizon territory is 0.8 percent, and the average CLEC serves 18 wire centers. MCI is the [redacted] CLEC, selling business local exchange services to [redacted] percent of the lines.[104]

The increase in concentration would generally be unacceptable in an unregulated market and will likely prolong the need to regulate Verizon's business rates.[105]

4. Will the Transaction Adversely Affect Competition for Special Access Services?

88 Staff analyzes the market for intrastate and interstate private line and special access channels together because, from a functional standpoint, private line channels and special access channels are the same thing.[106] Because of the FCC's "ten percent rule" for mixed use facilities, CLECs can and often do use interstate special access as a substitute for intrastate private line service or UNE loops.[107]

89 The market for access/private line services is highly concentrated in the geographic areas where Verizon operates.

> 58 CLECs and IXCs are providing intrastate and interstate private line and access channels across 96 wire centers. Overall CLEC market share in 2004 for intrastate and interstate private line and access channels was 58.9 percent, ranging from a maximum of 23.6 percent to a minimum of zero percent. The average CLEC market share was one percent. The average CLEC serves 15 wire centers, the largest CLEC serves 85 wire centers, and the smallest CLEC serves one wire center.[108]

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[104] *Id.* at 15, 16.
[105] Roth, 101T-HC at 17.
[106] Wilson, Ex. 121T-HC at 7,8.
[107] *Id.* at 8.
[108] *Id.* at 18.

Verizon's acquisition of MCI will increase concentration significantly -- an increase that would be unacceptable in an unregulated market and will likely prolong the need to regulate Verizon's access/private line services.[109]

5. Will the Transaction Create Other Adverse Effects?

a. Financial Impacts of the Merger on Verizon NW

90 Staff examined a number of publicly available documents including Verizon's Form S-4 Registration Statement filed with the Securities and Exchange Commission (SEC), bond rating announcements, and financial statements in order to assess the effect of the proposed merger on the surviving company's financial standing. Staff undertook this analysis because a change in financial standing, such as an increase in debt cost could be reflected in any future cost of capital calculation (and, therefore in rates) for Verizon NW.[110] Staff reviewed financial indices as they concern the proposed merged company including rate of return, coverage ratios, and any immediate demands for new financing. Finally, Staff obtained additional information through Staff and Public Counsel Data Requests.[111]

91 It does not appear likely, based on Staff's review of broad financial indictors, that the merger will be harmful to the financial health of the companies.[112] Nonetheless, there is reason to be cautious, because it is not certain that savings and synergies will materialize as anticipated.[113]

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[109] Roth, 101T-HC at 17.
[110] Folsom, Ex. 150T-HC at 4, 5.
[111] *Id.*
[112] *Id.* at 3.
[113] *See Id*. at 10-13 (discussing Moody's and Standard & Poor's "on review" and "CreditWatch" actions with respect to Verizon's debt rating).

b. Reduced CLEC Bargaining Power

92 Since the 1996 Telecommunications Act, the existence of a certain balance of bargaining power between incumbent local exchange carriers like Verizon, on the one hand, and competitive local exchange carriers like MCI and AT&T, on the other hand, has played a important role in gaining access for the whole CLEC community to Verizon wholesale services and UNEs through interconnection agreement negotiations and arbitration proceedings. One impact in Washington state of the proposed Verizon/MCI merger is to create less bargaining power on the CLECs' side. Without MCI to arbitrate new interconnection agreements (and it appears that AT&T will no longer fill that role, either), the CLECs remain vulnerable to costly and time-consuming arbitration of new agreements or amendments. The remaining CLECs in Washington simply will not have the matching resources to advocate against Verizon in arbitration and other regulatory proceedings necessary to establish rates, terms, and conditions for UNEs and other network elements that are no longer UNEs under Section 251 of the Telecommunications Act.[114] The diminishing ability of small CLECs to negotiate and arbitrate interconnection agreements presents a barrier to entry.[115]

[114] 47 U.S.C. § 251.
[115] Roth, Ex. 101T-HC at 19, 20.

B. Will the Transaction Provide Benefits to Washington?

1. Synergy/Savings Benefits

93 The Applicants have stated that the acquisition will yield a Net Present Value (NPV) of approximately $7.3 billion in additional revenues and operational cost savings company-wide.[116]

94 The cost reductions will be achieved through the reduction of 7,000 jobs, the reduction of information technology costs, increasing the efficiency of using existing network capacity to migrate long-distance business traffic, avoiding costs that Verizon would have incurred in building out its own networks, reducing procurement costs, and rationalizing the companies' real estate assets.[117]

> The savings and revenue enhancements that yield a NPV of $7.3 billion are projected to occur over at least the years [redacted] and [redacted]. The Companies' analysis shows at least [redacted] is predicted to occur during the period [redacted]. The remaining [redacted] is based on [redacted]. The majority of the costs to achieve those savings occur within the [redacted] after the merger. The largest savings occur in the [redacted] [redacted].[118]

To the extent that these savings can be allocated to the intrastate, Commission-jurisdictional, tariffed services of Verizon NW, they may be regarded as a public interest benefit within the meaning of WAC 480-143-170, because they may result in a lower revenue requirement for Verizon NW. A lower revenue requirement may result in lower rates to the extent that it keeps the company from filing for a rate increase as early as it otherwise would have to, or when it does file, from having to increase rates as much as it otherwise would. The issue

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[116] Folsom, Ex. 150T-HC at 17.
[117] *Id.* at 17, 18.
[118] *Id.* at 18.

also could be forced by the Commission complaining against the company's rates, once those savings have become "known and measurable."[119]

95 Another way to assure that savings flow to the benefit of consumers, and not solely to shareholders, is if the merging companies agree to pass on some of the savings in the form of specific investments or commitments for the public good.

96 Staff estimates that the minimum NPV of savings that will flow to Washington intrastate operations is [redacted], attributable to net revenue synergies, and [redacted], attributable to net expense cost savings, for a total of [redacted]. Staff estimates that the amount may be as much as [redacted] if the synergy allocation process is extended into the years [redacted].[120]

2. Other Benefits

97 Verizon argues that the merger will benefit enterprise customers in Washington with better, more innovative, and more competitively priced services. In approving the mergers, with conditions, the FCC and the Department of Justice have acknowledged this possibility.[121]

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[119] *See* WAC 480-07-510(3)(b)(ii).
[120] Folsom, Ex. 150T-HC at 4.
[121] *In the Matter of Verizon Communications, Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, at ¶ 203 (November 17, 2005); "Justice Department Requires Divestitures in Verizon's Acquisition of MCI and SBC's Acquisition of AT&T," Press Release, U.S. Dept. of Justice (Oct. 27, 2005).

C. Should Conditions Be Imposed?

1. Public Counsel's Proposed Conditions

a. Stand-Alone DSL

98 Verizon's commitment to the FCC (in return for that agency's approval of this same merger) effectively moots Public Counsel's proposal for this Commission to do the same.[122]

99 Even if the issue were not moot, DSL service—indeed all broadband services—are exclusively within the FCC's jurisdiction (except in the extraordinarily unusual case when Internet access would be used to visit websites within the user's home state more than ninety percent of the time).[123]

b. VoIP E-911 Platform Deployment

100 Staff believes this condition is beyond the scope of the Commission's public interest review in this case in the same way that issues concerning provision of CMRS (wireless) services, for example, are beyond the scope. The FCC has preempted states from regulating

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[122] *Id.* at App. G (conditions)("Within twelve months of the Merger Closing Date, Verizon will deploy and offer stand-alone ADSL within the local service areas of Verizon's incumbent local telephone companies. Standalone ADSL means ADSL service on ADSL-equipped lines without requiring customers to also purchase circuit switched voice grade telephone service. This service will be available both for existing Verizon voice and ADSL customers who wish to port their voice service to a VoIP provider or to another facilities-based provider such as cable or wireless, and for new customers who wish to subscribe only to Verizon's ADSL and not to its voice service. This service will remain available in a given state for two years after the "implementation date" in that state. For purposes of this condition, the "implementation date" for a state shall be the date that Verizon can offer this service on eighty percent of Verizon's ADSL- equipped lines in Verizon's local service area in that state. Within twenty days after meeting the implementation date in a state, Verizon/MCI will file a letter with the Commission certifying to that effect. In any event, this commitment will terminate no later than three years from the Merger Closing Date.")

[123] *In the Matters of Appropriate Framework For Broadband Access to the Internet Over Wireline Facilities*, CC Docket No. 02-33, 2005 WL 2347773 (F.C.C.), 36 Communications Reg. (P&F) 944, at ¶ 103 (Sept. 23, 2005); GTE DSL Order, 13 FCC Rcd at 22474, ¶¶ 16-32 (finding that GTE's ADSL service is an interstate special access service that should be federally tariffed); GTE DSL Reconsideration Order, 17 FCC Rcd at 27411-12, ¶ 9 (stating that, in some circumstances, ADSL services may be appropriately tariffed as interstate services).

VoIP service[124] and has recently ordered all VoIP providers to develop the capability to deliver E-911 calls over VoIP to the appropriate public safety answering point.[125]

c. Customer Notice of Merger and Right to Choose another Provider

101 Customers have received notice of the merger through publication in accordance with WAC 480-143-210, and would receive the bill notice required by term 6 of the settlement. To the extent that the notice requirement proposed by Public Counsel is tied to Public Counsel's proposed conditions regarding the waiver and rebate of service establishment charges, Staff's position with regard to those requirements is set forth in section III.A.6, above.

d. Waiver of Service Establishment Charges for MCI Customers Switching to Verizon

102 Staff's position with regard to this proposed condition is set forth in section III.A.6, above.

e. Rebate of Service Establishment Charges for MCI Customers Switching to a Carrier Other Than Verizon

103 Staff's position with regard to this proposed condition is set forth in Section III.A.6, above.

f. Prohibition against Verizon Operating MCI in Circumvention of Verizon NW's Tariffs

104 One of Public Counsel's assumptions is that the MCI local exchange company (MCImetro Access Transmission Services) will necessarily become subject to tariff, rather

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[124] *In the Matter of Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission,* WC Docket No. 03-211, Memorandum Opinion and Order, ¶ 23 (Nov. 12, 2004).

[125] *In the Matters of IP-enabled Services, E911 Requirements for IP-Enabled Service Providers,* WC Docket Nos. 04-36, 05-196 (June 3, 2005).

than price list regulation, following the merger.[126] This is not a given. One of Verizon's competitively classified affiliates, Verizon Avenue Corp., already provides local exchange services subject to price list regulation.

105 Public Counsel witness Dr. Roycroft states that, as a consumer protection condition, "Verizon should be prevented from operating its MCI subsidiary within Verizon's Washington service area in a manner which would allow Verizon to circumvent Verizon's Washington tariffs."[127] Aside from an abstract harm of "discrimination" (i.e., offering a different, presumably more favorable rate through a subsidiary) it is not clear how consumers would be harmed if the MCI LEC remains competitively classified after the merger.[128] In any event, should any possibility of harm arise, the Commission has the authority at any time to revoke a competitive classification when it finds that it is in the public interest to do so.[129] Public Counsel has not made the case for revocation on this record.

g. Enhanced Service Quality Reporting, and Annual Report to Customers

106 Public Counsel argues that the Commission should impose service quality reporting requirements on Verizon in addition to those already imposed by rule. Those are: (1) quarterly reports of investment by wire center, (2) quarterly headcount reporting for installation and repair personnel, and business office and repair call centers, (3) annual service quality report to customers as a bill insert for five years addressing all the areas of

[126] *See, e.g.*, King, Ex. 371T-HC at 13:16-17.
[127] Roycroft, Ex. 371T-HC at 5.
[128] reference to Tr.
[129] RCW 80.36.320(4).

the Commission-required report, and (4) mandatory explanation by the company of why it has failed to meet standards at open meetings.[130]

107 Public Counsel argues that the Commission imposed retail service quality conditions in prior mergers and should do so in this one as well because "mergers introduce pressures to cut costs, and the reality of cost cutting has the potential to reduce service quality."[131]

108 As discussed in section III.A.5, above, Staff believes these requirements are unnecessary for three reasons: (1) Verizon's service quality leading up to this merger is good; evidence of poor service quality leading up to the GTE/Bell Atlantic and US West/Qwest mergers was the primary reason for service quality conditions in those cases. (2) Even accepting public counsel's argument regarding pressure to cut costs after the merger, Verizon NW's management is not changing as US West's and GTE's did in prior mergers and the cuts in this merger are targeted at parts of the business other than the local exchange business. (3) The Commission's current service quality rules are more comprehensive than those that were in effect during prior mergers.

h. Sharing of Merger Savings

108 Public Counsel's theory with regard to merger synergies/savings is that "[w]ere a rate case to be initiated now, the synergy savings would be captured in the revenue requirement calculation and in consequent rates."[132] "Not to share those synergies creates harm because it would deprive ratepayers of the benefit of the lower revenue requirement resulting from merger synergies. The effect is the same as overcharging." However, Public Counsel witness King clarified on cross examination that:

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[130] Roycroft, Ex. 371T-HC at 92-94.
[131] Id. at 92.
[132] King, Ex. 411T-HC at 19, 20.

> If the rate case were right now, [the savings] wouldn't be captured very much, because we're right at -- well, assuming we had just consummated the merger, what you would be getting would be most of the transaction costs and not much of the synergies yet.
>
> The appropriate time frame to consider is beyond 2007, which is when the rate freeze, current rate freeze goes off, and sometime within the next two or three years is when the company would be filing and then the synergies would be beginning to kick in. And that's why I give 2007, 2008, 2009 results.

Tr. at 528, 529.

109 Public Counsel proposes, based on its adjusted calculation of the estimated merger synergies allocable to Verizon NW, that the Commission should reduce by $1.00 per line monthly, the $1.47 increase that is to go into effect on July 1, 2007, under the terms of the general rate case settlement. This would represent a revenue reduction of $8.69 million annually (even though Public Counsel's estimate of the amount of synergies that would eventually show up in a revenue requirement calculation for the merged company is only about $[redacted] for 2007, $[redacted] for 2008 and $[redacted] for 2009 and these numbers are substantially higher than Verizon's calculations[133]).

110 Public Counsel proposes to reduce rates to which the company would otherwise be entitled under the recent rate case, and to pass through to consumers considerably more "savings" than even Public Counsel estimates would eventually be recognized in a rate case. Public Counsel does not propose a stay out, and in fact, uncritically assumes that the savings will materialize exactly as predicted[134] (in fact to a greater degree than the company predicts for purposes of allocation to Washington regulated operations). In response to a question

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[133] King, Ex. 411T-HC at 19, 20.

[134] Tr. at 526:3-9 ("Q. Did you look at the possibility that [the savings] might not materialize? A. Not really. I'm taking the company at its word that these savings will materialize, and I would also take them at their word that they may not materialize as they predict them, but there certainly should be savings.")

regarding whether the actual savings to be achieved by the merger might turn out worse than predicted, Public Counsel witness King stated: "They could turn out worse. They could turn out better. I have no idea." Setting aside that there presently is no rate complaint, or even the threat of one pending against Verizon NW at this time, Public Counsel's "adjustment" plainly does not meet the "known and measureable" test for rate base/rate of return ratemaking. If the predicted savings or synergies do not materialize as estimated by Public Counsel, or if they are offset by other, as yet unknown factors, then Public Counsel's proposal could have the effect of forcing Verizon NW to file for a rate increase in two years.

111 The settlement proposal, by contrast, takes a more defensive and cautious approach toward the predicted financial effects of the merger by insulating rate payers against potential harm resulting from the proposed change in the status quo with an additional stay out through July of 2009. *See* sections III.A.3 and III.B.2, above.

i. Requirement to Deploy Broadband in Areas Currently Unserved by DSL

112 Public Counsel's theory for requiring Verizon to deploy DSL in areas that currently do not have access to DSL is that the Commission should hold Verizon to one of its promised public interest benefits of the merger.[135] However, as became clear in cross examination, Verizon's statements with regard to broadband deployment actually refer to speeding the introduction of its fiber-to-the-premises (which Verizon calls its "FiOS" service) in areas that, in all likelihood are already served by DSL service.[136] In other words, Verizon never touted more widespread deployment of DSL as a benefit of the merger. Thus,

[135] Roycroft, Ex. 371T-HC at 94:27 – 95:2 ("As a condition of the merger, Verizon should be required to substantiate its claims regarding the alleged broadband benefits of the merger.")
[136] Danner, Tr. at 213-215.

this condition would require Verizon to make investments in addition to any it has said it would make.

113 Additionally, as with the other conditions that pertain to broadband service, or VoIP technology, this condition treads into an area where the Federal Communications Commission has asserted exclusive, preemptive jurisdiction.[137]

2. XO's Proposed Conditions

a. Reduce Prices for Intrastate Special Access Services to Cost-Based Levels

114 Staff's position on this issue is set forth in Section III.A.8, above.

b. Recalculation of Locations Where High Capacity Loop, Dedicated Transport, and Dark Fiber UNEs Must Be Provided

115 As a condition of the FCC's approval of the merger, Verizon will recalculate—after excluding MCI collocations—to determine which wire centers and transport routes qualify for "delisting" of unbundled high capacity loops and transport.[138] This would appear to render this condition moot.

116 In addition, "impairment" determinations under 47 U.S.C. § 251 are within the jurisdiction of the FCC, not the states.[139]

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[137] *In the Matters of Appropriate Framework For Broadband Access to the Internet Over Wireline Facilities*, CC Docket No. 02-33, 2005 WL 2347773 (F.C.C.), 36 Communications Reg. (P&F) 944, at ¶ 103 (Sept. 23, 2005); GTE DSL Order, 13 FCC Rcd at 22474, ¶¶ 16-32 (finding that GTE's ADSL service is an interstate special access service that should be federally tariffed); *In the Matter of Vonage Holdings Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission,* WC Docket No. 03-211, Memorandum Opinion and Order, ¶ 23 (Nov. 12, 2004).
[138] In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Memorandum Opinion and Order, App. G (conditions) (November 17, 2005).
[139] 47 U.S.C. § 251(c)(3), *see, also United States Telecom Association v. Federal Communications Commission*, 359 F.3d 554, 565 (D.C. Cir. 2004).

c. Waiver of TRRO's 10 DSL Loop and Dedicated Transport Circuit Cap for Buildings and Routes

117 The Commission should not impose any such requirement as a condition of its approval of this merger. "Impairment" determinations under 47 U.S.C. § 251 are within the jurisdiction of the FCC, not the states.[140]

d. Reinitialize Existing Interconnection Agreements and Make Current Verizon-MCI Interconnection Agreement Available for Adoption for 3-5 Years

118 The Commission should not impose any such requirement as a condition of its approval of this merger. The process for negotiation and amendment of interconnection agreements is a matter of federal, not state law, although the state commissions have a delegated role in review of negotiated agreements and arbitration.[141]

3. Staff and Integra's Proposed Conditions

119 Staff's litigation position is that, in the absence of the eight conditions proposed in Ms. Roth's testimony, the merger would be harmful to the public interest and Washington consumers would see no real benefits as claimed by the Petitioners.[142] Staff's proposed conditions were intended to mitigate the harmful effects of the merger and to ensure that the merger could be found to be consistent with the public interest.[143] As discussed in Ms. Roth's testimony,[144] the settlement in the general rate case, Docket No. UT-040788, expressly does not prevent the Commission from implementing Staff's proposed conditions (or those proposed by any other party).

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[140] *Id.*
141 47 U.S.C. § 252.
[142] Roth, 101T-HC at 12, 13.
[143] Id. at 4.
[144] Ex. 101T-HC at 4, 5.

120 The settlement conditions largely adopt Staff's eight conditions, with the addition of Integra's condition. Where Staff compromised—most particularly on the special access rate reduction condition—it found good reason to do so aside from avoiding the expense of litigation. *See* section III.A.8, above.

D. Public Comment

121 This section was reserved at Public Counsel's request. Staff does not have any argument regarding the public comment in this docket.

VI. CONCLUSION

122 For the foregoing reasons, the Commission should accept the Multiparty Settlement in resolution of all contested issues in this docket. The settlement would assure that the transaction strikes a balance among the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available telecommunications service to Washington consumers.

DATED this 23rd day of November 2005.

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