BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of VERIZON COMMUNICATIONS, INC. For Approval of Agreement and Plan of Merger.	DOCKET NO. UT-050814

NON-CONFIDENTIAL

BRIEF OF PUBLIC COUNSEL

(MERGER REVIEW)

NOVEMBER 23, 2005

I. INTRODUCTION AND SUMMARY OF POSITION

A. The Context of the Verizon/MCI Merger.

1. Along with the SBC/AT&T merger, the Verizon/MCI merger represents a dramatic reversal of the original vision of the *Telecommunications Act of 1996*, which attempted to establish the conditions to bring competition to the local telephone markets. As FCC Commission Copps said in his concurring statement approving the Verizon/MCI merger:

> The mergers before us are about more than the union of this country's largest telecommunications carriers. They are about consumers' phone bills, the availability of competitive broadband options and the future of the Internet. But in a sense, these mergers can also be seen as an epitaph for the competition that many of us thought we would enjoy as a result of the Telecommunications Act of 1996. That legislation, I am convinced, envisioned a vastly different communications landscape than the one we find ourselves living in today.[1]

2. Since the divestiture of the AT&T monopoly in 1984, the local telecommunications market in the United States has been dominated by the Regional Bell Operating Companies (RBOCs), among them Bell Atlantic and US West (now Qwest), and by GTE, formerly the largest non-Bell incumbent, operating in over 20 states. Bell Atlantic acquired GTE in 1999, giving birth to Verizon. AT&T and MCI were the largest and most aggressive of the competitive carriers who sought to challenge the Bell companies and other incumbents in their own local markets, using the tools created by the *Telecommunications Act of 1996*.

3. The Verizon/MCI and SBC/AT&T mergers represent the end of that vision and a major consolidation of the market power of the incumbents, particularly in the mass market for small consumers. While incumbents and some industry observers argue that intermodal competition will offset the effects of this re-consolidation, the reality is that the ability of these forces to

---

[1] Re: Verizon Communication, Inc. and MCI, Inc., Applications for Approval of Transfer of Control, Memorandum Opinion and Order, FCC, WC Docket No. 05-75, Concurring Statement of Commissioner Michael J. Copps (FCC-05-184), p. 1(Appended to this brief as Attachment C)

constrain the market power of the Bells is not known. What is known is that the incumbents have resources that dwarf their competitors,[2] that they are themselves acquiring and offering the technologies and services that are cited as constraining competitors (VoIP, broadband, video, and wireless), and that they have the ability to offer one-stop shopping on a scale that few competitors can match. Market shares in the mass market are very high. To the extent that cable companies are able to offer an alternative choice for "one-stop shopping," the customer is at best faced with duopoly, a situation not viewed by any serious economist as representing vibrant competition. *See generally*, Exh. No. 371T-HC, pp. 6-17.

B. The Merger in Washington.

4. Based on the evidence provided by both Commission Staff (Staff) and Public Counsel in this case, there can be no question that the Verizon/MCI merger has significant negative consequences for consumers in Washington. Absent sufficient merger conditions to mitigate those consequences, the merger does not serve the public interest. Unfortunately, the merger conditions contained in the proposed settlement do not counteract the competitive harms introduced by the merger. The Commission should adopt the merger conditions proposed by Public Counsel to assure that Washington consumers receive some public interest benefits from the merger.

---

[2] *See* Exh. No. 373, pp. 2-4 (Charts 2, 3, 4) Roycroft's bar graphs showing the relative sizes of the major national telecommunications providers. The Verizon/MCI combination represents the largest in terms of revenues by a significant margin.

II. BACKGROUND OF THE TRANSACTION AND PROCEEDING

A. Description Of The Transaction.

1. The Applicants.

a. Verizon.

5. Verizon provides telecommunications service in Washington State primarily through its subsidiary Verizon Northwest, Inc. (Verizon Northwest).[3] Verizon Northwest is the second largest telecommunications carrier in Washington State. It serves approximately 825,000 lines in Washington. Its service territory covers many areas of the state, including the Seattle area, Everett and north to the Canadian border, Central Washington, Eastern Washington, and Columbia River communities.[4] Verizon offers a variety of services to residential and business customers in the state including local exchange telephone service, inter- and intrastate long distance (intraLATA and interLATA interexchange) service, access services, local private line voice and data services, and Centrex. Its annual intrastate operating revenues are $377 million.

6. Verizon Northwest market share, pre-merger, in the residential local exchange market ranges from a low of 96.5 percent to a high of 100 percent, with an average market share of 98.5%. Exh. No. 121T-HC, p. 14 (Wilson). Verizon has very high market power for residential local exchange lines, and virtually no facilities based competition. *Id*. Verizon's average market share in the business market is 69.7 percent. Verizon has very high market power in the business market, using HHI as a measure. Exh. No. 121T-HC at 16 (Wilson).

---

[3] Other Verizon subsidiaries registered in Washington are Bell Atlantic Communications, Inc., dba Verizon Long Distance, and Verizon Select Services. Exh. No. 101T-HC, p. 6 (Roth).

[4]Communities served by Verizon include: Redmond, Kirkland, Bothell, Woodinville, Everett, Lynden, Anacortes, Mount Vernon, Wenatchee, Pullman, Chelan, Richland, Naches, Westport, Newport, Oakesdale, Republic, Camas, and Washougal.

b. MCI.

7. MCI operates in Washington through the MCImetro Access Transmission Services, MCI WorldCom Communications, Inc., and other registered subsidiaries. MCI offers service to residential, business, and enterprise customers including local, long-distance, data, Internet, private line, and high-speed dedicated services. Highly confidential data on the number of MCI residential lines in Verizon territory and Qwest territory in Washington is provided by MCI witness Beach. Exh. 61T-HC, pp. 12-13 (Beach). Staff witness Tom Wilson also provides confidential data on residential and business line counts. Exh. No. 121T-HC, p. 14 (Wilson); Exh. No. 125-HC, l. 13 (residential); Exh. No. 127-HC, l. 14 (business).

8. MCI is Verizon's largest single competitor in the local exchange market. Exh. No. 101T-HC, p.17 (Roth). MCI is also a significant competitor in Qwest's service territory.

2. The Transaction

9. The transaction is summarized in Section IV of the Joint Petition, ¶¶ 13-17. A detailed description of the transaction is contained in the Agreement and Plan of Merger (Merger Agreement) which is attached to the Joint Petition as Attachment A. Attachments B and C to the Joint Petition contain amendments to the Merger Agreement which change the consideration and certain dates.

10. As described in the Agreement, MCI will merge into ELI Acquisition, LLC (ELI), which is wholly owned by Verizon and created solely to facilitate the merger. ELI will be the surviving company in the merger and Verizon will be its parent corporation. Verizon intends to rename ELI, the surviving company, as "MCI, LLC." Joint Petition, ¶ 14. After the transaction is completed, MCI will be a subsidiary of Verizon. *Id.*, ¶16.

11. Joint Petitioners describe the transaction as a parent company stock transaction, a merger of corporate parents (holding companies) and ELI, the Verizon subsidiary created solely to facilitate the transaction. Joint Petition, ¶¶ 20, 22, 23.

B. Summary Of Proceeding.

12. On May 27, 2005, Verizon and MCI (Joint Petitioners) filed their Joint Petition requesting a disclaimer of jurisdiction, or, in the alternative, approval of their Agreement and Plan of Merger. Joint Petitioners sought an expedited schedule for the proceeding, requesting an order be issued before year's end. The Joint Petitioners filed their opening testimony on June 28, 2005. The opening testimony contained virtually no financial information, and included no significant information about merger savings or synergies. After the Joint Petitioners declined to provide merger savings and synergy information in discovery, on July 27, 2005, Public Counsel and Staff filed a Joint Motion to Compel Production of Merger Savings/Synergies Models. The motion was ultimately resolved between the parties and the requested information was produced. Public Counsel and other parties filed their testimony on September 9, 2005. Joint Petitioners filed rebuttal testimony on October 9, 2005. Staff, Verizon, and Integra entered into a multiparty settlement on October 20, 2005. Evidentiary hearings were held in Olympia on November 1 and 2, 2005.

III. THE PROPOSED SETTLEMENT

13. The evidence presented to the Commission in this case establishes persuasively that the proposed merger will harm the public interest unless conditions are adopted to mitigate that harm.[5] The testimony in the record identifies a list of specific harms associated with the merger including a reduction in competitive activity and increased market concentration,[6] the loss of MCI as a supplier of inputs to other CLECs,[7] and the potential for an increased cost of capital in

[5] Exh. No. 371T-HC, pp.2-6 (Roycroft). Exh. No. 101T-HC, p. 11 (Roth). Exh. No. 150T-HC, p. 13 (Folsom). The standard of review for merger approval is discussed in Section IV of the brief.

[6] Exh. No. 371T-HC, pp. 72-75 (Roycroft). Exh. No. 101T-HC, p. 16 (Roth).

[7] Exh. No. 101T-HC, p.16 (Roth).

future Verizon rate cases.[8] Additional harmful impacts arise from the lack of adequate customer notification, the interference with customer choice, the general lack of any specific information regarding MCI's post-merger operations,[9] and the potential for a negative impact on service quality[10] were also identified. Having identified these areas of concern, both Commission Staff and Public Counsel witnesses recommended conditions designed to remedy, mitigate, and counterbalance the harms.[11]

14. Staff has now entered into a settlement with Verizon and MCI that it states "adopts all of Staff's proposals with one exception or modification [regarding special access]." Exh. No. 502, p. 11. Unfortunately, in Public Counsel's view, and as demonstrated by the record, the proposed settlement Agreement does not address in any effective way the range of issues raised in the testimony, nor does it even resolve or satisfy all of the conditions which Staff sought.

A. The Settlement Conditions in the Proposed Settlement are Not in the Public Interest.

15. The proposed settlement offers eight (8) terms which the settling parties state should adequately mitigate all the competitive and other harms caused by the merger. Each of the terms is discussed below.

1. Extension of service to UT-050778 complainants (Rupp Complaint)(Term 1).

16. This condition seeks to resolve the dispute in the above-referenced docket by obtaining a commitment from Verizon to extend service to a small group of residents of the Index-Galena Road who have not been able to gain access to telephone service due to the prohibitive cost.[12]

---

[8] Exh. No. 150T-HC, p. 29 (Folsom).

[9] Exh. No. 371T-HC, pp. 19-21 (Roycroft).

[10] Exh. No. 371T-HC, pp. 82-84 (Roycrfot); Exh. No. 101T-HC, p. 31 (Roth).

[11] Exh. No. 371T-HC, pp.85-86 (Roycroft); Exh. No. 101T-HC, pp.2-4 (Roth).

[12] Exh. No. 101T-HC, p. 24 (Roth).   The original complaint listed twelve residents. It appears one has withdrawn from the docketed proceeding.

The value of this term of the proposed settlement is $325,000. Exh. No. 502, p. 6. In the event that Verizon is unable to accomplish the service extension for some reason, Verizon agrees to pay this amount for some other unspecified public interest purpose. *Id*.

17. It is not apparent what connection this one-time benefit to a small group of customers has with the merger case. As was discussed at the hearing, this issue is the subject of a complaint case currently pending before the Commission, now stayed pending this decision. *In the Matter of the Petition of Rupp, et al., v. Verizon Northwest, Inc.*, Docket No. UT-050788 (Notice Suspending Schedule, November 10, 2005. The Verizon concession here is offset by Verizon's ability to earn a return on the investments made to serve these customers, and therefore imposes a cost on other customers.[13]

18. Regardless of whether a merger case is pending, the Commission has the authority to order a line extension in an appropriate case. RCW 80.36.090; WAC 480-120-071. It could do so in the Rupp complaint matter, TR. 579:20-580:6 (Roth), although it appears there is some question about whether this is an appropriate case. Examination by both Chairman Sidran, TR. 614:8-615:14, and Commissioner Oshie, TR. 601:14-602:19, raised questions about whether the Index-Galena road situation actually meets the Commission's criteria for line extensions under the *Taylor* case.[14]

19. In *Taylor*, the Commission held that Verizon was not required to implement the requested line extension. *Taylor* involved eight to twelve customers. The Commission found that the cost of the projects at issue was "extraordinarily high," relative to the number of customers. *Taylor*, ¶ 63. Verizon witness Danner's testimony "convincingly call[ed] into question the value of adding

---

[13] TR. 581:17-582:1, 603:23-605:4 (Roth).

[14] In the Matter of the Petition of Verizon Northwest Inc., For Waiver of WAC480-120-071(2)(a); Docket No. 011439, Twelfth Supplemental Order, ¶16 (Taylor) (listing the seven factors).

so small a number of customers to the network[.] *Id.*, ¶ 64. The Commission concluded:

> [T]he Commission is persuaded that there would be a potentially significant adverse effect on the company and other ratepayers if a waiver is not granted. A denial of the waiver would send the signal that extraordinarily costly line extensions to serve few customer are warranted under the new rule. *This in turn would make it increasingly difficult for carriers to devote resources to their existing network and would create an unreasonable increase in the subsidies paid by other ratepayers. It would increase maintenance costs and burdens for which carriers either would not obtain cost recovery or would have to seek recovery from other ratepayers.*

Id., ¶ 68. (emphasis added).

Staff witness Roth indicated she was not aware of "what the Commission's view is" under *Taylor*, TR. 602:19, and that Staff had not done an analysis of the Rupp request under the *Taylor* criteria. TR. 615:9-14. Public Counsel does not have a position on whether the Rupp line extension should be granted. It does seem clear, however, that the issue should be resolved in the complaint case, where all the necessary criteria can be reviewed. Ordering the line extension as a condition of the merger runs the risk of imposing added costs on ratepayers and applying line extension rules inconsistently, potentially raising an undue preference or discrimination issue under RCW 80.36.170, RCW 80.36.180.

20. Even if the Rupp line extension is consistent with Commission policy, however, the value of this agreement is only $325,000. This is obviously only a small fraction of the total savings and synergies that should be allocated to Washington according to Staff's own evidence.[15] It is a negligible benefit both in terms of numbers of customers and dollars. If viewed as sharing, this is a highly distorted attempt to share merger benefits.[16] Each of twelve customers would receive benefits that amount to approximately $27,000, not counting the waiver of their individual line

[15] Exh. No. 150T-HC, p. 21 (Folsom).

[16] TR. 475-476 (Roycroft).

extension fees, while the overwhelming majority of Verizon ratepayers receive no financial benefit whatsoever and would actually incur some costs.

In summary, while Public Counsel does not take a position on the merits of the Rupp complaint per se, for the reasons stated, Term 1 of the proposed settlement does nothing of significance to meet the public interest test for approval of the merger.

2. Rate Center Consolidation and Premium Adder Elimination. (Term 2).

a. Rate center consolidations.

21. The proposed settlement provides for consolidation of rate centers in two areas: Skagit County (Anacortes, Mount Vernon, Sedro Wooley) and North Snohomish County (Arlington, Darrington, Granite Falls, and Marysville). Confidential Appendix A of the proposed settlement also identifies the amount per year in reduced toll charges as the financial benefit from this agreement.

22. Public Counsel witness Roycroft indicated that only about 10% of Verizon's business and residential customers would see any benefit from the rate center consolidations.[17] On cross-examination, Staff witness Roth admitted that this benefit would not reach a high percentage of Verizon customers,[18] but argued that Dr. Roycroft was understating the percentage of customers affected by the North Snohomish consolidation.[19] Ms. Roth indicated that the number was closer to 30%[20] because customers in Everett, Silver Lake, and Stanwood would also benefit from the consolidation by getting new calling to Arlington, Granite Falls, Darrington, and Marysville. Asked to provide support for this assertion, Staff provided Exh. No. 528, a workpaper in

---

[17] TR. 476:3-9 (Roycroft). Exh. No. 105, p.3 (Public Counsel illustrative exhibit).

[18] TR. 590 (Roth).

[19] Staff did not make this argument for the Skagit County consolidation. TR. 587:22-588:18.

[20] TR. 590:13-22 (Roth).

response to Record Requisition No. 8 which identifies the wire centers and line counts which Staff believes represent the number of customers who will be affected by the consolidation.

23. There is, however, a fundamental problem with the calculation in Exh. No. 528, namely, the consolidations will not affect all consumers equally. For example, Darrington, which would be consolidated with four other rate centers as part of the proposal, would gain significant calling scope, including the ability to call Everett. However, a very small number of Verizon ratepayers benefit from this expansion, about two-tenths of one percent (0.22%). Most of the other wire centers identified by Staff in Exh. No. 528 already have local calling privileges with the consolidated exchanges. For example, the exhibit shows Everett and Silver Lake[21] as receiving benefits from the consolidation of the Arlington, Darrington, Granite Falls, and Marysville rate centers. At the hearing Ms. Roth stated: "If people in Everett today want to make a call to Arlington, Granite Fall [sic], Darrington today, they have to pay a toll charge." TR. 586:22-25.

She appears to be largely in error on this point. According to Verizon's Tariff, ratepayers in Everett and Silver Lake already have local calling privileges with Arlington, Granite Falls, Halls Lake, Marysville, Monroe, Snohomish, Stanwood, and Sultan.[22] Thus, although Everett and Silver Lake ratepayers will be able to call Darrington as a local call as a result of the settlement, this is a relatively small gain in calling scope. It is not appropriate to identify Everett and Darrington ratepayers as equal beneficiaries of the rate center consolidation provisions of the proposed settlement. The percentage of affected ratepayers identified in Exh. No. 528 overstates the impact of the consolidation. Ratepayers in Everett may save some toll charges should they have reason to call Darrington, but the magnitude of the savings for these ratepayers will be negligible. There is no evidence of what percentage of Everett customers call Darrington.

---

[21] Everett and Silver Lake contribute 60% of all the lines for which the Staff claims will benefit, but the benefits accruing to ratepayers in these exchanges will likely be very small.

[22] The tariffs describing their calling areas are attached to the brief as Attachments A and B. Public Counsel requests that the Commission take official notice of the tariffs pursuant to WAC 480-07-495(2)(a)(i)(C).

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

Darrington customers likely have more reason call Everett to call employers, health care providers and so on, than while a smaller percentage of Everett customers have reason to telephone Darrington. It is a reasonable assumption that calling volumes in both directions would be roughly equal. The relatively small number of ratepayers in Darrington are more likely to see higher individual benefits. At best, this term of the proposed settlement results in a minority of Verizon ratepayers seeing a potential benefit, and even then it results in a uneven distribution of benefits even within this small percentage of ratepayers.

24. Examination by the Bench also pointed to further issues with this term of the settlement. Questions raised by Commissioner Oshie revealed that an earlier analysis by Staff had concluded that the rate center consolidation for Skagit County "would not meet the test that the Commission has established for consolidation in that there's no community of interest for those calling communities[.]" and that Staff's position on the issue has not changed. TR. 607:20-608:8. In answer to Chairman Sidran's questioning on this issue, Ms. Roth testified that Staff had not done an "analysis applying the Commission's historic criteria to this proposed expansion of the calling areas." TR. 616:8-13.

25. While Public Counsel takes no position on whether the criteria for rate center consolidation have been met, Public Counsel questions whether approval of this merger should be based on adoption of arrangements or service changes that would otherwise violate Commission policy. Moreover, the change has no particular connection to the impacts of the merger, and as noted above, it affects only a minority of Verizon customers. If rate center consolidations are to be considered in the context of this case, it may well be, as Commissioner Oshie suggested, that there would be other areas of the state that should be reviewed. Staff apparently does not know whether there are such areas that are candidates for consolidation. TR. 609:23-610:6 (Roth).

b. Premium Plus Adders.

26. The settlement also eliminates the "Premium Plus Adders" that apply to Verizon customers residing in seven other rural exchanges. With regard to the Premium Plus Adders, Confidential Appendix A of the proposed settlement identifies the relatively small amount per year in benefits associated with this portion of the condition. About 0.38% of Verizon residential customers, and about 0.33% of Verizon business customers are located in the affected exchanges. Even more so than for the rate center consolidations, this benefit provides a minimal amount of financial benefit, and targets it to a tiny percentage of the customer base.

27. Like Term 1 regarding line extensions, Term 2 addresses rate center consolidations and rate adders that are incidental to the merger, affect few customers, and provide little pass-through of financial benefits. Term 2 does nothing substantial to justify merger approval.

3. Rate Freeze or "Stay Out" (Term 3).

28. Under the terms of the settlement of Verizon's 2004 general rate case, the second step of the agreed rate increase, amounting to $1.47 per line, will be implemented on July 1, 2007.[23] Term 3 of the proposed merger settlement states that "Verizon will raise its basic residential or business rates above the levels set by the rate case settlement in docket UT-040788 until June 30, 2009." Exh. No. 501, p. 5. This provision of the proposed settlement allows Verizon to reduce local service rates, and to make other rate changes on a revenue-neutral basis.

29. While Public Counsel does not oppose this provision as such, the value of the "stay out" is highly speculative, and fails to provide any quantifiable sharing of merger savings with customers.

30. There are several reasons why the "stay out" has questionable value. First, there is no way of knowing that Verizon would have filed a general rate case between July 1, 2007, and

---

[23] *WUTC v. Verizon Northwest Inc.,* Docket No. UT-040788, Order No. 15, Order Approving and Adopting Proposed Settlement; Rejecting Filed Rates; Accepting Proposed Settlement Rates (April 12, 2005) ¶1.

June 30, 2009 in any event. It is just as reasonable, perhaps more so, to conclude that having just received a rate increase on July 1, 2007, the second step in an overall 30% increase in residential rates, Verizon would be unlikely to immediately file for another. Verizon's 2004 general rate case was its first rate case in 23 years. Ms. Roth stated it was "possible" that Verizon would come in, but agreed that "it might happen, it might not happen" and that it was "speculation" whether Verizon would come in for rates between 2007 and 2009. TR. 595:15-23.

31. Second, the general rate case settlement precludes Verizon from filing for another increase prior to July 1, 2007. UT-040788, Order No. 15, ¶31. Assuming a standard rate case procedural time line of 11 months from initial filing to implementation of rates, if Verizon, filed for new rates on July 2, 2007, it would not normally expect to obtain a new rate increase until April or May of 2008. This means that even without this provision, Verizon would be unlikely to have been able to increase rates before spring 2008. In fact, therefore, the "two year stay out" provides only 13 or 14 months of rate stability at best.[24]

32. Confidential Appendix A to Exh. No. 502 quantifies the value of Terms 1 and 2 and also lists Term 3. The appendix appears to be an effort to show that some of the merger savings identified by Staff[25] are being passed through to Washington consumers. In the section titled "Summary – Total Cost" the appendix states a figure significantly lower than the merger savings identified by Ms. Folsom. The figure appears to be the sum of benefits from Terms 1 and 2 spread over four years. There is no quantification of Term 3, just a statement that "Verizon NW sought a rate increase of approximately $109 million, and received a total increase of $38.6 million."[26] It is also true that, in response to the $109 million request, after discovery and full review, Staff filed testimony recommending a $25 million rate decrease for the Company. UT-040788, Order No. 15, ¶ 8. On cross-examination, Staff witness Kathy Folsom acknowledged

---

[25] Exh. No. 150HTC, p. 4(Folsom).

[26] These numbers are public information available in the record of Docket No. UT-040788.

that her merger savings amount was not shown on Confidential Attachment A, but commented that "there are very likely other numbers included on this page that [Ms. Roth] could speak to. So I don't think you can compare the number under summary to my number." TR. 545:20-546:1.

33. When Ms. Roth later testified, she stated that Staff had been provided confidential information during the settlement negotiation that satisfied them that Term 3 had a "*possible* negative revenue impact" on the Company. TR. 596:10 (Roth)(emphasis supplied). Ms. Roth acknowledged that that information is not reflected in Confidential Attachment A, or anywhere in the record of the case. TR. 596:13-18. This was the extent of "other numbers" provided.

34. In the rate area, the settlement also fails to meaningfully address other issues identified by Ms. Folsom regarding transition costs and the impact of a Company debt rating downgrade on customer rates. Regarding the debt rating, Ms. Folsom stated:

> It is my recommendation, however, that that if the debt rating of Verizon is downgraded specifically as a result of the merger, an adjustment in the calculation of cost of debt should be made for ratemaking purposes to remove the effect of the downgrade on Verizon NW.

Exh. No. 150T-HC, p. 3, ll. 14-18.

35. This condition was not included in the settlement. TR. 541. Ms. Folsom also recommended that transaction costs of the merger not be passed on to ratepayers and adjusted for that issue in her calculation of merger savings. Exh. No. 150T-HC, pp. 25-26 (Folsom). This issue is also not reflected in the proposed settlement.

36. Staff argues that the two year stay out addresses this because no increased costs can be passed through in rates during that period. As noted above, this protection only gains ratepayers a few months protection at best. In addition, there is no logical basis for concluding that effects of debt rating downgrades would only occur during the stay out period. Nothing in this settlement prevents a struggling post merger Verizon/MCI to look to its regulated customers in

2009 to help strengthen a balance sheet clouded by high debt costs. This is not an unfounded concern. Verizon has specifically declined to make any commitment to "insulate customers from any costs or cost increases that would result from the merger." TR. 270:22-272:2 (Danner). *See also*, Exh. No. 46.

37. Term 3 of the proposed settlement does not provide any quantifiable sharing of the merger savings identified in the testimony of Staff witness Ms. Folsom and Public Counsel witness Charles King. In addition, it provides little value in terms of rate stability. Public Counsel does not oppose the provision per se, but it should not be viewed as providing any significant value to ratepayers or offset to the harm from the merger identified in Staff and Public Counsel testimony.

4. Wholesale Performance Metrics (Term 4).

38. Public Counsel did not file extensive testimony on wholesale competition issues and will defer to other parties briefing this issue. Public Counsel does note the contrast between the attention given to wholesale service quality issues in Term 4 compared with the minimal scope of the provisions on retail service quality.

5. Retail Service Quality (Term 5).

39. The "commitment" in Term Five of the proposed settlement regarding retail service quality requires absolutely nothing of the Joint Petitioners beyond what they are already required to do – comply with the Commission's service quality rules. Further, while Staff contends that the proposed settlement "fully satisfies" the public interest by adopting "all of Staff's proposals with one exception [special access]," Exh. 502, p. 11, TR. 160:19-22, this is decidedly not the case with respect to retail service quality. In her direct testimony, Staff witness Ms. Roth recommended that Verizon and MCI "*guarantee* that the retail service quality performance of

both Verizon and MCI will not deteriorate after the merger." Exh. No. 101T-HC, p. 4, ll.1-2 (emphasis added) and p. 35 (Roth). The proposed settlement contains no such "guarantee."

40. The proposed settlement simply requires Verizon and MCI "to continue to meet the Commission's retail service quality standards." Exh. No. 501C, p.7. As discussed in more detail below in Section V.C.1(g), Verizon has not always met the Commission's service quality standards. Further, there is no "guarantee" in the proposed settlement to hold the Company accountable should performance deteriorate after the merger. Moreover, the reporting requirement discussed in Term Five of the proposed settlement agreement, "requiring" MCI to file service quality reports applicable to Class A companies, is superfluous. Exh. No. 501C, p.7. As Ms. Roth aptly points out in her responsive testimony, if the Commission approves the merger then MCI will be considered a Class A company and will be required to file service quality reports. Exh. No. 101T-HC, p. 38, ll.10-13 (Roth). Finally, Ms. Roth testified that Staff's role monitoring Verizon and MCI's service quality performance after the merger will be no different than Staff's typical ongoing activity monitoring industry performance. TR.568:23 – 569:11.

41. In summary, Term 5 is not a true condition because it does not actually commit the Joint Petitioners to do anything beyond what will already be required of them post-merger, that is, to obey the law. As discussed in further detail below in Section V, the proposed settlement therefore fails to provide sufficient protection or mitigation to potential harm to the public interest as a result of deterioration in service quality. Verizon has made it very clear to their board and shareholders that they intend to achieve their anticipated merger synergies. TR. 386:24 – 387:2 (Smith), and if that if they don't achieve savings in the intended areas, they may make it up elsewhere. TR. 389:12-21 (Smith). The risk to Washington ratepayers is that in an effort to trim expenditures the merged Company may reduce network investment or staffing, which could in turn result in diminished service quality.

42. In her direct testimony, Ms. Roth clearly shares Public Counsel's concern, stating: "When viewed from a public interest perspective, although the public will benefit from greater efficiency, reduced costs, and increased innovation, it should not be done at the expense of consumers who could experience deteriorating service quality as a result." Exh. No. 101T-HC, p.35, ll. 9-12 (Roth). Although Staff testimony proposed a service quality guarantee to address this, Verizon has not agreed to any "guarantee" in this settlement. Term 5 does nothing to address service quality concerns and has nothing to protect customers from the pressures on service quality that are inherent in this merger.

6. LPIC Credits (Term 6).

43. Staff has concluded that Verizon is the dominant carrier in the long-distance market in its service territory, and that, as a result of the merger, MCI long distance customers will be "thwarted" in their freedom to choose a competitive provider. Exh. No. 101T-HC, p. 22 (Roth); TR. 555:6-23. In order to remedy this competitive harm, Staff has recommended a condition that waives the PIC and LPIC charges which Verizon levies when a customer changes long distance companies. Exh. No. 101T-HC, p. 22. The charge ranges between $4.50 and $5.00. As Staff testified: "Verizon should provide those customers who selected MCI as their long-distance carrier with an opportunity to change to another, unaffiliated carrier without incurring any service charge."[27]

44. No similar condition has been included in the settlement for the benefit of local service customers, even though the local market is also "highly concentrated," TR. 556:7-16, and local customers who chose to leave Verizon and take MCI's competitive local service are likewise "thwarted" in that choice, as Ms. Roth reluctantly conceded on cross-examination. TR. 560:10-16. For reasons that are unclear, Staff believes these local customers are somehow differently

[27] Exh. No. 101T-HC, p. 18 (Roth).

situated. Unlike long-distance customers, Staff does not believe "Verizon should provide those customers who selected MCI as their [local] carrier, with an opportunity to change to another unaffiliated carrier without incurring a service charge." Exh. No. 101T-HC, p. 18, ll. 13-18 (Roth).

45. As discussed below in connection with Public Counsel's recommended conditions, the impact of the merger is to nullify the choice of former Verizon customers who chose to take local service from MCI as a competitor. The involuntary nature of the acquisition of these customers, without their consent, and without notice (at least as originally intended) is indistinguishable from slamming. Staff apparently views the numbers as too small to matter, although the thousands of local service customers affected certainly outnumbers those receiving the line extension benefits of the settlement.[28] Moreover, the dollar impact on local customers who wish to change providers may be much greater than the $4-5 impact on long-distance customers.

46. Given that MCI's stated business plan is a managed exit from the mass market,[29] including the local exchange market, and a continuation of rates and fee increase. Exh. No. 61T-HC, p. 9, ll. 11-12; it seems likely that at least some MCI local customers will want to make a change. By ignoring the impact of the merger on the costs of consumers switching local service providers, Term 6 of the proposed settlement fails to address a tangible and direct negative effect of the merger. While Public Counsel does not oppose Term 6, by addressing only one situation for one class of service, it does not go far enough. Without more, it is not a sufficient basis for merger approval.

---

[28] *See Wilson Testimony*, Exh. No. 121T-HC, p. 14; Exh. No. 125-HC, l.13 (residential); Exh. No. 127-HC, l. 14 (business).

[29] Exh. No. 1T-C, p. 59 (Taylor). .

7. Commercial Agreement Availability (Term 7).

47. Staff testimony identified the availability of Commercial Agreements under the same terms and conditions as are available to MCI as a pro-competitive condition. [30] This condition, while ostensibly offering a pro-competitive benefit of the proposed settlement, must be evaluated in light of the ample evidence that MCI intends to exit the mass-market.[31] Following the merger, MCI's management will no longer be independent. Thus, any future interconnection agreement that is negotiated between MCI and Verizon to replace MCI's current interim agreement with Verizon[32] will not be the result of arm's length negotiation. Even if MCI continues to exist, which is not a certainty, any agreement that is reached will be the result of Verizon's internal business planning with regard to the operations of its affiliates, not a hard fought agreement between a competitor and the firm on which it relies for bottleneck inputs.

48. Furthermore, if MCI does exit the mass market, it is unclear whether the terms of any existing agreement between Verizon and MCI would continue to be available for use by other CLECs.

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

49. Pursuant to RCW 80.12.020 and RCW 80.12.040, the Commission has the authority and jurisdiction over the proposed merger as discussed more fully in the jurisdiction section of the brief. The Commission's enabling act gives it the authority to regulate in the public interest. RCW 80.01.040(3).

50. The Commission explained the standard for approval in its most recent major

---

[30] Exh. No. 101T-HC, p. 18 (Roth).

[31] Exh. No. 1T-C, p. 59 (Taylor); Exh. No. 60T-HC, pp. 10-11 (Beach); Exh. No. 61T-HC, p. 11 (Beach)

[32] Mr. Beach indicated that the interim agreement expired on July 15, 2005. Exh. No. 60T-HC, p. 15 (Beach).

telecommunications merger docket, the US West/Qwest transaction:

> In order to approve the proposed transaction, the Commission must determine whether it is consistent with the public interest. [WAC 480-143-050]. 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." *In Re PacifiCorp and Scottish Power PLC*, Docket No. UE-981627, Third Supplemental Order on Prehearing Conference (April 2, 1999), p. 3.
>
> Applicants' initial burden requires them to produce sufficient evidence to demonstrate no harm will result as a result of the transaction. That is the burden of going forward with the *prima facie* case. Assuming Applicants meet their initial burden, other parties who assert the transaction, as proposed, is inconsistent with the public interest then must offer evidence to support their assertions. If there is evidence to support allegations that the proposed transaction is not consistent with the public interest, the burden then shifts back to the Applicants who bear the ultimate burden of proof.[33]

The Commission went on to identify the issues that were proper for review in the merger proceeding, identifying the following as appropriate:

- the impact on competition at the wholesale and retail level, including whether the transaction might distort or impair the development of competition;
- whether the surviving corporation has the technical, managerial and financial capability to operate the operating subsidiary;
- the potential impact on service quality, including the impact on investement in Washington and neglect and abandonment of facilities;
- how any benefits or synergies would be shared between customers and shareholders;
- the financial impacts of the proposed merger on cost of capital, capital structure, and access to financial markets;

---

[33] In re the Application of U S West, Inc., and Qwest Communications International, Inc, Docket No. UT-991358, Third Supplemental Order Outlining Scope of Review, p. 3 (WUTC website pagination) (US West/Qwest merger).

.

- the impact of the merger on rates, terms, and conditions of service.[34]

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

51. The answer to this question is no. Certainly, without any mitigating conditions, "the merger would be harmful to the public interest ….[and] could potentially harm competition and consumers." Exh. No. 101T-HC, p. 12, ll. 13-15 (Roth). This is not the end of the inquiry, however. Even taking the proposed settlement into account, the merger does not meet the standard for approval. As the preceding section has just explained, the conditions agreed to in the proposed settlement do little to address the harm posed by the merger. The standard for approval can only be met through adoption of Public Counsel's proposed conditions.

A. Will the Transaction Adversely Affect Competition?

52. RCW 80.36.300(5) states that it is the policy of the state to "[p]romote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state." The merger does not promote the diversity of supply. Following the merger, consumers in both Verizon's and Qwest's territory will experience the elimination of a major alternative source of supply, resulting in a less diverse supply. This reduction in supply will result in harm to competition.[35] Staff noted that the "prospects for vigorous competition in the future would be the strongest if MCI were to remain independent" and that "the merger runs counter to the public policy of promoting competition."[36] Competition be harmed in the mass market local exchange, mass market long distance, enterprise, and special access markets.

---

[34] *Id*., pp. 4-5. The final order in the U S West/Qwest merger is Exh. 27. The standard of review is discussed again at ¶¶26-27; *See also*, Exh. No. 26, *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation*, Docket No. UT-981367 et al., Fourth Supplemental Order.

[35] Exh. No. 371T-HC, p. 19 (Roycroft).

[36] Exh. No. 101T-HC, p. 11, 13 (Roth).

1. Will the transaction adversely affect mass market local exchange services?

53. The merger results in Verizon absorbing the operations of the largest CLEC competitor in its residential market.[37] In spite of MCI's repeated claims that their mass market business is in "irreversible decline," testimony presented by Mr. Beach shows that MCI's residential local market share in Verizon's service area increased by over 30% between July of 2004 and August of 2005. Exh. No. 61T-HC, p. 12. *See also,* Exh. No. 4T-HC, p. 18, Figure 1 (Taylor). This increase in market share indicates that consumers will face a definite competitive loss in the marketplace as a result of the merger. The euphemistically labeled "managed-decline" of MCI in the mass market affects competition statewide in Washington, in Qwest territory as well as Verizon's. There is nothing in the evidence offered by the Joint Petitioners to suggest that MCI plans to vigorously or aggressively compete with Qwest for its mass market customers. On the contrary, at the hearing, Mr. Beach agreed that "MCI will be effectively managing the decline of a competitive option in Qwest's service territory for the residential and small business customers." TR. 381:11-20. The most probable outcome of this merger is a consolidation by both Verizon and Qwest of their dominant positions in the mass market in their service territories.

54. Analysis conducted by Public Counsel witness Dr. Roycroft indicated that the combination of Verizon and MCI results in an increase in the Herfindahl-Hirschmann Index (HHI), a measure utilized by economists to evaluate market concentration, of 163 points. This value exceeds a Department of Justice threshold for the evaluation of mergers in highly concentrated markets, and provides confirming evidence that the merger results in an increase in Verizon's market power.[38]

[37] Exh. No. 101T-HC, p. 17 (Roth); Exh. No. 371T-HC, p. 65, p.76 (Roycroft).

[38] Exh. No. 371T-HC, p. 75 (Roycroft).

55. Dr. Roycroft also identified a number of other factors which indicate that the merger is likely to harm competition and the public interest. These include Verizon's ability, absent regulatory control, to coordinate pricing in the local exchange market, due both to Verizon's dominant position in the retail market, and its continued role as a monopoly provider of inputs to CLECs.[39] Dr. Roycroft also pointed to the lack of viable rivals which might replace the independent source of supply that will be lost once Verizon finalizes its acquisition of MCI.[40] Furthermore, Dr. Roycroft noted that continuing barriers to entry in the local exchange market also reduce the likelihood that new rivals will be able to make up for the lost competition resulting from the merger.[41]

56. Staff also noted competitive harm arising from the merger. Staff identified both current and prospective harm to local competition resulting from the merger.[42]

2. Will the transaction adversely affect mass market long distance service?

57. Evidence indicates that the merger will reduce competition for long distance services, and remove a significant supplier from the market, resulting in harm to Washington consumers. MCI has been an important long distance competitor in Washington for many years.[43] Absent the merger, MCI's market share in the long distance market has decreased as Verizon's share has grown.[44] However, the merger will result in Verizon's long distance market share increasing

---

[39] Exh. No. 371T-HC, p. 77 (Roycroft).

[40] Exh. No. 371T-HC, p. 78 (Roycroft).

[41] Exh. No. 371T-HC, p. 79 (Roycroft)

[42] Exh. No. 101T-HC, p. 11, p. 17 (Roth).

[43] Exh. No. 101T-HC, p. 11 (Roth).

[44] Exh. No. 121T-HC, p. 19 (Wilson).

significantly,[45] and will remove a competitive choice from the marketplace.[46] Staff Witness Roth noted that "These [MCI long-distance] customers could have chosen Verizon as their long-distance provider and made the decision to use a competing provider. *Their choice not to use Verizon will effectively be thwarted by this transaction.*"[47] The reduction in choice illustrates an immediate and negative consequence of the merger.

3. Will the transaction adversely affect competition for enterprise services?

58. Where Verizon does discuss alleged benefits of the merger before this Commission, these are associated with the national and international level enterprise market.[48] However, even for enterprise-level customers, the potential benefits that are described are either vague or not specifically associated with the state of Washington. For example, Joint Petitioners identify the following merger benefit for enterprise customers: "Verizon will be able to carry traffic over MCI's Internet backbone, improving efficiency and enhancing the ability to manage complex network assets and applications."[49] In fact, Verizon can enter into an agreement today with MCI, and purchase Internet transmission services from MCI, which would provide Verizon access to MCI's backbone network. Alternatively, Verizon could purchase "Internet-based virtual private networks ("IP VPN"), private Internet protocol ("PIP") networks, and web hosting services" from MCI, which could be used to deliver services to enterprise-level customers.[50] When Verizon gains control of the MCI assets which provide these services, however, consumers will

[45] Exh. No. 101T-HC, p. 22 (Roth); See also, Exh. No. 371T-HC, p. 65 (Roycroft); Exh. No. 121T-HC, p. 19 (Wilson).

[46] Exh. No. 371T-HC, p. 65 (Roycroft); Exh. No. 101T-HC, p. 22 (Roth)

[47] Exh. No. 101T-HC, p. 22 (emphasis added) (Roth).

[48] Joint Petition, ¶44.

[49] Verizon/MCI *Joint Petition*, p. 15.

[50] Exh. No. 371T-HC, p. 25 (Roycroft).

witness the departure of MCI, an important provider in the market.[51] Joint Petitioners do not provide sufficient evidence for this Commission to determine whether the enterprise market will receive benefits from the merger. In fact, the FCC was so concerned regarding the potential harm to consumers of interstate special access services, that the FCC has requires a 30-month freeze in interstate special access rates,[52] which are paid by enterprise customers.

4. Will the transaction adversely affect competition for special access services?

59. Staff identified direct and indirect harms associated with the loss of MCI as an alternative to Verizon.[53] The direct harm arises from the loss of MCI's presence in the retail market. The indirect harm results from the loss of MCI as a provider of wholesale services to other CLECs, as MCI competes with Verizon for the provision of special access/private lines in Verizon's service area.[54] Staff witness Roth noted:

> The market for access/private line services is highly concentrated in the geographic areas were Verizon operates. 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.[55]

As noted by Dr. Roycroft, even MCI was concerned with Verizon's pre-merger market power in the special access market.[56] MCI had recently pointed to Verizon's ability and incentive to raise special access rates to the detriment of CLECs.[57]

---

[51] Exh. No. 371T-HC, p. 25 (Roycroft).

[52] Exh. No. 511, "FCC Approves SBC/AT&T and Verizon/MCI Mergers," Corrected FCC Press Release, October 31, 2005.

[53] Exh. No. 101T-HC, p. 16 (Roth).

[54] Exh. No. 101T-HC, p. 17 (Roth).

[55] Exh. No. 101T-HC, p. 17 (Roth).

[56] Exh. No. 371T-HC, pp. 11-12 (Roycroft).

[57] Exh. No. 371T-HC, p. 12 (Roycroft).

60. As discussed further in Section V.C of this brief, the Final Judgment issued by the Department of Justice in the Verizon/MCI merger case addressed the special access/private line market and required divestiture of assets in some cases. The DOJ conducted its analysis based on the number of providers of special access/private line services on a building-by-building basis, noting that:

> Although entry may occur in response to a post-merger price increase in some of the buildings where MCI is the only connected CLEC, the conditions for entry are unlikely to be met in hundreds of those buildings. Thus, entry is unlikely to eliminate the competitive harm that would likely result from the proposed merger.[58]

61. The vast majority of divestitures, however, were associated with Verizon's "East" operations (i.e., the former NYNEX and Bell Atlantic states), and the divestiture affected only limited portions of other Verizon operations, namely in Tampa, Florida.[59] Dr. Roycroft testified that it was difficult to believe that the conditions which were associated with the divestiture requirements for Verizon's "East" operations were not also present in any other buildings in Verizon's service area.[60] Joint Petitioner's response to Bench Request No. 2 sheds some light on the state of the market in Verizon's service area, and indicates that Dr. Roycroft's intuitions was correct. The response identifies a number of buildings in Verizon Washington's service area where Verizon and MCI provide the only special access/private line facilities. However, the Department of Justice's merger conditions, with the required divestiture of assets through indefeasible right-to-use contracts of ten-year duration, will not apply to these buildings in Washington. Thus, the result of the merger on the special access/private line market will be

---

58 *USDOJ Antitrust Division v. Verizon Communications, Inc. and MCI, Inc*., Case No. 1:05CV02103, *Complaint*, pp. 9-10.

59 TR. 471 (Roycroft).

60 TR. 472 (Roycroft).

decidedly negative, and will result in Verizon monopolizing provision of special access/private line services to these buildings. This is another competitive harm associated with the merger.

5. Will the transaction create other adverse effects?

62. In addition to the competitive harm described above, the merger will expose Washington customers to the consequences of debt rating downgrades that could occur if the merger or its aftermath is not viewed favorably by the financial markets. Ratepayers also may incur transaction costs unless there is affirmative action to bar their recovery. Staff witness Kathy Folsom identified these risks in her testimony. Exh. No. 150T-HC, pp. 3, 25-26 (Folsom).

Service quality is also a matter of concern in this merger. As discussed below, Verizon's current service quality record is not unblemished. The pressure to achieve merger synergies can, in turn, cause pressure to cut costs, including in the area of staffing, maintenance, and infrastructure.

These issues are addressed in more detail elsewhere in the brief.

B. Will the Transaction Provide Benefits to Washington?

63. The Joint Petition details a range of asserted benefits from the merger for consumers and small business, including: "a platform that can support a broad array of multimedia communications services and applications for all customers;" "the enhanced deployment of wireline and wireless broadband services;" Internet backbone and service quality benefits; a continued choice of competitive suppliers.[61] The Joint Petition also projects that the merger will have no adverse impact on rates or service quality of any regulated telecommunications utility in Washington and that it will enhance the abilities of Verizon and MCI to provide a "comprehensive suite of services to consumers, businesses, and government customers." *Id.*, ¶ 38.

[61] Joint Petition, ¶¶ 47-48.

64. Verizon's affirmative evidentiary case provides little support for the proposition that the merger will provide benefits for Washington consumers and sparse information as to the nature, or magnitude, of benefits that will actually be provided in the state. In response to virtually every question seeking to elicit information about post-merger operations (and hence, where benefits will be seen), Joint Petitioners have responded that post-merger planning has not begun. *See, e.g.*, Exh. Nos. 31 and 33 (broadband deployment); Exh. No. 37 (post-transaction operational planning); Exh. No. 47 (changes in operations and staffing levels in Washington); Exh. No. 63 (treatment of MCI customers); Exh. No. 64 (services MCI will offer, operations under MCI name); Exh. No. 69 (continued availability of MCI "Neighborhood Broadband Calling" plan); Exh. No. 71 (business plans for post-transaction entities); Exh. No. 72 (transition planning); Exh. No. 91 (Washington share of merger benefits, data provided after motion to compel).

65. Furthermore, with regard to the alleged flow of benefits, the Joint Petitioner's case is highly contradictory, with Dr. Danner claiming that benefits will "filter down" to mass market customers,[62] while at the same time pointing to "irreversible decline" of MCI's business, and while Mr. Beach admits that the business plan for the entire mass market statewide is managed decline and continuing price increases. Merger benefits, however, absent competition, will not "filter down." Rather, absent a reasonable sharing of merger benefits, the benefits will remain with Verizon shareholders.

66. In summary, Joint Petitioners have not provided evidence that the merger will provide *any* benefit to Washington consumers. However, there is ample evidence of competitive harm resulting from the merger. Absent a reasonable set of merger conditions, the harm associated with the merger will be the only impact felt by consumers in the state.

[62] Exh. No. 21T, p. 23 (Danner).

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

C. Should Conditions Be Imposed?

67. Given the evidence of competitive harm resulting from the merger,[63] conditions should be imposed to make approval of the merger consistent with the public interest.

68. Thus, this Commission can and should impose conditions on the Verizon/MCI merger to offset the competitive and other harms that arise from the merger.

1. Public Counsel's proposed conditions.

a. Stand-Alone DSL.

Summary of Proposed Condition: Verizon should be required to offer stand-alone ("naked") DSL service to existing and new customers in its service area.

69. About 40% of all residential CLEC lines in Verizon's service area are provided by MCI.[64] Unfortunately, absent a corresponding growth in CLEC activity, which seems unlikely at this time, pro-competitive conditions that can be required by the Commission are only indirect. One pro-competitive offset to the reduction in competition could include actions which would make VoIP a more viable competitive choice.

70. While it is Verizon's stated policy to offer stand-alone DSL, Verizon currently places limitations on the ability of consumers to obtain DSL service, unless they also purchase Verizon voice services.[65] These limitations have the potential to undermine emerging competition from intermodal alternatives, such as VoIP, as the inclusion of Verizon voice services considerably undermines a consumer's incentive to pay extra to purchase VoIP.[66] Under cross-examination, Dr. Danner, testifying on behalf of Verizon, indicated that Verizon's policy with regard to the availability of stand-alone DSL was evolving, and the expanded availability of stand-alone DSL

---

[63] Exh. No. 371T-HC, pp. 66-75 (Roycroft); Exh. No. 101T-HC, p. 16 (Roth).

[64] Exh. No. 371T-HC, p. 86 (Roycroft).

[65] Exh. No. 371T-HC, p. 88 (Roycroft).

[66] Exh. No. 371T-HC, pp. 89-90 (Roycroft).

would emerge at the beginning of 2006.[67] In response to Record Requisition No. 1, Exh. No. 521, Verizon now indicates that Verizon is planning on increasing the scope of stand-alone DSL availability during the first quarter of 2006. Verizon notes, however, that stand-alone DSL service will not be made available to consumers served by remote terminals during that period.[68]

71. Notwithstanding the FCC decision on the eve of this hearing, and the stand-alone DSL conditions established in other states, Verizon declines to agree that this Commission can or should require stand-alone DSL in Washington. It is imperative that the Commission require that this service be made available as a pro-competitive condition of the merger. While it has been Verizon's stated corporate policy to offer "naked" DSL for some time,[69] the availability of the service has not been advanced by the Company, as evidenced by continuing restrictions being placed on its provision in Washington.[70]

72. The importance of stand-alone DSL has been recognized by regulators at both the state and federal level. The FCC, in approving the Verizon and SBC mergers, has required that stand-alone DSL be provided for a period of 24 months.[71] The California Public Utilities Commission, in a Proposed Order**,** also recommended as a condition of the Verizon/MCI merger (and the SBC/AT&T merger) that stand-alone DSL service be made available, and has just announced its final decision to that effect.[72] The Ohio Public Utilities Commission, in approving

---

[67] TR. 186 (Danner).

[68] Exh. No. 521.

[69] Exh. No. 371T-HC, p. 88 (Roycroft).

[70] Exh. No. 371T-HC, pp. 88-89 (Roycroft).

[71] Exh. No. 511.

[72] In the Matter of the Joint Application of Verizon Communications, Inc. (Verizon) and MCI, Inc. (MCI) to Transfer Control of MCI's California Utility Subsidiaries to Verizon, Which Will Occur Indirectly as a Result of Verizon's Acquisition of MCI, Application 05-04-020. Proposed Decision of Commissioners Kennedy and Peavy, October 19, 2005. p. 119. Exh. No. 513 is the original press release describing the recommended conditions. The press release announcing the November 18 decision to adopt the conditions is attached as Appendix E. The final

the merger of SBC and AT&T, required that SBC make stand-alone DSL service available.[73] In addition, yesterday, the New York Public Service Commission adopted a condition that stand-alone DSL be required for the approval of the Verizon/MCI merger.[74]

73. Verizon has argued that issues relating to DSL in general are outside of the jurisdiction of this Commission.[75] However, it is notable that other state entities, as referenced above, have taken positions on stand-alone DSL as a merger condition, including explicit requirements for the availability of stand-alone DSL. This Commission has very recently exercised its authority over bundled and tariffed DSL promotional offerings by a Washington ILEC.[76]

The Commission should not simply rely on the FCC's stand-alone DSL requirement. The FCC's requirement, while certainly a step in the right direction, is limited on two counts. First, the FCC condition on the availability of stand-alone DSL appears to allow Verizon to tie together DSL and Verizon VoIP services. The FCC's Corrected Press Release announcing the

---

order has not been published as of the time of filing of this brief. Public Counsel requests official notice of Appendix E and the underlying decision pursuant to WAC 480-07-495(2)(a)(i)(A).

[73] *In the Matter of the Joint Application of SBC Communications, Inc., and AT&T Corporation for Consent and Approval for Change of Control*, Ohio PUC, Opinion and Order, Case No. 05-269-TP-ACO, p. 74 (November 4, 2005). Public Counsel requests official notice.

[74] *Joint Petition of Verizon Communications, Inc., and MCI, Inc.*, New York Public Service Commission, Case No. 05-C-0237, Order Asserting Jurisdiction and Approving Merger Subject to Conditions, p. 63 (November 22, 2005). Public Counsel requests official notice

[75] See, for example, Mr. Carrathers summary statement at TR. 190. The Joint Petitioners' jurisdictional issue regarding DSL is stated in Exh. No. 502 (Narrative Supporting), p. 15. Public Counsel notes, however, that the exhibit takes pains to list these as Joint Petitioners' concerns, rather than those of Staff.

[76]*See., WUTC v. Ellensburg*, UT-051641, Order No. 1, instituting investigation.

merger approval states:

> The applicants committed to provide, within 12 months of the Merger Closing Dates, DSL service to in-region customers without requiring them to also purchase circuit-switched voice telephone service. The companies will make the offering for two years from the time it is made available in a particular state.[77]

This condition, as written, does not prohibit Verizon from requiring that a consumer purchase the Verizon VoIP product (or any other non-circuit switched service) along with the DSL service. This has the potential to undermine competition from stand-alone VoIP providers.[78] FCC Commissioner Adelstein raised this concern in approving the merger:

> A stand-alone DSL offering is an important contribution to the marketplace, but I do not pretend that it is a panacea. It will not provide greater choice for those who cannot afford DSL, or who do not have DSL available in their area. *Especially vexing is that the stand-alone DSL offering outlined in this Order could also have been more robust. For example, we could have done more to enable consumers to purchase DSL services free from any voice services, rather than just traditional circuit-switched service.* Attachment D, pp. 1-2.

74. Second, the term of the condition is only for 24 months. It is doubtful that consumers will have expanded choice of broadband facilities in that time period, thus raising the possibility that anti-competitive bundling of circuit-switched services could emerge in a relatively short time.[79] FCC Commissioner Copps cited this concern in his concurring statement on the merger, observing: "[S]ome will argue that several of the commitments outlined … are not in perpetuity and are not long enough. I agree. Commissioner Adelstein and I fought long and hard for lengthier commitments." Attachment C, p. 2

75. It is imperative that this Commission recognize what other states have recognized, i.e., that the availability of stand-alone DSL service is a reasonable merger condition, one that will

---

[77] Exh. No. 511 "*Corrected* FCC Approves SBC/AT&T and Verizon/MCI Mergers," FCC Press Release, October 31, 2005.

[78] TR. 480 (Roycroft).

[79] TR 481 (Roycroft).

partially offset the competitive harm inflicted by the merger. This Commission also has an opportunity to address the shortcomings in the FCC condition identified by Commissioners Copps and Adelstein. Not faced by the same constraints, this Commission can afford Washington consumers "real" stand-alone DSL, with no bundling of any other service permitted. It can also put that condition in place for a longer period than 24 months. Public Counsel recommends that the condition be in place for five years. As an alternative, the Commission could require the condition for a minimum of two years, with a right for Verizon to petition for modification or termination after that time.

76. Verizon does not currently impose an incremental charge for stand-alone DSL. Exh. 29. Dr. Danner could not say at the hearing whether that would be the case post-merger. TR 192:1-193:4. As an additional element of this condition, Public Counsel recommends that Verizon be required to maintain the status quo and impose no incremental charge for stand-alone DSL during the life of the condition.

b. Deployment of VoIP E911 platform.

> Summary of Proposed Condition: Verizon should be required to deploy in Washington the VoIP E911 platform which it currently has deployed in the New York City area.

77. One major limitation to VoIP services today is their incompatibility with E911 services.[80] Lack of E911 makes VoIP decidedly inferior to telephone service provided over conventional facilities.[81] According to information provided by Verizon, the Company has developed a platform which enables E911 capability for VoIP.[82] Furthermore, while this platform has already been deployed by Verizon in the New York City area, Verizon indicates that this

[80] Exh. No. 371T-HC, p. 86 (Roycroft).

[81] *Id.*, Exh. No. 7; TR. 406:3-408:22.

[82] Exh. No. 371T-HC, p. 87 (Roycroft). Exh. Nos. 34, 35, 36, 40.

platform can be deployed in Washington and could be offered to CLECs. Exh Nos. 36, 37.[83] Deployment of Verizon's E911 platform for E911 should be required as a condition of the merger. The availability of E911 service has significant public interest benefits and contributes to public safety objectives. Even Verizon witness Dr. Taylor indicated that "I think that public policy ought to ensure that some kind of E911 service is available."[84] Given the ability of Verizon to deploy its E911 platform in Washington, the Commission should require the timely deployment of the technology as a condition of the merger. On May 19th, 2005, the FCC ordered VoIP providers to be E911 compliant within 120 days. As this deadline approached, the FCC indicated that lack of compliance will not require the disconnection of existing VoIP customers. However, the FCC indicates that VoIP providers cannot sign-up new customers unless the customer can be served with E911.[85] This provision certainly dampens the ability of consumers to consider pure play VoIP where E911 service is not available from a provider. Thus, implementation of this merger condition will allow pure play VoIP providers to again begin offering service. Benefits will accrue to Washington consumers, both in the form of an incremental improvement in the service quality of VoIP service, and an improvement in the public safety. This benefit will contribute to offset some of the harm done to consumers resulting from the merger.

c. Customer notice of merger.

> Summary of Proposed Condition: Verizon should be required to notify MCI customers that Verizon will be taking over the operations of MCI. Consumers should be clearly informed that they have the option to choose another service provider should they prefer not to take service from Verizon.

---

[83] Exh. No. 371T-HC, p. 87 (Roycroft).

[84] TR. 411 (Taylor).

[85] FCC Public Notice in WC Dockets 04-36 and 05-196, November 7, 2005. http://hraunfoss.fcc.gov/edocs_public/attachmatch/DA-05-2945A1.pdf.

78. One of the troubling aspects of this proceeding is the Joint Petitioners' refusal, until a change of heart late in the proceeding, to provide notice to the affected customers. The notice that has now been published in newspapers does not address Public Counsel's proposed condition here. While Commission rules require notice, they do not specify that merging companies must notify customers that a merger is affecting their choice of service provider, or advise them of their options. It is critical that MCI customers are made aware of the fact that, following the merger, the Company they will be doing business with is actually Verizon so that they can make an informed decision about their service.[86] If markets are to be successfully opened to competition, consumers must have accurate information regarding market conditions and service providers. All Washington consumers who are currently purchasing service from MCI should be notified that Verizon is acquiring MCI, including those in Qwest service territory. This notification should be accomplished through a customer billing insert, which clearly explains the facts to the consumer. In addition to the bill insert, a message should be printed directly on the customer bill which calls the customer's attention to the bill insert. For MCI customers residing in Verizon's Washington service area, the customer notice should indicate to consumers their rights, including the right to switch to a provider other than Verizon. Finally, if the Commission adopts the fee waiver conditions recommended below, the notice should provide customers with that information also.[87]

d. Waiver of service establishment charge.

> Summary of Proposed Condition: Within Verizon's Washington service area, Verizon should be required to rebate service establishment charges for current MCI subscribers who decide to take service from Verizon.

---

[86] Exh. No. 371T-HC, p. 20 (Roycroft).

[87] Exh. No. 371T-HC, pp. 90-91 (Roycroft).

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

79. As was discussed earlier, the proposed settlement requires that Verizon file a promotional tariff which will result in the waiver of the PIC and LPIC charges. While Public Counsel supports adoption of this condition, as noted by Dr. Roycroft, the waiver of these charges does not go far enough.[88] MCI's local service customers face the same harm that long distance customers face – nullification of their competitive choice. MCI's stated business plan is a managed exit from mass market.[89] As MCI continues to raise its rates,[90] MCI consumers, which Verizon witness Dr. Taylor revealingly referred to as "cash cows,"[91] will be growing incentives to leave. At the same time, they will face the exit barrier of service initiation fees with other carriers. Because their situation is involuntary, the application of these charges to this customer group has anti-competitive effects. Thus, to avoid the same type of harm that the PIC-change condition of the proposed settlement is designed to mitigate, Verizon should be required to waive service establishment fees for MCI customers who decide to return to Verizon.

e. Rebate of service establishment charges for MCI customers switching to a carriers other than Verizon.

> Summary of Proposed Condition: Within Verizon's Washington service area Verizon should be required to rebate service establishment charges for current MCI subscribers who decide to take service from another CLEC.

80. This proposed condition is based on the same rationale as the Verizon fee waiver above. Should consumers be forced off MCI's service as a result of the managed decline of its mass market business,[92] they may face service initiation fees if they choose to go to a Verizon

---

[88] TR. 478-479.

[89] Exh. No. 1T-C, p. 59 (Taylor).

[90] Exh. No. 61T-HC, p. 9 (Beach).

[91] TR. 443 (Taylor).

[92] TR. 303 (Beach).

competitor.[93] To avoid this anti-competitive impact, Verizon should be required to reimburse these consumers for service initiation costs that they may incur when switching to other providers.

81. The two fee waiver conditions should be effective for a 90 day period following the individualized customer notice issued pursuant to Public Counsel's recommended condition (c).

f. Prohibition against Verizon operating MCI in circumvention of Verizon NW's tariffs.

Summary of Proposed 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.

82. As noted above, Verizon's plans for MCI's operations have never been firmly described to this Commission.[94] Joint Petitioners indicate that following the merger, both companies will continue to offer service.[95] However, Joint Petitioners also indicated that they were unable to determine whether, following the merger, MCI would continue to offer service under the MCI brand name.[96] In addition, the Commission was also told that MCI might someday have no mass market customers.[97] In other words, the Commission has been informed by Joint Petitioner witnesses both that MCI's operations will be business as usual, and that there may well be a complete cessation of operations. Verizon witness Smith's description on the stand of post-merger operations does not add clarity. TR. 338-339. This lack of clarity raises significant

[93] TR. 308 (Beach).

[94] Exh. No. 371T-HC, pp. 19-23 (Roycroft).

[95] Exh. No. 371T-HC, p. 20 (Roycroft).

[96] Exh. No. 371T-HC, p. 21 (Roycroft).

[97] TR. 306 (Beach).

concerns regarding Verizon's ability to game a system where its affiliated CLEC, the former MCI, operates alongside the regulated operations of Verizon.[98]

83. A core issue under this heading is whether MCI should retain its competitive classification. As Commissioner Jones noted at the hearing, the classification was made "in very different circumstances." TR. 382:15-16. Indeed, in its order originally classifying MCI as a competitive telecommunications company, the Commission noted that MCI lacked market power and was not affiliated with any local exchange company.[99] Finding of Fact No. 9 states: "MCI and U.S. Sprint have agreed that if they are classified as competitive and if they are acquired by a company still subject to rate regulation, their competitive status will automatically be subject to reevaluation by the Commission." *Id.*, p. 16. Accordingly, the Commission stated in Conclusion of Law No. 3: "The Commission will review this classification automatically at any time MCI or U.S. Sprint is acquired by a company still subject to rate regulation."

84. This makes sense. Local exchange service customers in Verizon's territory, whether served by Verizon Northwest or a subsidiary, are being served by a company with a very high market concentration and market power. In this monopoly environment, those customers should have the benefit of the protection of regulation unless Verizon's provision of local service, through whatever corporate form, has been competitively classified. Absent these protections, customers could be subject to discriminatory market segmentation, cross-subsidies, customer confusion, and limited review of price increases. In light of the uncertainty regarding how MCI will be operated following the merger and the provisions of the original classification order, the Commission should immediately require a proceeding to be initiated for the review of MCI's

---

[98] TR. 466 (Roycroft).

[99] In the Matter of the Petition of U.S. Sprint Communications Company and MCI Telecommunications Corporation for Classification as Competitive Telecommunications Companies, Docket Nos. U-86-79, U-86-101, Order Granting Petitions in Part, p. 8.

competitive classification. Since MCI agreed that the proceeding would be automatic, the burden of proof is appropriately placed on the company.

g. Enhanced service quality reporting, and annual report to customers.

Summary of Proposed Conditions: Verizon should be required to maintain its retail service quality as merger-related cutbacks are implemented. Verizon should be required to adopt enhanced service quality reporting. Verizon should be required to provide its customers an annual report of its service quality performance for a five year period.

85. In order to implement this recommendation, Public Counsel has recommended the following detailed conditions related to retail service quality:

- *Enhanced Reporting to the Commission*. Quarterly reports should be filed with the Commission for five years following the merger regarding investment, including investment in advanced technologies (FTTP/FiOS) by wire center, and headcount reporting for installation and repair personnel, and business office and repair call centers. See Exh. No. 371T-HC, p. 92 (Roycroft).

- *Annual Report to Customers*. Verizon should provide an annual service quality report to customers, for five years following the merger, outlining the Company's performance on each of the Commission's standards referred to in WAC 480-120-439. *Id*. p. 93.

- *Explanation to the Commission should Service Quality Deteriorate*. In the event that Verizon's service quality shows a trend of poor performance, by violating four or more Commission standards for two consecutive months or for any four months within a twelve-month period, the Company would be required to provide an explanation of their performance at a Commission Open Meeting. The Commission at that time would have an opportunity to determine if any enforcement action is appropriate. *Id.* p. 94.

86. Conditions related to retail service quality provide an important safeguard to the public interest because the merger causes pressure to achieve efficiencies and savings, which can result in cost-cutting that negatively impacts service quality. This has been recognized in every major merger case in recent years. In the *PacifiCorp/Scottish Power* merger order, service quality conditions included: Network Performance Standards with a $1 payment to every customer for failure to achieve standards; customer service performance standards; and customer service guarantees, including payments to customers for service failures. The conditions were in place for five years. Exh. No. 25, p. 9. In the *GTE/Bell Atlantic* merger order, conditions included: maintaining and improving levels for consumer complaints, held orders, and installation appointments; enhanced reporting and action plan requirements; investment reporting, and other conditions effective for three years. These conditions were in place approximately three years. Exh. No. 26, p. 23. In the *US West/Qwest* merger order, service quality conditions included: a three to five year Service Quality Performance Program measuring performance against eight company-specific measures with $20 million in penalties at stake annually; continued and expanded customer specific service guarantee programs with payments to customers for service failure; specific network upgrades; and a commitment to maintain historic capital investment levels in Washington State for threeyears after merger closing. Exh. No. 27, p. 10-11. The "Competitive Settlement" provided for, *inter alia*, specific technical standards for provisioning of DSL capable loops. *Id*., p. 15

87. This issue is discussed in the response testimony of Dr. Roycroft and Ms. Roth. See Exh. No. 371T-HC, pp. 82-83, 92 (Roycroft); Exh. No. 101T-HC, pp. 31, 35 (Roth). At hearing, Verizon witness Mr. Smith emphasized that the Company intends to achieve their anticipated merger synergies (TR. 386:24 – 387:2), and if that if they don't achieve savings in intended areas, they may make it up elsewhere. TR. 389:12-21. The risk to Washington ratepayers is that in an effort to trim expenditures the Company may reduce network investment or staffing, which could in turn result in consumers experiencing inferior service quality.

88. The Joint Petitioners have addressed retail service quality in only the most cursory fashion, as discussed in Dr. Roycroft's testimony. Exh. No. 371T-HC, pp. 82-83 . Dr. Danner states in his testimony that "the terms of the transaction require no change to the operations of the regulated subsidiaries of either MCI or Verizon; therefore, there should be no impact on rates, service quality or operations at the regulated Company level." Exh. No. 21T, p. 22 (Danner). In his rebuttal testimony, Dr. Danner states: "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." Exh. No. 23T-C, p. 6, ll. 17-21 (Danner). These "assurances" are merely empty promises, without the "guarantee" that Staff recommended in its testimony. Exh. No. 101T-HC, p. 4, ll.1-2, and p. 35 (Roth).

89. Verizon failed to sponsor a witness in this proceeding with any knowledge of the Company's plans related to operations, network investment and service quality performance after the merger. Dr. Danner confirmed at hearing that he is not currently employed by Verizon, and has never worked for the Company. TR. 177:7-11. Dr. Danner further confirmed that he has not been retained by Verizon or MCI to develop plans after the merger to ensure effective service quality going forward after the merger, TR. 230:19-24, nor has he been involved in any plans related to network investment after the merger. TR. 231:9-17.

90. When asked about a particular area of service quality performance – Verizon's 22 % rate of missed appointments during the 12-month period ending June, 2005 – Dr. Danner testified that he had no knowledge of any initiatives or controls the merged companies will put in place to improve performance in this area. TR. 234:12 – 235:7. Dr. Danner's assertion that Public Counsel's concerns are "speculation" and not based on any evidence related to the transaction, Exh. No. 23T-C, pp.6, 35-36 (Danner), is ironic given that he has no knowledge of service quality-related issues, particularly post-merger, and was not able to provide any meaningful information regarding service quality issues to aid the Commission's review of this issue.

91. Staff witness Ms. Roth asserts that Verizon has recently had good service quality and therefore it is sufficient to simply require Verizon to comply with the Commission's service quality rules. TR. 569:11-16. This misses the point. As Ms. Roth herself discusses in her responsive testimony, the risk to consumers is a risk going-forward, after the merger. Exh. No. 101T-HC, pp. 31, 35 (Roth). Thus, simply looking at Verizon's past service quality performance does not provide a sufficient safeguard to the public interest. Dr. Danner also refers to the "high service quality" achieved by Verizon Northwest, and asserts that this was achieved during a period of low earnings by Verizon Northwest. Exh.No. 23T-C, p. 36, ll. 2-4 (Danner).

92. A review of Verizon's recent service quality performance, however, indicates that in 2004 the Company's performance was below the Commission's standards for installation of basic service, order completion, and out-of-service (no dial tone) repair. Exh. No. 371T-HC, pp.83-84 (Roycroft). *See also* Exh. Nos. 38C and 39C. As noted, Verizon missed an average of 22% of installation appointments for the twelve-month period ending June, 2005. Exh. No. 48. From July 2004 to December 2004, Verizon missed 25% to 33% of installation appointments. *Id.* We disagree that this should be viewed as a high level of service quality. We also note that while Verizon offers customer credits for missed appointments, those credits are not issued automatically. From Verizon's supplemental response to Record Requisition No. 3, Exh. 523, it appears customers must be aware of the credits and contact Verizon to complain in order to receive a credit.

93. The Commission's rules require all orders for access lines to be complete within 180 days. WAC 480-120-105(c). Verizon's June, 2005 service quality report shows that for December 2004 there were 33 orders for installation of basic service not complete within 180 days, and for June, 2005 there were 15 such orders.[100] Exh. No. 38C, pp. 5, 7. Seeking ways to ensure that these customers and others like them don't have to wait six months for service installation would seem at least as important as the line extension issues included in the proposed settlement.

---

[100] WAC 480-120-105(c) refers to orders for access lines, while Verizon's June, 2005 service quality report refers to "installation of basic service" (see Exh. No. 38C, p.5). It is unclear whether Verizon is reporting on all access lines, as required by rule.

94. Public Counsel's proposed conditions related to retail service quality are reasonable, particularly given the potential harm to the public interest that could result from deteriorating service quality. Public Counsel's proposed conditions are not overly burdensome, indeed, they require less of the company than any of the recent mergers discussed above. Enhanced reporting is better than standard reporting under the rules because it acts as a "canary in a coal mine" – allowing for easier and clearer monitoring and earlier indications of any potential problems.

h. Sharing of merger savings.

Summary of Proposed Condition: Merger savings should be shared with consumers in the manner specifically described in Charles King's testimony.

(1) There is ample Commission precedent for sharing merger savings.

95. In each of the three major utility mergers approved since 1999, the merged Company shared at least a portion of the merger savings with its ratepayers in some fashion. Exh. Nos. 25-27.

96. In the *PacifiCorp/Scottish Power* merger order, approval was conditioned on a settlement that provided for a merger credit of $3 million per year for four years. The approval was also conditional on a commitment to fund an estimated $55 million in network expenditures required to implement service standards outlined by Scottish Power. The funds would be derived from efficiency savings and redirected internal funding.[101]

97. In the *GTE/Bell Atlantic* merger, approval was conditioned on a settlement which included a commitment by GTE Northwest (now Verizon Northwest) to reduce rates for its regulated services in Washington in four phases to achieve a $30 million annual net revenue reduction.[102]

---

[101] *In Re PacifiCorp Scottish Power PLC*, Docket No. UE-981627, Fifth Supplemental Order, October 14, 1999.

[102] *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation*, Docket No. UT-981367, et. al. Fourth Supplemental Order.

98. In the *US West/Qwest* merger order, there were a number of commitments by the merging companies. These included a multi-year rate freeze, service quality standards with financial penalties attached, and investment commitments.[103] In this case, the Commission ruled that an important part of the analysis of the public interest was an examination of merger synergies:

> Applicants state that the merger will provide "substantial benefits" to Washington consumers. They also claim "[t]he proposed merger will produce economies of scope and scale." Application at 10. It is appropriate to inquire into the nature and extent of the claimed benefits. *As Public Counsel pointed out at the prehearing conference, if the merger is approved, synergies may arise that lead to cost savings and enhanced revenue. Conditions may be required to ensure any such benefits are shared in a fashion that is consistent with the public interest.* The transaction 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 service. (emphasis supplied).[104]

99. It is clear from this record that the Commission's past policy has been to share synergy benefits from mergers if there is evidence that such synergies exist.

(2) The record contains ample evidence that the merger will yield substantial synergy benefits.

100. Initially, Verizon submitted no evidence with regard to merger synergies. However, in response to Public Counsel and Staff data requests, and after a motion to compel, Verizon provided two synergy studies. The first was a national study of the total synergies that will result from merging all components and divisions of Verizon and MCI. Initially, this study indicated

---

[103] In Re Application of US West, Inc., and Qwest Communications International, Docket No. UT-991358, Ninth Supplemental Order.

[104] In Re Application of U S WEST, Inc. And QWEST COMMUNICATIONS INTERNATIONAL, INC.For An Order Disclaiming Jurisdiction, or in the Alternative, Approving the U S WEST, INC.--QWEST COMMUNICATIONS INTERNATIONAL, INC. Merger, UT-991358, Third Supplemental Order Outlining Scope of Review, p. 5 (emphasis added).

merger synergies of $7.0 billion in present value. Exh. No. 91, but this study was later revised to show synergies of $7.312 billion. Exh. No. 88-C**.** The second study submitted by Verizon purported to identify the portion of these national synergies that relate to the Washington intrastate operations of Verizon Northwest. The net present value of these allocated synergies, according to Verizon, is **[Begin Highly Confidential] ************* [End Highly Confidential]** from 2006 through 2009. Exh. No. 87-HC.

101. Both Staff and Public Counsel submitted critiques of Verizon's Washington intrastate study and offered their restatements of the results. Staff witness Ms. Folsom had two criticisms of Verizon's study. First, the study covered only the first four years of the merger, in contrast to the national study that calculated synergies specifically through **[Begin Highly Confidential] ** [End Highly Confidential]** Exh. No. 150T-HC**,** p. 4 (Folsom). Second, by excluding any reductions in MCI headcounts from Verizon's synergies, the study failed to recognize that the shifting of MCI work to the remaining Verizon employees would result in employee costs being spread over a broader spectrum of operations. This greater efficiency of labor should reduce the costs assigned to Verizon Northwest. Ex. 150T-HC at 20, 21. Staff recalculated the net present value of Verizon's Washington intrastate synergies as **[Begin Highly Confidential] **************************** [End Highly Confidential]** more than Verizon had estimated. Exh. No. 150T-HC, p. 4 (Folsom). The net present value for the longer period through 2014 is **[Begin Highly Confidential] ************* [End Highly Confidential]** *Id.*

102. Public Counsel witness Charles W. King also criticized Verizon's study for its failure to recognize that reductions in MCI's headcount would result in savings to Verizon's operations. Mr. King objected to the study's exclusion of MCI's intrastate revenues and expenses on the grounds that MCI and Verizon would likely merge their Washington operations. Even unmerged, MCI's intrastate landline services would be subject to the Commission's regulatory jurisdiction – as they currently are. For these reasons, Mr. King incorporated the merger-related market expansion of both MCI's and Verizon's regulated services as relevant to the merged Company's intrastate activities. Exh. No. 411T-HC, pp 12-19 (King). Mr. King restated the specific Washington intrastate merger synergies as **[Begin Highly Confidential] ******* million in 2007, ************* in 2008 and ************ in 2009. **[End Highly Confidential]** Exh. No. 417-HC. Thus, Mr. King's total is close to the amount calculated by Ms. Folsom.

103. In a wholly separate calculation, Mr. King computed the portion of the national synergies that could be allocated to Washington intrastate operations. Mr. King reasoned that even seemingly unrelated synergies would ultimately benefit the merged Company's Washington intrastate operations. For example, Verizon allocated all procurement cost savings to MCI, on the theory that Verizon, the larger Company, had already realized the benefits of large volume and long-term equipment and service procurement. Yet, Verizon is not that much larger than MCI. Its domestic telephony revenues were $38.5 billion in 2004, while MCI's were $13.9 billion, over one third of Verizon's. This indicates there might be further economies of scale from mass procurement that would accrue to Verizon and, by extension, Verizon's Washington intrastate operations. Savings in jurisdictionally interstate long-distance operations could accrue to the benefit of intrastate service if the packages of inter- and intra-state services could be made more competitively attractive. Even the sale of MCI's money-losing Canadian operations could benefit Washington intrastate services if it freed up capital for investment in fiber optic local loops. Exh. No. 411T-HC, pp.20-21 (King). Accordingly, Mr. King applied his estimated 1.1898 percent Washington intrastate allocator to the total present value synergies of $7.31 billion to derive a Washington intrastate allocation of those synergies of **[Begin Highly Confidential] *************** [End Highly Confidential]** Exh. No. 411T-HC, p. 22 (King).

(3) The settlement contains no provision for sharing synergy benefits.

104. Notwithstanding the precedent for sharing merger synergies, and notwithstanding the extensive evidence from Staff, Public Counsel, and even Verizon that such synergies exist, the Settlement Agreement contains no provision whereby the synergies resulting from the forthcoming merger will be shared between ratepayers and the merged Company's shareholders. This omission is particularly surprising in light of the evidence submitted by Staff, a signatory to the Settlement, that substantial merger synergies will accrue to the merged Company's Washington intrastate operations. The token amounts cited in Confidential Appendix A to Exh. No. 502 are allocated to very small portions of the customer base and do not represent a real sharing of benefits. As discussed, Term 3 has no quantifiable allocation of savings to customers.

(4) Any resolution of this case should include a provision for the sharing of merger benefits.

105. In light of the evidence of synergies in this case, this proceeding should include some provision for the sharing of these benefits between Washington ratepayers and the merged Company's shareholders. Such sharing is particularly appropriate given the loss of competitive options that Verizon's intrastate subscribers will experience due to the merger, as well as the other deleterious consequences of the merger discussed elsewhere in this brief.

106. Public Counsel witness King proposed maximums and minimums for this sharing. The minimum share of the synergy benefits that should flow to ratepayers is the reduction in the merged Company's revenue requirement that would appear in a rate case. This reduction is quantified in Exh. No. 417-HC as **[Begin Highly Confidential]** ** **[End Highly Confidential]** The maximum share should be a portion – but not all – of the Washington intrastate allocation of the total national synergies expected from the merger.

(5) A reasonable sharing of merger benefits would be a reduction of $1.00 per line per month in the local service rate increase due July 1, 2007.

107. On April 12, 2005, the Commission approved a settlement agreement that resolved all issued in Docket Nos. UT-40788 and UT-040520. That settlement granted Verizon an immediate increase of $33,672,583, with a second installment of access charge reductions and local service rate increases that would net Verizon $4,977,016 on July 1, 2007. The increase portion of the 2007 rate change was to be implemented through a $1.47 increase in local service rates per line. All parties agreed not to seek any change in rates until after July 1, 2007.

108. Public Counsel recommends that the Commission abide by the rate freeze in that rate case settlement and refrain from requiring any sharing of merger synergies until July 1, 2007. On July 1, 2007, local service rates should increase by $0.47, rather than $1.47, the $1.00 difference being the ratepayers' share of the merger synergy benefits from the overall systemic synergies.

109. Public Counsel witness King calculated the effect of this $1.00 rate increase adjustment as $8,691,000 annually. He then compared the present value of this annual revenue reduction with the present value of the Washington intrastate allocation of the national merger synergies. He found that the present value of the revenue reduction through 2014 is 54 percent of the present value of the merger synergies to the same year. Exh. No. 418-HC. Public Counsel submits that this is a reasonable sharing of merger synergies between Washington ratepayers and the merged Company's shareholders.

(6) Alternative method of passing through merger savings.

110. In addition to the systemic or global synergies calculation in the previous section, the record also supports an alternate finding of merger savings based on the testimony of either Ms. Folsom for Staff, or on Mr. King's "rate case scenario" (subsection (4) above). If the

Commission chooses this option, Public Counsel recommends one of the following approaches. Direct Verizon to:

- Return the funds to its customers in a one-time bill credit.
- Take a revenue reduction as an offset to the rate increase scheduled for July 1, 2007. This could be accomplished by a delay of the July 1, 2007, increase until the following year.
- Use the funds to help implement the enhanced broadband deployment recommended by Public Counsel (see below). Under this option, the Commission would identify a specific amount of funds as merger savings and require Verizon to regularly report on and verify the expenditure of the funds on deployment projects to achieve the condition. These costs would not be recoverable in rates.

If the Commission chooses one of these alternative, it could ask the parties to file compliance recommendations within 10 days in order to establish details of implementation.

i. Deployment of broadband in unserved areas.

> Summary of Proposed Condition: Verizon should be required to deploy DSL, or other high-speed Internet access, in areas of Verizon's Washington service area which are currently unserved by Verizon's DSL service. Verizon should be required to identify how, when, and where advanced broadband services will be deployed, through the filing of broadband investment and deployment reports. Verizon should refrain from red-lining the availability of these services.

111. One of the purported benefits of the merger is the positive impact on broadband deployment.[105] The Joint Petition states "American consumers and small businesses will benefit from the enhanced deployment of wireline and wireless broadband services that this transaction will promote."[106] Dr. Danner also indicates that it makes sense for Verizon to acquire MCI to

[105] Exh. No. 21T, p. 3 (Danner).

[106] Joint Petition, p. 17.

supplement "its investment strategy to bring enhanced broadband capabilities to mass-market customers."[107] However, in spite of these claims, Verizon was unable to provide any specifics regarding the broadband benefits which will accrue to Washington consumers.[108]

112. Public Counsel's discovery revealed that a significant percentage of Verizon ratepayers currently have no DSL service available, and that another significant percentage have DSL available only at reduced data speeds.[109] The lack of this service thus limits broadband availability to Washington consumers. Dr. Danner was asked at the hearing

> Q. (ffitch). So Verizon is not willing to make any specific commitment in this proceeding to enhance the deployment of DSL service in Washington State, is that correct?
>
> A. Yes, that would be correct. TR. 226:2-6.

113. The lack of specifics regarding post-transaction plans limits the Commission's ability to assess the validity of the claims that Washington consumers will benefit from the deployment of broadband. Furthermore, on the issue of broadband deployment, Verizon indicates that it is "assessing its Washington service territory to determine *where it will offer* FTTP/FiOS,"[110] which indicates that Verizon is not planning an advanced broadband deployment that will reach all areas of Verizon Washington's service area. Verizon also indicates that it has not incurred investment associated with residential enhanced broadband capabilities in Washington.[111]

114. Holding Verizon to its promises regarding the merger-related benefits associated with broadband deployment will further the public interest by bringing the benefits of broadband to

---

[107] Exh. No. 21T, p. 3, ll. 9-10 (Danner).

[108] Exh. No. 371T-HC, p. 26 (Roycroft).

[109] Exh. No. 371T-HC, pp. 27-28 (Roycroft).

[110] FTTP is Fiber to the Premises. FiOS is Verizon's brand name for the technology. Verizon response to Public Counsel's Data Request No. 70(B), emphasis added, cited in Exh. No. 371T-HC, p. 26 (Roycroft).

[111] Exh. No. 371T-HC, p. 26 (Roycroft).

Washington consumers.[112] The Commission has authority to condition the merger on this type of deployment requirement because of its authority over the underlying network infrastructure in Washington. DSL uses the local loop, including the distribution portion of the loop (generally copper) and the feeder portion (some of which is fiber). TR. 243:2-17 (Danner). Fiber to the premises, which improves broadband capability, adds new material to the loop in place of copper. TR. 243:21-244:2. All of these feeder and distribution facilities are part of the Company's rate base. TR. 244:3-5. As noted in the service quality discussion above, the Commission's conditions in *US West/Qwest* included requirements for provisioning of DSL capable loops in the wholesale market. RCW 80.36.260 authorizes the Commission to order improvements, additions, or extensions be made to telecommunications lines in order to secure adequate service.

115. The conditions proposed by Public Counsel, which require broadband deployment to customers currently unserved by Verzion's DSL service gives the Company the flexibility to determine the most economical technology needed to satisfy the commitment, whether that is fiber, DSL, or some other high-speed service.[113] The three-year time frame for deployment is a reasonable period to satisfy this condition.[114] The requirement to document the progress of the deployment of broadband through quarterly reports will allow the Commission to track the progress of deployment and availability of service,[115] and is a reasonable condition on the merger.

116. Verizon witness Dr. Danner also indicates that is makes sense for Verizon to acquire MCI to supplement "its investment strategy to bring enhanced broadband capabilities to mass-

---

[112] TR. 463 (Roycroft).

[113] TR. 462 (Roycroft).

[114] Exh. No. 371T-HC, p.95 (Roycroft).

[115] Exh. No. 371T-HC, pp. 95-95 (Roycroft).

market customers."[116] However, when asked about specific plans regarding broadband deployment in Verizon Washington's service area, Public Counsel witness Dr. Roycroft points out that Joint Petitioners respond as follows:

> While the transaction will enhance the post-transaction firm's ability to deploy broadband services, post transaction planning has not yet begun, so it is not possible to specify timeframes, data speeds, prices and other details regarding the services that might be deployed after the transaction is completed.[117]

117. The lack of specifics regarding post-transaction plans limits the Commission's ability to assess the validity of the claims that Washington consumers will benefit from the deployment of broadband. Furthermore, on the issue of broadband deployment, Verizon indicates that it is "assessing its Washington service territory to determine *where it will offer* FTTP/FiOS,"[118] which indicates that Verizon is not planning an advanced broadband deployment that will reach all areas of Verizon Washington's service area. Verizon also indicates that it has not incurred investment associated with residential enhanced broadband capabilities in Washington.[119] This recommended condition would address this issue.

2. XO's proposed conditions.

118. Public Counsel does not address XO's proposed conditions.

3. Staff and Integra's proposed conditions.

119. Public Counsel does not address this section.

---

[116] Exh. No. 21T, p. 3, ll. 9-10 (Danner).

[117] Exh. No. 371T-HC, p. 26 (Roycroft).

[118] FTTP is Fiber to the Premises. FiOS is Verizon's brand name for the technology. Verizon response to Public Counsel's Data Request No. 70(B), emphasis added, cited in Exh. No. 371T-HC, -. 26 (Roycroft).

[119] Exh. No. 371T-HC, p. 26 (Roycroft).

D. Public Comment.

120. Prior to the November evidentiary hearing, the Joint Petitioners had not provided any notice to their customers of the proposed merger. To Public Counsel's knowledge there has been little press coverage in Verizon's service territory of the merger. As a result, little public comment has been received to date at the Commission. Verizon has agreed to place notices in newspapers in its service territory and customers have been asked to provide comments to the Commission by December 8, 2005. When the comments have been received, Public Counsel will collect them and file them as Exh. No.510, providing service to the other parties. The exhibit will include a cover sheet tallying the comments received.

VI. CONCLUSION

The record is clear that without remedial conditions, the merger will be harmful for consumers in Washington. Unfortunately, the conditions contained in the proposed settlement fall far short of counteracting the competitive and other harms posed by the merger. The Commission should adopt the conditions proposed by Public Counsel to assure that the merger is in the best interests of Washington consumers.

DATED this 23rd day of November, 2005.

ROB McKENNA
Attorney General

Simon J. ffitch
Assistant Attorney General
Public Counsel

TABLE OF CONTENTS

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

TABLE OF AUTHORITIES

Cases

Statutes

Rules

Commission Orders

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012