BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of Verizon Communications Inc., and MCI, Inc. for a Declaratory Order Disclaiming Jurisdiction Over or, in the Alternative, for Approval of, an Agreement and Plan of Merger	)	Docket No. UT- 050814 BRIEF OF JOINT PETITIONERS VERIZON COMMUNICATIONS INC. AND MCI, INC. (REDACTED VERSION)

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POST HEARING BRIEF OF VERIZON
COMMUNICATIONS INC. AND MCI, INC.

1 Petitioners Verizon Communications Inc. (Verizon) and MCI, Inc. (MCI) submit this brief in support of their Petition for Approval of their Agreement and Plan of Merger (Petition). Petitioners urge the Commission to adopt the proposed Joint Settlement among Commission Staff, Verizon, MCI and Integra Telecom, Inc. (Integra) and reject conditions proposed by the Non-Settling Parties, Public Counsel and XO Communications Services, Inc. (XO). If the Commission rejects the Joint Settlement, Petitioners request that the Commission approve the Petition without any conditions.[1]

I. INTRODUCTION AND SUMMARY OF POSITION

2 The Joint Settlement, along with the decisions of the Department of Justice (DOJ) and the Federal Communications Commission (FCC), will ensure that the merger will cause no harm and is in the public interest. The Commission should adopt the Joint Settlement without change.

3 In order to remedy the only competitive issue it discerned, the DOJ imposed conditions in a limited number of markets (outside of Washington) and otherwise found that the merger will not harm competition for any service, including "local private line [service], residential local and long distance service, Internet backbone services and a variety of telecommunications services provided to business customers."[2] The DOJ also found that the merger is "likely to generate substantial efficiencies that should benefit consumers."[3]

4 The FCC also concluded that the merger will "serve the public interest, convenience, and necessity" and that "significant public interest benefits are likely to result from this transaction."[4] The benefits likely to flow to consumers, according to the FCC, include "enhancements to

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[1] If the Commission does not approve the Settlement Agreement without material change, Joint Petitioners ask the Commission to render a decision on the Petition for Declaratory Order Disclaiming Jurisdiction, which is briefed separately. If, however, the Commission approves the Settlement Agreement, Joint Petitioners believe no decision is necessary on the jurisdictional issues.

[2] Exh. No. 512.

[3] *Id.*

[4] ***In the Matter of Verizon Communications Inc. and MCI, Inc., Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion And Order, Nov.17, 2005, para. 2. ("FCC Order")**

national security and government services, efficiencies related to vertical integration, economies of scope and scale, and cost savings."[5] The FCC also concluded that "to the extent that the merger increases concentration in relevant markets, . . . the public interest benefits of the merger outweigh any potential public interest harms."[6] The FCC's conclusion that the merger is in the public interest was influenced by the conditions adopted by the DOJ and the voluntary commitments, adopted as enforceable conditions, to which the Petitioners agreed.

5 With the DOJ and FCC orders, the Joint Settlement ensures that the merger is in the public interest by providing additional benefits to consumers and competitors. The Joint Settlement promotes universal service by settling a line extension case; preserves numbering resources; expands local calling; provides rate stability; provides for wholesale service quality reporting; provides credits to customers switching from MCI long distance; and ensures that other CLECs can obtain UNE-P replacement contracts similar to MCI's.

6 Only XO and Public Counsel oppose the Joint Settlement. In pre-filed testimony, XO claimed that the merger would harm the "mid-size business market" and proposed conditions alleged to mitigate its concerns. XO presented some claims to the FCC before the DOJ and FCC decisions. Following the FCC decision, however, XO applauded that decision as a "victory" that "safeguards competition in the wholesale market."[7] XO noted that the FCC decision "forge[d] meaningful conditions designed to ensure ongoing customer choice and price competition for millions of small to medium business customers."[8] Thus, all of XO's issues are moot and its proposed conditions unnecessary.[9]

7 Public Counsel voices several reasons to oppose the merger and the Joint Settlement: concern over effects on competition; the lack of a broadband or other investment requirement; and insufficient (in Public Counsel's estimate) "flow through" of merger synergies. Based on

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[5] *Id.*
[6] *Id.*
[7] A copy of the XO press release is attached as Attachment A, and is available at XO's website, www.xo.com/news/227.html.
[8] *Id.*
[9] Much of XO's and Public Counsel's testimony rests on their misguided application of the DOJ Merger Guidelines. Now that the DOJ has approved the merger, those arguments are also moot.

these concerns, Public Counsel proposes a number of conditions. As discussed below, Public Counsel's proposed conditions are either moot given the DOJ and FCC decisions; irrelevant because they have nothing to do with the merger; inappropriate due to the limits on the Commission's authority to order synergy sharing; or unlawful because they concern services over which this Commission has no jurisdiction.

8 The record in this proceeding proves that the merger will not harm competition for any type of customers in Washington. The evidence shows that:

> •There is minimal overlap of Verizon and MCI facilities, and where such overlap exists, other competitors also have deployed facilities;
>
> •MCI is no longer an economically meaningful competitor in the mass market for reasons unrelated to the merger; therefore, MCI does not now, and would not absent the merger, impose price discipline on Verizon's mass market services;
>
> •MCI and Verizon are rarely direct competitors for enterprise customers as MCI serves larger national and international enterprise customers, while Verizon serves smaller enterprise customers mostly within its own region. There are numerous other competitors in the enterprise market;
>
> • MCI does not provide substantial competition for special access services in Washington, serving only a small fraction of the buildings served by CLECs in Verizon's service territory with MCI-owned facilities. Indeed, the unrebutted evidence shows that MCI does not provide ***any*** intrastate special access service in Washington to XO or any other CLEC.

9 XO and Public Counsel have adduced no evidence of potential anti-competitive effects of this merger. With the DOJ and FCC decisions in hand, and the comprehensive settlement before the Commission, there is no justification to adopt any of the conditions proposed by XO or Public Counsel.

10 Petitioners respectfully request that the Commission adopt the Joint Settlement approve the transaction expeditiously.

II. BACKGROUND OF THE TRANSACTION AND PROCEEDING

A. Description of the Transaction

1. The Petitioners

11 Verizon is a Delaware corporation headquartered in New York. Verizon itself provides no services and is not a regulated telephone company within Washington or elsewhere. Verizon Northwest Inc. (Verizon NW) is the Verizon subsidiary that provides local exchange service in Washington.

12 MCI is a Delaware corporation headquartered in Virginia. MCI provides no services and is not regulated. Its subsidiaries in Washington include: MCImetro Access Transmission Services LLC; MCI Communications Services, Inc.; MCI Network Services, Inc.; Teleconnect Long Distance Services and Systems Co. d/b/a Telecom USA; and TTI National, Inc. (collectively, "the MCI subsidiaries").

2. The Proposed Transaction

13 The details of the proposed transaction are set forth in the Agreement and Plan of Merger (as amended) that was appended to the Petition. Under the Agreement, MCI will become a subsidiary of Verizon. As discussed, the merger has been approved by the DOJ and the FCC, as well as multiple state commissions.[10] The Agreement does not call for the merger of any assets, operations, lines, plants, franchises, or permits of MCI's regulated subsidiaries with the assets, operations, lines, plants, franchises, or permits of any Verizon entity. Similarly, the Agreement does not call for any change in the rates, terms, or conditions for the provision of any telecommunications services provided in Washington by Petitioners' subsidiaries.[11] Thus, the merger will not affect the regulatory authority of this Commission over any of Verizon's or MCI's regulated subsidiaries.[12]

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[10] The merger has been affirmatively approved, or found not to require affirmative review, by 23 states as of November 23, 2005.

[11] *See, e.g.*, Exh. No. 21T at 6.

[12] Exh. No. 23T-C at 37-38.

B. Summary of Proceedings

14 On May 27, 2005 Verizon and MCI filed a Joint Petition requesting that the Washington Utilities and Transportation Commission (the "Commission") declare it lacks jurisdiction over the proposed transaction. Alternatively, the Joint Petition asked for approval of the transaction. Parties intervening in the proceeding include: Commission Staff, Public Counsel, XO, Integra, Covad Communications Company ("Covad"), and Citizens Utility Alliance of Washington ("CUA").[13] Opening Testimony by Petitioners was filed June 29, 2005; rebuttal testimony was filed September 9, 2005; and Petitioners' Reply testimony was filed October 6, 2005.

15 On October 20, 2005, Petitioners reached a Joint Settlement with Commission Staff and Integra, which was filed for Commission approval on October 21. A hearing on the Joint Settlement was held November 1, 2005, and hearings on all issues were held November 1-2, 2005.

III. THE PROPOSED JOINT SETTLEMENT

A. Are the Joint Settlement Conditions in the Public Interest?

16 The Joint Settlement terms are in the public interest. They provide a package of tangible and significant benefits to consumers and competitors; indeed, the Non-Settling Parties pose no credible objection to any of them. This package of terms should be adopted without change.

1. Extension of Service to UT-050778 Petitioners

17 Under this term, Verizon NW will extend its network and provide service to the 12 petitioners in the *Rupp* case, Docket No. UT-050778. Based on the facts stated in the *Verizon NW* petition, Verizon estimates that the cost of the line extension to be about $325,000, and Verizon will not seek recovery of this cost through its Interim Terminating Access Charge (ITAC). If Verizon NW, despite all reasonable efforts, cannot provide service to these petitioners, then Verizon and Staff will agree upon another, similar public benefit (e.g., a different line extension) and present their proposal to the Commission for approval.[14]

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[13] Covad and CUA withdrew from the proceedings prior to the evidentiary hearings.

[14] Exh. No. 501 at 4. As explained during the hearing, Verizon might not be able to provide service because it may need to traverse national forest land and might not be able to obtain the required permits. TR. 606-07 (Roth).

18 This term is in the public interest. As Staff witness Roth testified at the hearing, the Rupp petitioners do not have any telephone service at this time, and many of them are older and have medical problems. Thus, this line extension will greatly benefit the petitioners and achieve "the fundamental goal of universal service."[15]

19 At the hearing, Chairman Sidran and Commissioner Oshie asked whether extending service in this case is consistent with the Commission's decision in the *Taylor* case, Docket No. UT-011439, where the Commission held Verizon NW did not have to extend service to eight houses. Settlement of the *Rupp* case is not inconsistent with the *Taylor* case because the underlying legal and factual postures of the cases are different.

20 The *Rupp* case deals with an issue of first impression: whether the Commission can compel a carrier to provide service outside its tariffed service area. The Commission has developed no criteria for resolution of this question. In contrast, *Taylor* dealt with the application of waiver criteria in a new rule (WAC 480-120-071(7)) for line extension obligations within a carrier's service territory. Thus, *Taylor* is not precedent for *Rupp*. Moreover, the Joint Settlement specifically states that settlement of *Rupp* will not be precedent for future line extension cases.

21 *Taylor* is also distinguishable on the facts. In *Taylor*, the estimated cost to serve eight customers at two remote locations was $1.2 million (or $150,000 per customer), whereas in *Rupp* the cost is only $325,000 ($27,000 per customer); in *Taylor*, the line extensions totaled up to 30 miles, whereas the *Rupp* extension is approximately 3 miles;[16] the *Taylor* petitioners had alternative telephone service (wireless) available to them, whereas the *Rupp* petitioners do not have wireless, radio, or any other type of service and cannot obtain such service due to natural topography;[17] finally, the second set of petitioners in the *Taylor* case lived at the end of a 26-mile dirt road, which would have increased Verizon's maintenance costs tremendously, whereas the *Rupp* petitioners live along a paved, well-maintained road.

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[15] TR. 581:2-3 (Roth).

[16] Rupp Petition at ¶ 3.1 (filed May 17, 2005).

[17] Ms. Roth explained this point at the hearing, TR. 603, and petitioners made this point in their pleadings. *See* Rupp Petition at ¶ 3.5-3.7.

22 In sum, this Joint Settlement term benefits these customers with ***no*** adverse impact to the public because Verizon will pay the $325,000 cost and will not seek recovery from the ITAC,[18] and the Commission's acceptance of this term does not create a precedent or conflict with prior cases.

2. <u>Rate Center Consolidations and EAS Adder Elimination</u>

23 Under this term, Verizon NW will consolidate the three Skagit County rate centers into a single rate center, resulting in county-wide local calling for customers in Skagit County. Verizon NW will also consolidate the Arlington, Darrington, Granite Falls, and Marysville rate centers into a single rate center. Finally, Verizon NW will eliminate the flat and measured Premium Plus Adders that currently apply to customers in Fairfield, Farmington, Latah, Oakesdale, Rockford, Rosalia, and Tekoa and will maintain the existing unlimited usage service area for each exchange.[19] As Staff explained in its direct testimony, and as Ms. Roth explained on the stand, this term provides significant public benefits: it improves local calling areas and eliminates long distance charges for many customers, and it benefits *all* customers by conserving telephone numbering resources.[20]

24 At the hearing, Public Counsel argued that this term was of limited benefit because it covered "only" 10% of Verizon's customers.[21] As Ms. Roth explained, however, this Joint Settlement term actually benefits about 30% of Verizon NW's customers because it benefits customers in contiguous exchanges.[22]

25 Finally, Chairman Sidran and Commissioner Oshie asked why Staff did not apply the Commission's historic criteria to these particular rate center consolidations.[23] First, Ms. Roth

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[18] At the hearing, Public Counsel suggested that this term might not be of any value because it is possible the Commission could order Verizon to extend service in the *Rupp* case. Ms. Roth explained that even if the Commission ordered Verizon to extend service, "Verizon is entitled to recover the cost through the line extension rule," and that the end user would also have to pay "much higher rates to get the line in their homes." TR. 580.

[19] Exh. No. 501 at 4-5.

[20] Exh. No. 101T-HC at 25; TR. 609.

[21] TR. 585-90:13-15 (Roth)

[22] TR. 590:15-19 (Roth); *see also* Exh. No. 528

[23] TR. 616:8-12 (Roth).

explained that Staff considered *other* issues, such as number conservation.[24] Second, Staff is not aware of other calling scope problems in Verizon NW's territory, but would have wanted these particular rate center consolidations sooner or later.[25] Finally, Ms. Roth explained that the settlement eliminates the only premium adders in Verizon NW's territory, thus serving the public interest.[26]

26 Based on the above, this term of the Joint Settlement is in the public interest. And since this rate center consolidation is part of a settlement, it will not serve as precedent for future rate consolidation cases.

3. Rate Freeze or "Stay Out"

27 Under this term, Verizon NW agrees not to seek an increase in its basic rates beyond the levels set by the rate case settlement in Docket No. UT-040788 until June 30, 2009. Under the rate case settlement, Verizon NW was awarded a total rate increase of $38.6 million, and agreed not to seek any further increase (with some exceptions) for two years, i.e., until July 1, 2007. This settlement was supported by Public Counsel, who noted that the "two year rate stability period" was a benefit to consumers.[27]

28 In contrast, Public Counsel now argues that the two-year extension of the "stay-out" period does not provide ***any*** benefit because it is not known whether Verizon NW would seek a rate increase before 2009 with the Joint Settlement.[28] Public Counsel is wrong – two more years of "rate stability" is both a public benefit and in the public interest. As Staff witness Roth explained, "it's very possible the company will come back for a rate case [before 2009] or ask for increases in residential rates."[29]

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[24] As Ms. Roth testified, rate center consolidation would enhance number conservation, and thereby "delay the possibility of another area code for Western Washington." TR. 609:2-6 (Roth).

[25] TR. 610:2-6 (Roth).

[26] TR. 588:15-18; 610:7-12 (Roth). Staff also viewed these premium adders ($15.00 residential; $30.00 business) as expensive. *Id.*

[27] Docket No. UT-040788, Narrative Supporting Settlement, Joint Statement of Public Counsel and AARP, ¶¶ 47-48.

[28] TR. 595:4-23 (Roth).

[29] TR. 595:12-14 (Roth)

29 Ms. Roth also testified that this term has a "significant dollar amount attached to it" based on her review of the company's financial data.[30] Dr. Danner's rebuttal testimony explains that Verizon NW's most recent earnings report filed with the Commission shows that Verizon NW is currently earning only about [redacted]% versus an authorized rate of return of 8.68%. The additional annual revenues required for Verizon NW to earn its authorized return exceeds [redacted] million.[31] As noted in Confidential Appendix A to the Narrative,[32] in its last rate case, Verizon NW sought a rate increase of approximately $109 million and was awarded (via the settlement) an increase of $38.6 million. Using this experience as a benchmark, the potential value of this term of the Joint Settlement is indeed "significant," as Ms. Roth testified.

30 Finally, Ms. Roth explained that the benefit of the additional two-year stay out for consumers is "tremendous" because the *costs* of the merger occur in the first few years, whereas the *financial benefits* of the merger do not occur until later years. Citing Ms. Folsom's testimony, Ms. Roth said:

> [T]he savings would realize in later years of the merger and the transaction cost is going to be likely occur in . . . the earlier years and the later years of the savings. So to that extent, to settle this case, to have Verizon agree not to come in until July 2009, I think the benefit to consumers is tremendous. It's because the transition cost, by then, I hope will flow through the system and we'll now be able to recognize in the rate base.[33]

In short, this term provides direct, tangible public benefits and should be accepted.

4. Wholesale Performance Metrics

31 Under this term, Verizon NW will report the Bell Atlantic-GTE FCC merger condition metrics until it implements the California JPSA Verizon NW metrics in Washington. These metrics measure Verizon NW's wholesale performance with CLEC customers such as Integra. Under the Joint Settlement, Verizon NW will report on wholesale metrics at least until the end of

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[30] TR. 596, 612:6-7 (Roth).

[31] Based on Verizon NW's second quarter 2005 surveillance report on file with the Commission, which reflects the company's financial condition for the twelve months ending June 2005, and making the rate case normalizations to reflect the rate case changes and depreciation rate changes effective May 2005 and July 2007, Verizon NW's earnings are [redacted]%. See Exh. No. 23T-C at 28, n.12. Verizon NW would need [redacted] million in additional annual revenues to achieve the 8.68% cost of capital established in the rate case settlement in Docket No. UT-040788.

[32] Exh. No. 502-C.

[33] TR. 612:15-24 (Roth).

2008. As Integra explained in its statement in the Narrative, "Verizon NW's commitment satisfies Integra's interest and the public interest because it provides certainty and accountability in wholesale transactions, which ultimately strengthens the provision of service to end user customers."[34] At the hearing, neither Public Counsel nor XO questioned the benefits of this term.

5. Retail Service Quality

32 Joint Settlement term #5 addresses retail service quality. At the hearing, Public Counsel suggested that this term was insufficient because (a) Verizon NW is already subject to the Commission's service quality rules and (b) MCI would automatically be subject to the rules applicable to Class A companies as a result of the merger.[35] As Ms. Roth explained, however, Verizon NW must continue to meet the Commission's service quality standards and to file reports with the Commission, and that "Staff will review those reports, monitor those reports, enforce the standards set in the rule, so that's how [Staff] will deal with [the issue] if the service quality declines from its current performance."[36] Ms. Roth also testified that Verizon NW has good service quality, and that additional service quality reporting conditions that Public Counsel proposes are not necessary because:

> In this case, the control of the management did not change. The same management team will continue to control Verizon NW's service quality and there is no upper management change, so that's why Staff less of concern about service quality in this particular merger than the previous merger.[37]

33 Staff is better positioned to opine on Verizon NW's service quality than is Public Counsel and there is no credible evidence contradicting Staff's finding that no additional measures are needed as a condition of merger approval. For all of these reasons, this term furthers the public interest.

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[34] Exh. No. 502 at 14.
[35] TR. 569:13-16 (Roth).
[36] TR. 568:23-25 - 569:1-3 (Roth).
[37] TR. 569:21-25 - 570:1-3 (Roth).

6. <u>LPIC Credits</u>

34 Under this term, Verizon NW agrees to file a promotional intrastate tariff under which it will issue a credit equal to the applicable local PIC (LPIC) charge to current residential customers who switch long distance service from MCI to another company. Staff requested this condition based on its belief that it promotes customer choice.[38] Verizon NW is not required by statute or rule to issue these credits. Moreover, nothing about this parent- level transaction will change the prices, terms or conditions of MCI's long distance customers' services. Nonetheless, in the spirit of compromise, Verizon NW and MCI agreed to this condition.

35 Public Counsel and XO do not oppose this term. Public Counsel, however, wants to expand the scope of this term so that it gives a credit to MCI's *local service customers* who choose to switch local providers. But as Ms. Roth explained in her pre-filed testimony and at the hearing, the reason Staff recommended a credit when a customer changes its long distance provider (as opposed to its local service provider) is because Staff believes Verizon NW's market share for long distance service will increase significantly as a result of the merger.[39] For local service, however, Verizon NW's market share will not change as a result of the merger – indeed, the change in Verizon NW's local market share is so small Staff could not even quantify it.[40]

36 Public Counsel characterized the merger as an "involuntary recapturing" of MCI local customers by Verizon NW for which customers must pay a fee, but Ms. Roth explained why this characterization is plainly wrong:

> [E]very customer today in the state of Washington pays the initiation fee if they choose to leave one local provider to another. This merger is -- you know, it didn't impose any additional charges in that regard.
>
> * * *
>
> [I]f I were [a Qwest customer] today and didn't like Qwest, I choose a provider providing local service in Olympia, I still have to pay the same . . . type of charges that [a] customer has to pay for Verizon NW's services.[41]

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[38] Exh. No. 101T-HC at 22-23.
[39] Exh. No. 101T-HC at 22; TR. 555-59 (Roth).
[40] TR. 557:3-7 (Roth).
[41] TR. 560-61:14-19 (Roth).

37 As discussed below in Section V.C.1(c)-(e), there are other reasons why Public Counsel's proposal should be rejected. Ms. Roth's testimony, however, provides sufficient evidence of the public benefits of this term of the Joint Settlement.

7. Commercial Agreements Availability

38 As noted in the Joint Settlement, Verizon and MCImetro are parties to a Wholesale Advantage Services Agreement for Washington. Upon request, Verizon will make this Agreement, or any replacement agreement between Verizon and MCImetro (or another telecommunications carrier affiliate), available to similarly situated CLECs. Staff requested this condition in its pre-filed testimony with the goal of promoting a competitive market.[42] The benefits of this term were not questioned.

8. Special Access Rates

39 Under this term, Verizon NW would have supported a review by this Commission of Verizon NW's intrastate special access rates if the FCC had required Verizon NW to reduce interstate special access rates as part of the FCC's merger review. The FCC decision is now available and the FCC did not reduce Verizon NW's special access rates.[43] XO argues that the Commission should reduce Verizon NW's intrastate special access charges regardless of the FCC's actions. Section V.C.2(a) below explains why XO's proposal should be rejected.

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

40 The Joint Settlement ensures that the merger meets the "public interest" standard discussed in Section IV, especially when considered in light of the recent DOJ and FCC approvals. The DOJ found that, with the exception of a few markets outside Washington in which the DOJ adopted conditions, the transaction will not harm competition and will likely benefit consumers.[44] Similarly, the FCC concluded that the merger is in the public interest:

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[42] Exh. No. 101T-HC at 19-20.
[43] See FCC Order, Appendix G, Conditions.
[44] Exh. No. 512.

> We find that public interest benefits are likely to result from the proposed transaction and that, in light of the DOJ Consent Decree, the merger is not likely to have anticompetitive effects in any relevant markets.
>
> * * *
>
> We also find potential public interest benefits from the proposed merger that, taken as a whole, outweigh the relatively limited possible public interest harms. These public interest benefits relate to enhancements to national security and government services, efficiencies related to vertical integration, economies of scope and scale, and cost savings.
>
> We therefore conclude that on balance, the positive public interest benefits likely to arise from this transaction are sufficient to support the Commission's approval of Verizon's and MCI's application under the public interest test of sections 214 and 310(d) of the Communications Act.[45]

The FCC concluded that the voluntary commitments made by Verizon and MCI serve the public interest as well. The specific commitments to which the FCC refers are set forth in Exh. No. 522 and discussed in greater detail below.[46]

41 The Joint Settlement also is a reasonable compromise of contested issues relating to the sharing of merger synergies. As Verizon explained in its pre-filed testimony, and as explained further in Section VI, the Commission should not (indeed, it cannot) require Verizon to pass through any synergies because no statute permits this and, in any event, Verizon is subject to rate-of-return regulation, and its revenues cannot be reduced in a vacuum. Nevertheless, under just the first two terms of the Joint Settlement, Verizon will flow-through approximately $[redacted] million over the next four years, and, unless Verizon files a rate case, a portion of this benefit will continue in perpetuity.[47] This amount is comparable to the *total* merger synergies – including revenue synergies – that are attributable to Verizon's regulated intrastate operations in

[45] FCC Order at para. 219 – 221.

[46] Exh. No. 522.

[47] As shown on Exhibit 502-C, Verizon forgoes almost [redacted] dollars per year *every year* in lost toll revenue and premium adder revenue.

Washington.[48] In other words, the settling parties have ensured that Washington consumers derive significant benefits from merger synergies through the terms of the Joint Settlement.[49]

42 In sum, there can be no doubt that this Joint Settlement, in light of the DOJ and FCC orders, is in the public interest and should be approved without change.

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

Under WAC 480-143-170, the proposed transaction must be "consistent with the public interest." In the *Scottish Power* case, the Commission held that this standard requires only a showing of "no harm":

> [T]he standard in our rule does not require the Petitioners to show that customers, or the public generally, will be made better off if the transaction is approved and goes forward. In our view, appellant's initial burden is satisfied if they at least demonstrate no harm to the public interest."[50]

43 The Joint Settlement Agreement, in light of the DOJ and FCC orders, is in the public interest and should be approved without change. The Commission need not impose conditions beyond those agreed to in the Settlement Agreement to find that the transaction is in the public interest. Indeed, as discussed throughout this brief, the evidence in this case proves beyond any doubt that the merger causes no harm. Moreover, the evidence shows that the merger will result in tangible and significant benefits to Washington consumers and businesses, and therefore it should be approved under any standard.

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[48] The net present value of the total synergies is $█ million (Exh. No. 86-T-HC at 7). The $████ million associated with terms 1 and 2 of the Settlement is the nominal value. The net present value, using an 8.68% discount rate, is $████ million.

[49] Public Counsel argues that this flow-though is insufficient; it claims the flow-though amount is $███ million per year. Public Counsel is wrong, and Section VI of this brief explains the many errors in Public Counsel's calculations.

[50] *In the Matter of the Application of Pacific Corp. and Scottish Power, PLC*, Docket No. UE-981627, (3rd Supplemental Order on Prehearing Conference, April 1999); *see also In Re Application of US WEST Inc. and Qwest Communications International, Inc.*, Docket No. UT-991358 (9th Supplemental Order, June 19, 2000).

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

A. The Transaction Will Not Create Adverse Effects for Competition or in Other Areas

44 It is clear that even without the Joint Settlement the transaction meets the standard for approval. Based on a comprehensive review in which it "considered numerous product and geographic markets and evaluated all overlaps between the merging parties, [and] took into account competition from cable companies as well as emerging technologies such as voice over Internet protocol (VoIP),"[51] the DOJ concluded that the only competitive issue raised by the merger was the elimination of MCI as a provider of private line or special access services in a handful of markets and in a small number of buildings. Taking into account the agreement between the DOJ and Petitioners to address that one concern, the DOJ concluded that "the transaction will not harm competition and will likely benefit consumers, due to existing competition, emerging technologies, the changing regulatory environment, and exceptionally large merger-specific efficiencies."[52] The FCC likewise has approved the transaction and found that it is in the public interest.[53] The DOJ and FCC eliminate any concerns about competitive harm in Washington or elsewhere. The record in this proceeding supports a conclusion by this Commission consistent with those reached by the DOJ and FCC.

45 Dr. William Taylor, Joint Petitioners' economics expert, explained that the transaction should be analyzed using a forward-looking market structure (with and without the merger).[54] He concluded that the merger would have no adverse impact in either the "mass market" (consisting of residential and small business customers) or the "enterprise" market (consisting of medium-sized and large business and carrier customers that purchase communications services on a retail and wholesale basis) based on three principal reasons. *First*, the companies have minimal overlap of facilities in Washington and where such overlap exists, numerous other competitors are using their own facilities to serve customers in those areas.[55] *Second*, for reasons

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[51] Exh. No. 512.
[52] *Id.*
[53] Exh. No. 511.
[54] Exh. No. 1T C at 49:16-17.
[55] Exh. No. 1T C at 54:17-20; 55:1-15; 56:1-12.

unrelated to the merger, MCI is no longer an economically meaningful competitor for mass market customers in that it does not now, and would not absent the merger, discipline Verizon's prices for mass market services.[56] *Third*, Verizon has not been a significant competitor to MCI in the enterprise market because MCI serves primarily large enterprise customers on a national and international basis and Verizon serves a relatively small number of smaller enterprise customers regionally; numerous other providers serve the enterprise market as well.[57] These conclusions are supported by solid factual evidence and eliminate any reason for imposing conditions on approval.

1. **The Transaction Will Not Adversely Affect Mass Market Local Exchange Services.**

46 In addition to MCI's insignificance as a mass market competitor, Dr. Taylor explained that substantial intermodal competition does have a price disciplining effect on Verizon's mass market services. Intermodal competitors are already serving increasing numbers of mass market customers in Washington and nationally and such competition will not be affected by the transaction in any way.[58] Moreover, even assuming (contrary to fact) that intermodal competition would not constrain the prices for Verizon's mass market services, since Verizon is rate-regulated, the Commission's continuing regulatory oversight will prevent any adverse impact on mass market customers.[59] Indeed, Public Counsel's witness Dr. Roycroft admitted that the transaction will not affect the Commission's rules, regulations or oversight role in any way.[60] As discussed below, the other parties have not presented any valid proof that the transaction will harm mass market competition – and none exists.

[56] Exh. No. 1T C at 59:21-29; 60:1-7; Exh. No. 4T HC at 15:15-21; 16:1-18; 17:1-13; *see also* Exh. No. 60T HC at 16-22; Exh. No. 61T HC at 3-6.
[57] Exh. No. 1T C at 6:3-17; Exh. No. 4T HC at 76:17-21; 77:1-6.
[58] Exh. No. 1T C at 62-76; Exh. No. 4T HC at 28-45.
[59] Exh. No. 4T HC at 8.
[60] Exh. No. 391.

a. Absent The Transaction, MCI Would Not Be A Meaningful Competitor To Verizon

47 In the mass market, MCI provides local and long distance services and uses leased facilities, not its own facilities, to provision the local components of mass market services.[61] The evidence shows that MCI's mass market business is in an irreversible decline due to: increasing competition from wireless providers, , RBOCs (with their entry into long distance), and non-traditional providers such as Skype, Vonage, and Net2Phone; the establishment of a national Do-Not-Call registry in 2003 which obliterated MCI's most effective and efficient consumer sales channel; and federal regulatory decisions which eliminate UNE-P at regulated TELRIC-based rates and led MCI to enter into commercial agreements with ILECs at commercial rates that are already substantially above TELRIC rates and that will increase annually.[62]

48 As a result of this confluence of technological, market and regulatory changes, MCI's mass market business has declined substantially in Washington and throughout the nation.[63] MCI has been managing the decline of this business by sharply curtailing its marketing efforts here and across the country, and by closing customer centers and call centers.[64] Perhaps most significant, MCI has increased its prices to mass market customers and expects to continue to do so in the future.[65] Consequently, MCI is not now, and does not expect to be, a price leader for mass market services, is not putting price pressure on Verizon's current retail rates, and would not do so in the future absent the transaction.[66] As Dr. Taylor explained, "From an economic perspective, [this is] the most significant consideration in any analysis of whether a transaction will adversely affect prices ...."[67] Dr. Taylor stressed that

> Verizon isn't asking to be deregulated here. [T]hey're not trying to argue that competition is sufficient that they should have complete pricing flexibility. They may think they should, but that's not this docket. [The only relevant issue is] what is the incremental effect of MCI and Verizon coming ... under one roof. ...

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[61] Exh. No. 60T HC at 8:163-171; 9:171-172.
[62] Id. generally at 10-25.
[63] *Id.* at 19:376-395; 20:396-413; 201:414-435; 22:436-457.
[64] *Id.* at 15:307-310; 16:311-332; 17:333-351..
[65] *Id.*; Exh. No. 61T HC at 17:351-354; 18:355-358; Exh. 61T HC at 9:6-22.
[66] Exh. No. 61T HC at 7:7-26; 8:1-25; Exh. No. 60 T HC at 23:458-463
[67] Exh. No. 4T HC at 19:1-14.

> And in fact, for mass market, the fact that, even though MCI is going to continue to milk its cash cows, my phrase, not theirs, that doesn't have much of an effect on price. You know, if you want to see that MCI has an effect on price, cast your mind back ten years at dinnertime when the phone rang. There was somebody telling you about why you should shift to MCI, because it was a lot cheaper than Verizon or whoever. But they're not doing that anymore. The marketing is cut out.[68]

49 Indeed, the FCC concluded that the merger is "not likely to result in anticompetitive effects for mass market customers because … MCI has significantly reduced its marketing" to these customers.[69]

50 The record supports Joint Petitioners' showing that MCI is not a significant mass market competitor. While Staff's witness Wilson's HHI calculations indicate a slight increase in post-merger concentration in the mass market, his most significant conclusion is that MCI has "virtually no market power."[70] As Dr. Taylor noted, "if MCI has 'virtually no market power' or market share, the merger cannot possibly harm competition for residential customers."[71]

51 Public Counsel's witness, Dr. Roycroft, ignores MCI's competitive insignificance in the mass market and focuses entirely – and simplistically – on the fact that the merger will result in the elimination of an independent CLEC serving residential customers.[72] While Dr. Roycroft assumes that the transaction will enhance Verizon's ability to increase prices, the record evidence shows that the transaction will not have that effect because MCI would not influence Verizon's prices if the transaction did not take place.[73]

52 Implicitly conceding that MCI is not now a competitive force in the mass market segment, Dr. Roycroft speculates that MCI *could become* such a force using VoIP technology.[74] Mr. Beach testified, however, on the reasons why Dr. Roycroft is wrong.[75] As Mr. Beach explained, MCI's limited VoIP trial proves that MCI is well behind other significant competitors such as

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[68] TR. 443:23-25 - 444:1-7 (Taylor).
[69] Exh. No. 511 at 2.
[70] Exh. No. 121T HC at 14:16.
[71] Exh. No. 4T HC at 4:28-30.
[72] Exh. No. 371T HC at 21:20-22; 22:1-14.
[73] While Dr. Roycroft offered HHI calculations purportedly to show increased post-merger market power, the DOJ's review and approval of the merger proves the irrelevance of those HHI calculations; the calculations should also be rejected because Dr. Taylor showed that the calculations are flawed in numerous material respects. *See* Exh. No. 4T HC at 11:4-18; 12:1-14; 13:1-16; 14:1-10; 69:13-20; 70:1-21; 71:1-18; 72:1-8.
[74] Exh. No. 371T HC at 33:2-20.
[75] Exh. No. 61T HC at 10:1-17.

Vonage, Net2Phone, Lingo, AOL, Earthlink, VoicePulse, Futura Voice, eGlobalPhone, VoIP.net, Packet 8 and BroadVox, if it were to offer that service on a commercial basis.[76] MCI does not possess any unique advantages that it could use to distinguish its VoIP service from other providers' service. Indeed, since MCI's primary means of customer acquisition – telemarketing – is not an effective tool to reach VoIP customers, MCI is at a competitive disadvantage to VoIP providers that target Internet users through advertisements on the Internet.

53 Dr. Roycroft argues that MCI's commercial agreements with Verizon would enable MCI to continue offering local service to mass market customers if it did not agree to merge with Verizon.[77] This testimony, however, is inconsistent with Mr. Beach's evidence that:

> within Verizon's service territory [in Washington], the number of MCI's residential local access lines peaked in May 2005, and has since begun to decline, as predicted based on MCI's experience elsewhere, and as evidenced by the most recent customer line count. At [its] peak, [MCI] only served less than 1% of the residential local access lines available in Verizon territory.[78]

54 Dr. Roycroft also overlooks the evidence that MCI has for some time been increasing its prices and will continue to do so to recover the increased costs of providing local service pursuant to the commercial agreements that Dr. Roycroft cites and that call for periodic wholesale rate increases.[79]

b. Intermodal Competition Further Mitigates Any Competitive Concern

55 The presence and effectiveness of intermodal competitors is relevant only insofar as it provides additional assurance of no harm to mass market customers. The record evidence shows that intermodal alternatives have displaced and are continuing to displace a significant amount of traditional wireline service and usage.[80] It shows that the growing pressure on traditional wireline carriers from intermodal alternatives continues unabated, with significant events occurring in the months since the filing of the Joint Petition.[81] For example, since April 2005,

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[76] Id.
[77] Exh. No. 371T HC at 13:10-14.
[78] Exh. No. 61T HC at 11:13-17.
[79] Exh. No. 4T HC at 15:15-21; 16:1-18; 17:1-7.
[80] *See* Exh. No. 1T C at 62 -76.
[81] *See generally*, Exh. No. 1T C 20-24; and 62-76.

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Internet giant, eBay, announced its purchase of VoIP provider Skype for $2.6 billion.[82] In addition, on September 22, 2005, Microsoft announced that it would partner with Qwest to provide enhanced VoIP services to small and medium sized businesses, making it just the latest formidable entrant into the convergent communications field.[83]

56 In concluding that the transaction will not harm competition for mass market customers, the DOJ recognized that these changes pose serious threats to traditional wireline carriers, such as Verizon and MCI.[84] Similarly, the FCC "found that facilities-based intermodal competition, including cable VoIP and wireless services, is growing rapidly and will play an increasingly important role with respect to future mass market competition."[85] Staff witness Mr. Wilson also acknowledges that:

> Much more activity is occurring in the relevant market than appears under direct Commission oversight. For example, intermodal offerings of analog and digital services via wire and non-wireline transmission technologies are often presented as competitive alternatives, in whole or in part, to what Verizon currently offers in the relevant market.[86]
>
> The Applicants currently compete with VoIP/Internet, cable TV companies, wireless (wi fi, wi max, microwave, low-earth-orbit satellite), public utility districts (PUDs), Noanet, municipal networks and private/public partnerships, and broadband over powerline (BPL) to name a few unregulated alternatives. ***I do not dispute that intermodal competition should be an important part of the analysis …***[87]

57 While Dr. Roycroft admits that intermodal competition exists, he attempts to understate the impact of such intermodal alternatives. For instance, he states that "cable CLEC activity has been negligible in Verizon's Washington service area" and suggests that it is "less than clear" whether these firms will be offering telephony service to all customers.[88] Dr. Roycroft, however, fails to consider the ease with which wireline customers can switch to cable telephony if wireline

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[82] Exh. No. 4T HC at 53:7-25; 54:1-3.
[83] *Id.* at 54:5-8.
[84] Exh. No. 512 at 2.
[85] Exh. No. 511 at 2.
[86] Exh. No. 121T HC at 4:17-19 (emphasis supplied).
[87] Exh. No. 121T HC at 9:4-9
[88] Exh. No. 371T HC at 38:10-12.

carriers attempt to raise prices above competitive levels.[89] He also fails to consider the steadily increasing growth of cable telephony services in Washington.[90]

58 While Dr. Roycroft described wireless as a "complement" to wireline service, Dr. Taylor showed that wireless is a substitute for wireline and explained that the mere observation that a large number of consumers subscribe to both wireline and wireless services is *not* sufficient to conclude (as Dr. Roycroft incorrectly concluded) that the two services are complements.[91] In an attempt to support his claim that wireless is merely a complement to wireline, Dr. Roycroft cites one of the very same studies that Dr. Taylor cited to show that wireless is increasingly viewed as a ***substitute*** for wireline.[92] That study concludes, in relevant part:

> The finding that intermodal competition is significant in the communications market, and that local competition is enhanced by it, suggests that regulatory policies ought to account for these effects – perhaps without regard to CLEC line share. Otherwise, ILECs will be overly constrained in responding to market competition in the core wireline market.[93]

59 Dr. Roycroft also claimed that the small number of wireless customers who have "cut the cord" implies that wireless is not a viable competitive alternative to wireline, and that wireline customers view wireless service as inferior to wireline.[94] Dr. Taylor explained, however, that: (1) whatever the percent of "cord cutters," the merger will still not affect mass market prices or market outcomes; and (2) it matters only that wireline customers can switch to wireless in response to wireline price increases.[95] He explained that because competition takes place at the margin, not the average, the number of customers who cut the cord need not be significant in order for wireless displacement to discipline wireline pricing; and competition at the margin is particularly effective against wireline companies with cost structures disproportionately dominated by fixed or sunk costs because even small losses of volume can result in measurable

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[89] Exh. No. 4T HC at 29:3-8.
[90] Exh. No. 1T C at 18:19-23; 19:1-21; 20:1-17; 21:1-18.
[91] Exh. No. 4T HC at 31:10-19; 32-52..
[92] Exh. No. 371T HC at 45 n. 79.
[93] David G. Loomis and Christopher M. Swann, "Intermodal Competition in Local Telecommunications Markets," *Information Economics and Policy* 17, 2005, p. 111 (cited in Exh. No. 4T HC at 34:9-14).
[94] Exh. No. 371T HC at 45-47, citing a newspaper article and research report.
[95] Exh. No. 4T HC at 41:7-23; 42: 1-14.

profit losses.[96] Dr. Roycroft ignores these basic economic principles in dismissing wireless competitors as insignificant.

60 Dr. Taylor also testified wireless is a substitute for wireline on the supply side as some integrated wireline and wireless firms (*e.g.,* Sprint and Alltel) are spinning off their wireline businesses expecting that a wireless only product offering would be more profitable.[97]

61 Refuting Roycroft's arguments regarding wireless coverage and service quality, Dr. Taylor testified between 1985 and 2004, wireless service providers invested $174 billion in network and as a result, one or more wireless carriers cover virtually all households in Washington generally and in Verizon's service area in particular.[98] Dr. Taylor showed that while Dr. Roycroft selectively relied on surveys that purportedly show high levels of customer dissatisfaction with wireless service,[99] other surveys show high levels of customer satisfaction with wireless service and high percentages of customers who find wireless service to be a "good value." Dr. Taylor also explained that because customers choose products based on a variety of characteristics, differences in service quality may be offset by other characteristics, such as mobility.[100]

62 Dr. Roycroft erred in rejecting VoIP as a competitive alternative to wireline service, citing factors such as pricing, availability, service quality, and E911 availability.[101] Dr. Taylor first explained that the rapid growth of VoIP subscriptions means traditional wireline cannot assume that broadband costs will deter consumers from choosing VoIP.[102] He also explained that differences in quality do not mean that VoIP would fail to constrain wireline pricing since it matters only that a substantial number of customers would switch to VoIP if the price of wireline was raised above competitive levels.[103] Dr. Taylor also observed that the inability of VoIP

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[96] *Id.* (*citing* Jerry A. Hausman, "Regulated Costs and Prices in Telecommunications," in Gary Madden (ed.), International Handbook of Telecommunications Economics, Volume 2: Emerging Telecommunications Networks, 2003).
[97] Exh. No. 4T HC at 42:15-20; 43:1-2.
[98] Exh. No. 4T HC at 43:3-16; 44:1-6; 45:1-7.
[99] *Id.* at 47:8-20; 48:1-5.
[100] *Id.* at 46:4-19; 47:1-7.
[101] Exh. No. 371T HC at 57:4-21; 58:1-7.
[102] Exh. No. 4T HC at 55:1-11.
[103] *Id.*

providers to provide 911 or E911 when VoIP was first introduced did not deter VoIP customers and considerable progress has been made in E911 deployment.[104]

63 Dr. Taylor testified about *actual* consumer behavior and preferences demonstrating sufficient substitution by intermodal alternatives to constrain mass market wireline pricing:

- **Cable Telephony:** 99% of all homes passed by Comcast in Washington are broadband ready. Comcast plans to offer telephony to 15 million homes by year-end 2005 (a 50% increase from year-end 2004) and to all homes passed by the end of 2006.[105] Analysts say that Comcast's "move could be the most significant challenge yet to traditional local phone companies such as Verizon ...."[106] Cable providers' "triple play" of voice, data and video, which ILECs are not currently able to offer, is a potent attraction for customers.

- **Wireless**: Wireless connections now outnumber wireline connections nationwide, accounting for more than half of the voice lines counted by the FCC.[107] Surveys show that wireless has displaced 60% of long distance and 36% of wireline local calling in households with wireless phones.[108] Wireless usage has skyrocketed, prices have fallen steadily,[109] and a growing number of customers are "cutting the cord" altogether, with up to a third of wireless customers expected to do so within the next few years.[110] Similar patterns are evident in Washington where wireless penetration grew 66% in the period from June 2000 to June 2004 and reached nearly 60% in 2004.[111]

- **VoIP:** The record shows that consumers are adopting VoIP at a rapid rate, and that Verizon's competitors expect this trend to continue.[112] The entry of Internet giants Google and eBay into VoIP provisioning and Microsoft's partnership with Qwest, confirm that VoIP technology is well established and there are formidable VoIP competitors. eBay's $2.6 billion acquisition of Skype is compelling evidence that VoIP will be a significant competitive substitute for traditional wireline.[113] Verizon's decision to launch its own VoIP service (VoiceWing) also confirms the significance of the VoIP threat.

- **Broadband:** E-mail and Instant Messaging are displacing significant volume of traditional wireline traffic. If just 5 percent of e-mail and IM messages displace a 90 second voice call, this would represent more than 10 percent of the voice traffic that would otherwise have been handled by ILEC networks.[114]

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[104] *Id.* at 63:3-23; 64:1-2.
[105] Exh. No. 1T C at 64:13-23; 65:1-17; 661-19; 67:1-4.
[106] *Id.* at 65:10-12.
[107] *Id.* at 21:915; 22 1-7.
[108] *Id.* at 24: 3-7.
[109] *Id.* at 22 8-10; 23:1-16; 24:1-2.
[110] *Id.* at 24:3-26; 25:1-13; 26:1-9..
[111] Exh. No. 1T C at 61:1-31; 62:1-21; 63:1-2; Exh. No. 4T HC at 35-38; 70:12-18; 1-9.
[112] Exh. No. 1T C at 32:4-10; 34:7-17; 35:1-11; 36:1-10.
[113] *Id.* at 53:7-25; 54:1-8.
[114] UNE Fact Report (2004) p. I-6, cited in Exh. No. 1T C at 29:3-14; 30: 1-2.

- **Emerging Technologies:** Wi-Fi is already widely used by consumers and businesses.[115] Wi-Max is expected to roll out in early 2006 and attract a substantial number of customers by 2009.[116]

64 This evidence is not needed to conclude that the transaction will not harm competition but serves that purpose nonetheless.

2. The Transaction Will Not Adversely Affect Mass Market Long Distance Service.

65 The record evidence shows that the transaction will not harm competition for mass market long distance customers. As a threshold matter, Dr. Taylor testified that it is inappropriate to regard local and long distance services as stand-alone markets to be analyzed independently.[117] The intermodal competition that he described in detail has obliterated the distinction between "local" and "long distance" services. Wireless customers now buy "buckets" of any-time, any distance minutes and no longer think in terms of local and long distance calls. Similarly, Internet communications via e-mail, IM or VoIP all take place without regard to geographical location or the local and long distance boundaries set for the traditional wireline market.[118]

66 Even if there were a stand-alone long distance market, however, the merger would have no adverse effect on competition. As the FCC concluded, the market for long distance services "is likely to remain competitive after the merger[], due primarily to the presence of nationwide competitive fiber networks with excess capacity."[119] The evidence shows that Washington customers will continue to have multiple alternative services available once the transaction is complete. Even if a customer does not use or own a cell phone, the price of that customer's long distance service will be protected from anti-competitive increases in wireline prices because such intermodal competition constrains the prices of all wireline services and, in particular, "long distance" service.

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[115] Exh. No. 1T C at 36-41.
[116] *Id.* at 41-43.
[117] Exh. No. 1T C at 76:2-7; 77 1-16.
[118] *Id.*
[119] Exh. No. 511.

3. The Transaction Will Not Adversely Affect Competition for Enterprise Services.

67 As Dr. Taylor testified, the market for enterprise services includes the full array of highly differentiated advanced information services that medium-sized and large businesses and governmental users demand," including "local voice and data, long distance and international data, convergent voice and data, system integration and merged service."[120] The DOJ concluded that "business customers that provide or buy telecommunications services to locations in Verizon's ... service territories will continue to benefit from competition ...."[121] The FCC found that "competition for medium and large enterprise customers should remain strong after the merger because medium and large enterprise customers are sophisticated, high-volume purchasers of communications services that demand high-capacity communications services, and because there will remain a significant number of carriers competing in the market"[122] The federal agencies' decisions provide further support to the record evidence proving that the transaction will not harm enterprise competition.

68 The record shows that MCI is a leading provider of enterprise services to large national customers, and Verizon has served smaller enterprise customers primarily within its traditional service area.[123] An internal study of more than 800 instances in which MCI bid on enterprise contracts between October 1, 2004 and April 20, 2005 showed that 96% of the time, Verizon was not a competing bidder.[124] This highly competitive market also includes IXCs (such as AT&T, MCI and Sprint), global network service providers (such as Deutsche Telekom and BT), system integrators (such as IBM, etc.), CLECs and DLECs, cable companies and equipment vendors.[125] Accordingly, the transaction will not unduly increase concentration or decrease the extent of bidding for enterprise customers. In light of this robust competition and the fact that these

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[120] Exh. No. 1T C at 78:5-18.
[121] Exhibit 512 at 2.
[122] FCC Order at para. 3.
[123] Exh. No. 60T HC at 29: 586-592; Exh. No. 4T HC at 103:5-11.
[124] Exh. No. 4T HC at 77:3-6.
[125] *See generally* Exh. No. 1T C at 78-94.

customers are sophisticated purchasers that typically employ competitive procurement practices,[126] there is no risk of harm to the enterprise market.

69 In addition to wireline competitors in the enterprise segment, wireless, cable telephony and other intermodal providers also compete for enterprise customers and enterprise customers are using intermodal alternatives both as replacements for their employees' office phones and for high capacity circuits.[127] That said, however, the complementary nature of Verizon's and MCI's enterprise businesses, as well as the robust competition in this segment from many carriers and other participants make it unnecessary for the Commission to find that intermodal alternatives are part of this market in order to determine that the transaction does not adversely affect competition for enterprise services.

a. The Transaction Will Not Harm Competition for Medium-Sized Business Customers

70 XO's witness, Mr. Wood, claims there is a separate, stand-alone market for medium-sized business customers that use special access services. He contends that Verizon and MCI are the only special access providers in Washington such that the "elimination" of MCI as one such provider will harm competition for medium-sized business customers that rely on special access services to conduct their businesses.[128] Mr. Wood offered ***no*** Washington specific evidence to support his claim, but instead relied on rehashed testimony he submitted in other states where he made similar claims and where, unlike here, he did submit state-specific (albeit flawed) data. Dr. Taylor explained why Mr. Wood's analyses of competition and of the transaction's effect on competition are incorrect in all respects.

71 Dr. Taylor testified that, contrary to Mr. Wood's claim, there is no stand-alone market for medium-sized business customers:

> [O]nce a carrier has deployed network facilities to reach larger customers, the firm is likely – as demonstrated by the historical pattern of CLEC entry and expansion – to diversify from serving the large customers to serving smaller customers who demand similar services. Moreover, the high-capacity services to

[126] Exh. No. 1T C at 78-80.
[127] *Id.* at 87-94.
[128] Exh. No. 301T at 15:12-22; 16:1-2; 49:16-28; 50:1-16.

which Mr. Wood refers, whether they are special access services, high-capacity loops, or high-capacity local transmission, are essentially point-to-point services that are fundamentally the same for both large and midsized customers. Thus, high-capacity services, including special access services, local loop services, or local transmission services, are segments of an enterprise market and should be considered in any analysis of an enterprise market.[129]

72 Dr. Taylor also explained that even Mr. Wood's client, XO, regards special access services as part of a single enterprise market, quoting XO's website discussion of its range of special access services: "from XO VPN, an economical private network application *for businesses of all sizes*, to sophisticated Private Data Networking solutions *for our largest customers* ...."[130]

73 Moreover, the fact that some enterprise customers are carriers that purchase services on a wholesale basis does not matter when determining whether these services should be considered part of the relevant product market for enterprise services. Whether the customer is a large retail establishment, a government institution, or a wholesale provider, the basic demand and supply characteristics are similar enough to warrant that they be grouped for analysis purposes. Dr. Taylor testified that, on the demand side, customers who demand high-capacity services require DS1 level services and higher.[131] Such customers, whether retail or wholesale, have the same characteristics as other enterprise customers, *i.e.*, they purchase services through contracts, issue RFPs, and are marketed to through direct-sales contacts.[132] On the supply side, midsized businesses are not geographically isolated from larger or smaller businesses or residential customers.[133] The networks, facilities, and operations that existing competitors currently are using to serve larger customers also can be used to serve midsized business customers if profitable conditions arise (assuming they are not already being used to serve them).[134] The networks serving residential and small businesses and the networks serving large business customers can be used to serve midsized businesses at low incremental cost in pursuit of

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[129] Exh. No. 4T HC at 86:4-14.
[130] *Id.* at 86:14-24; 87:1-13 (quoting from <http://www.xo.com/products/smallgrowing/data/index./html> (August 17, 2005)(emphasis supplied)).
[131] *Id.* at 88:6-14.
[132] *Id* at 88: 15-19.
[133] *Id.* at 88:20-21; 89:1-3.
[134] *Id* at 89:3-24; 90:1-21.

profitable opportunities. In fact, competitors attempt to serve as many types of customers as they possibly can.[135]

74 There is no reason to conclude that the transaction will harm medium-sized business customers even assuming *arguendo* they are a separate market. As the FCC concluded, MCI is not an important competitor for midsized businesses.[136] Dr. Taylor cited results from a recent survey of midsized businesses (defined as those with between 100 and 1,000 employees) which showed that just 3.5 percent of them named MCI as a primary communications provider.[137] By contrast, AT&T was named as a preferred provider by 16.4 percent of those businesses. Furthermore, many national and regional CLECs and DLECs specialize and compete actively for medium-sized business customers. The merger will have an insignificant impact on competitive options for midsized businesses and will not harm competition for customers in this segment of the enterprise market.

4. The Transaction Will Not Adversely Affect Competition for Special Access Services.

75 The transaction will not harm competition for special access services. Although, as noted, the DOJ was concerned that the transaction, "as originally proposed, would have resulted in higher prices for certain business customers in eight metropolitan areas in Verizon's franchised territory," it accepted an agreement by Verizon and MCI to provide IRUs to specified buildings in those areas which "would resolve the Department's competitive concerns ...."[138] While the FCC shared the DOJ's limited concerns regarding special access services, it found that the Joint Petitioners' agreement with the DOJ adequately addressed that issue, such that the FCC concluded that the merger will not have an adverse competitive effect with respect to special

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[135] Id.

[136] FCC Order at para. 3 (MCI "was not exerting significant competitive pressure" with respect to small enterprise customers). *See also* Declaration of Ronald J. McMurtie, at ¶¶ 3-4, Attachment 12 filed at the FCC in WC Docket No. 05-75; and Declaration of Eric J. Bruno and Shelly Murphy at ¶ 58, Attachment 3 filed at the FCC in WC Docket No. 05-75.

[137] K. Burney, InStat/MDR, "*Darwin Laughs: Exploring Broadband Preferences for Network and Managed Services in the US Business Market*," Part Two: US Mid-sized Businesses (100 to 999 Employees), December 2004, Table 27.

[138] Exh. No. 512 at 1.

access services that combine one carrier's facilities with those of another.[139] As with other areas of competition, these agencies' views concerning the transaction's effect on special access competition provide an adequate basis on which to approve the transaction without conditions.

76 Further, Dr. Taylor presented data proving that MCI does not provide substantial competition for special access services in Washington because it serves with its own facilities only a small fraction of the buildings served by CLECs in Verizon's service area. Specifically, Dr. Taylor showed that:

77 The Agreement with the DOJ does not include the 13 buildings in Verizon's Washington service area that are served by Verizon and MCI alone because the DOJ concluded that there is no risk of competitive harm in situations where there are 10 or fewer buildings in an MSA that are served by Verizon and MCI alone.[146] The DOJ recognized that pricing for special access services is determined on a national basis, not on the basis of a few buildings within an MSA.

78 Dr. Taylor provided other reasons to conclude that the transaction will not harm special access competition in Washington. He testified that MCI resells only a fraction of the special

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[139] Exh. No. 511 at 1.
[140] Exh. No. 1T C at 55:9-15.
[141] Exh. No. 530..
[142] *Id.*
[143] *Id.*
[144] *Id.*
[145] Exh. No. 526.
[146] Exh. No. 530.

access circuits it purchases from Verizon (*i.e.*, only about one third of DS-1 circuits and less than ten percent of DS-3 circuits that MCI purchases from Verizon are used by MCI to provide circuits to other carriers).[147] He showed that other competitors have more extensive fiber routes in Verizon's area of the Seattle-Tacoma-Bellevue region.[148] Dr. Taylor also explained that MCI is not receiving the largest discounts for special access services purchased from Verizon. In fact, at least two other carriers receive larger discounts and MCI's average price per DS 1 channel termination is equivalent to the average paid by other carriers in Washington.[149]

79 In short, the record shows there is no risk of competitive harm in the provision of special access and therefore, no conditions regarding special access services are appropriate. The DOJ "thoroughly investigated ... private line issues"[150] and entered into a settlement with Verizon and MCI designed to address the DOJ's limited concerns regarding competition for special access services. That settlement eliminates any need that might otherwise have existed for this Commission to impose special access conditions. Under the terms of the Agreement between the DOJ and the Joint Petitioners (DOJ Stipulation), the Joint Petitioners will provide ten-year leases (indefeasible rights to use or IRUs) to fiber facilities to buildings in numerous cities outside of Washington. The DOJ determined that no conditions were necessary to protect competition for special access services in Washington and XO has publicly announced that the DOJ's action addresses XO's competitive concerns regarding the merger. The Commission should accept XO at its word.

5. The Transaction Will Not Create Other Adverse Effects

80 The transaction will not create any adverse effects. Furthermore, the record contains no allegations of adverse effects (other than those raised by Public Counsel and XO), and therefore the Commission should reject any attempt by the Non-settling Parties to raise additional concerns in their post-hearing briefs.

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[147] Exh. No. 4T HC at 106:7-12.
[148] Exh. No. 5C.
[149] Exh. No. 4T HC at 106:13-17.
[150] Exh. No. 512 at 1.

B. The Transaction Will Provide Significant Benefits To Washington's Economy And Customers

81 As demonstrated above, this Commission need not find that Washington customers are "better off" as a result of the merger in order to find that it is in the public interest. Nonetheless, as expressed by the DOJ and the FCC, this transaction will create a variety of important economic benefits for customers. The FCC found that in response to fundamental changes that are redefining the communications industry, this transaction brings together complementary strengths of Verizon and MCI to create a stronger competitor better able to deliver a full suite of high quality services to businesses and consumers.[151]

82 The combination of these complementary strengths will benefit enterprise customers. The new company will be able to develop and deploy new services more rapidly than either company could on its own. For example, the combined company with MCI's IP backbone and Verizon's wireless network will possess the essential infrastructure to deploy mobile IP devices.[152] The combination of Verizon's local network and MCI's IP backbone will also benefit customers by enabling them to obtain all of these capabilities in a single transaction and allow Verizon to extend its IP-based service offerings geographically.[153] Enterprise customers will be able to take advantage of a comprehensive suite of service offerings provided over a centrally managed network, leading to increased transparency in network management and standardized service quality across the entire network.[154] Indeed, the desire to provide more attractive products and services to enterprise customers and to respond to the increasingly intense competition in this segment is the principal rationale for this transaction.

83 Public Counsel argued that these benefits could be achieved simply through a leasing partnership of the two independent companies and thus a purchase by Verizon of MCI was unnecessary. Both Dr. Danner and Mr. Beach rebutted this argument, showing that owning the end to end facilities provides distinct advantages, including better provisioning of services and

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[151] Exh. Nos. 511 & 512.
[152] Exh. No. 21T at 18-19.
[153] *Id.*
[154] Exh. No. 21T at 17-18; Exh. No. 23T - C at 18-19; Exh. No. 61T-HC at 15-16.

improved trouble isolation and repair time.[155] As Verizon witness Stephen Smith testified at the hearing,

> [A]nd so you have a complete solution, and you have a single accountable company for delivery. And that will improve things like service level commitments to customers. Today if I'm partnering with a Level 3, I can't necessarily provide service level guarantees the way I will be able to do when I can – when I know what the end to end capability of the company is, I know the systems and the infrastructure which supports the entities, and can feel comfortable making the kind of service level commitments that customers will be looking for.[156]

84 Mass market customers will also benefit, as products and services developed for the enterprise sector are delivered to smaller business customers with similar needs, and as the transaction allows Verizon and MCI to meet customer demand for any-distance voice and data needs more effectively than either company could alone.[157] Enterprise services are used to support a broad range of consumer applications, are provided over the same network that also serves consumers, and allow enterprises to produce wholesale inputs to consumer services and products.[158] Thus, enhanced competition for enterprise customers and the increased investment in the companies' networks will ultimately rebound to the benefit of consumers and small businesses as well.[159] Mr. Smith stated the following about the pass through of benefits to mass market customers:

> We believe this transaction . . . is really intended to build the MCI enterprise business. The service suite that MCI offers to its enterprise customers we believe has application into the mid-market. It's our expectation that together the companies can bring some of those high-end applications down into the mid-market so there will be opportunities there for mid-market customers, small business customers to enjoy many of the enhanced services. . . .

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[155] Exh. No. 23T –C 19 and Exh. No. 61T-HC 15-16.
[156] TR. 340:9-12 (Smith).
[157] Exh. No. 23T-C at 16-17.
[158] *Id.*
[159] TR. 244:9-25 - 245:1-14 (Danner).

[Public Counsel] Q. All right. But it sounds like those benefits will not inure to anything below the mid-market, to the small business or residential customer?

A. The analysis that we performed identified revenue opportunities in -- new revenue opportunities in the enterprise and mid-market space, but as I indicated, I don't believe that's the only way in which mass market customers will benefit. They'll benefit, as I just said, from the improvement in the MCI network, which Verizon will use to enable it to deliver services to the mass market customers. Ultimately, if, you know, if technology development follows the path it has traditionally followed, that which starts in the enterprise space does work its way down to the mass market arena. Internet services are a perfect example of that. . . .[160]

85 The transaction also will produce significant cost savings for the combined firm; benefits that will be passed through to Washington consumers as a result of competition and market forces. Washington law does not require Verizon and MCI directly to flow through monetary benefits of the transaction to Washington consumers. Nonetheless, it is clear that Washington consumers will benefit from the significant cost savings and other synergies created by this transaction.[161]

86 Transaction-related costs savings will come from a variety of sources. For example, Verizon will realize significant savings by moving a large share of its long-distance traffic onto under-utilized portions of MCI's existing long-haul transport facilities, allowing Verizon to avoid payments to third parties for such transport services. In the information technology area, Verizon's investment will make it possible to integrate the multiple information technology systems MCI currently operates.[162] MCI witness Mr. Beach expanded on this point during his testimony at the hearing, explaining that "certain improvements in MCI's systems, particularly in the order processing for example or billing system improvements could affect customers across the country, including Verizon territory," and that the systems "don't have to be in Washington

[160] TR. 355:3-23 - 356:1-9 (Smith).
[161] Exh. No. 23T-C at 20-23; Exh. No. 86T-HC at 4; Exh. No. 87 – HC at 1.
[162] Exh. No. 86T-HC at 4.

to benefit Washington customers. Billing systems and so forth, you know, may be located regionally or even at a single point nationally and used for all products across the country."[163]

87 Dr. Danner succinctly summarized the merger's benefits during the hearing:

> [T]he transaction will benefit customers in at least three ways. First, it will make the combined companies stronger competitors in the enterprise market, especially here in Washington compared with Qwest. Second, it will allow substantial new investments to be made in MCI's backbone network and systems. And third, it will create synergies that will benefit customers and the economy. At the same time, the merger poses no threat of harm to competition or customers in Washington, and it will preserve intact the Commission's existing authority over Verizon and MCI.[164]

C. Should Conditions Be Imposed?

88 No conditions should be imposed. Petitioners respectfully submit that the Commission lacks jurisdiction over this parent company merger. But if the Commission has such authority, it must exercise it lawfully by limiting conditions to those necessary to ameliorate harms created by the transaction. Moreover, as discussed, the DOJ and FCC have concluded that the merger will cause no harm and will create significant benefits, and the Joint Settlement in this docket provides even greater benefits. Therefore, Petitioners request that the Commission approve the Settlement Agreement without change and approve the transaction.

89 Public Counsel and XO, however, appear to view this docket as an opportunity to satisfy their own agendas by attempting to impose conditions unrelated to the transaction itself. As former FCC Commissioner Powell noted on a number of occasions, "[t]he approach of rounding up 'voluntary' conditions to compensate for largely unrelated potential harms is fraught with public policy problems."[165] Specifically, "when conditions are not calibrated to remedy harms, there is no constraint on how voluminous or unrelated they might be. The consequence of this approach is that the slightest harm opens up a quarry of 'would-be-nice-to-haves' that can be

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[163] TR. 294:4-15 (Beach).

[164] TR. 165:17-25 - 166:1-2 (Danner).

[165] *In re Applications of Ameritech Corp., Transferor, and SBC Communications, Inc.*, 14 FCC Rcd. 14712, Separate Statement of Commissioner Michael K. Powell, Concurring in Part and Dissenting in Part, at 15197-15198.

piled on the scale."[166] The Commission should not accede to intervenors' attempts to fulfill their wish-lists by imposing proposed conditions having little or nothing to do with the transaction itself.

90 In addition, many of the proposed conditions are contrary to law and invite the Commission to exceed its jurisdiction, which is limited to ***intrastate*** services.[167] A service is classified as interstate or intrastate based on the physical end points of the communications - the so-called "end-to-end analysis."[168] Where services are capable of "jurisdictionally mixed" uses -- that is, where they are capable of both interstate and intrastate communications -- they are generally subject to dual federal/state jurisdiction.[169] The FCC may, however, preempt state jurisdiction over mixed-use services in circumstances where it is deemed impossible or impractical to separate the service's intrastate from interstate components and where the state regulation of the intrastate component interferes with valid federal rules and policies.[170]

91 Against this backdrop, the Commission has no authority even to entertain many of the proposed conditions. For example, the Commission lacks jurisdiction with respect to the Internet and broadband services about which Public Counsel has complained. The FCC has expressly held that Internet backbone services are interstate in nature.[171] Similarly, DSL transport is classified as an interstate information service subject to exclusive jurisdiction of the FCC.[172]

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[166] *Id.*

[167] *See* 47 U.S.C.§§151, 152.

[168] *See, e.g., Bell Atl. Tel. Cos. V. FCC*, 206 F.3d 1, 3 (D.C. Cir. 2000).

[169] *See, e.g., Southwestern Bell Tel. Co. v. FCC*, 153 F.3d 523, 542-543 (8th Cir. 1998).

[170] *See, e.g., Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 368 (1986); *Qwest Corp. v. Minnesota Pub. Utils. Comm'n*, 380 F.3d 367, 374 (8th Cir. 2004).

[171] According to the FCC, "[m]ost Internet-bound traffic traveling between a LEC's subscriber and an ISP is indisputably interstate in nature when viewed on an end-to-end basis." Order on Remand and Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 16 FCC Rcd 9151, ¶58 (2001); see Petition for Declaratory Ruling that pulver.com's Free World Dialup Is Neither Telecommunications Nor a Telecommunications Service, WC Docket No. -3-45, FCC 04-27, ¶16 (FCC rel. Feb. 19, 2004)("federal authority has already been recognized as preeminent in the area of information services, and particularly in the area of the Internet and other interactive computer services."); *Bell Atlantic Tel. Cos. v. FCC*, 206 F.3d 1, 5 (D.C. Cir. 2000)("[t]here is no dispute that the Commission has historically been justified" in employing an end-to-end analysis to treat Internet-bound traffic as interstate, even for dial-up Internet access terminating at a local modem bank).

[172] *See Report and Order and Notice of Proposed Rulemaking*, CC Docket No. 02-33 (rel. Sept. 23, 2005) ¶ 3 (finding that "the transmission component of wireline broadband Internet access is not a telecommunications service")("Broadband Access Reclassification Order").

92 In addition, a number of proposed conditions would require the Commission to violate specific provisions of federal law. For example, XO proposes that the Commission effectively rewrite the FCC's Triennial Review Remand Order (TRRO) by requiring that Verizon offer more high capacity UNEs than are required by federal law.

93 The fact that this is a merger proceeding does not allow the Commission to expand its jurisdiction to include interstate matters. The Commission's authority under Chapters 80.04 and 80.36 RCW cannot provide the Commission with jurisdiction that is prohibited by federal law and the Supremacy Clause of the U.S. Constitution, and federal courts have made clear that the imposition of conditions by state agencies on services, the regulation of which is preempted by federal law, is also pre-empted.[173]

1. Public Counsel's Proposed Conditions

a. Stand-Alone DSL

94 Public Counsel's proposal to require Verizon to offer stand-alone or "naked" DSL should be rejected. First, this issue is moot, because the FCC adopted as an enforceable condition Verizon's commitment to deploy stand-alone DSL within one year of merger close.[174] Even if this issue were not moot, the Commission should not adopt this proposal because (1) it is unrelated to the merger; (2) DSL service is an interstate service, and therefore the Commission does not have jurisdiction to entertain the proposal;[175] and (3) the market, not regulation, best

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[173] *See, e.g., United States v. Commonwealth of Kentucky*, 252 F.3d 816 (6th Cir. 2001) (Sixth Circuit rejected permit conditions imposed by a state agency on the disposal of radioactive waste in a landfill operated by the United States Department of Energy finding that the Atomic Energy Act "preempts any state attempt to regulate materials covered by the Act for safety purposes.") *See also Freeman v. Burlington Broadcasters*, 204 F.3d 311 (2d Cir. 2000) (Second Circuit found that attempts by local zoning authorities to condition construction and use permits on a requirement to eliminate or remedy the effects of radio frequency interference were preempted by federal law regulating this type of interference.)

[174] See October 31, 2005 letter that Verizon sent to the FCC outlining the Company's acceptance of "voluntary conditions", Exh. No. 525.

[175] DSL transport, which had been classified as an interstate telecommunications service subject to exclusive jurisdiction of the FCC, was recently reclassified as an information service. *Report and Order and Notice of Proposed Rulemaking*, CC Docket No. 02-33 (rel. Sept. 23, 2005) ¶3. The FCC and the courts have consistently held that states are preempted from regulating "information services" within the meaning of the Communication Act. *See, e.g., Vonage Holdings Corp. v. Minn. PUC*, 290 F. Supp. 2d 993, 998-999 (D. Minn. 2003); *California v. FCC*, 39 F.3d 919, 931-33 (9th Cir. 1994)(affirming the FCC's authority to preempt state regulation of jurisdictionally mixed enhanced (information) services); *see also* Amendment of Section 64.702 of the Commission's rules and Regulations, Report and Order, 104 F.C.C.2d 958 (1986)(finding that information services must remain free of state and federal regulations to promote the competitive growth of such services.).

determines when and under what circumstances this service should be deployed. Verizon already is offering stand-alone DSL and is working to overcome operational difficulties so that it can expand this offering.[176] Verizon's current capability for providing stand-alone DSL is set forth in its Response to Exhibit 521 (RR 1).

95 For all these reasons, Public Counsel's proposed condition should be rejected.

b. VoIP E-911 Platform Deployment

96 Public Counsel also invites the Commission to exceed its jurisdiction by requiring Verizon to deploy in Washington an operational platform that facilitates E-911 service to VoIP providers that Verizon has deployed in New York. First, the Commission does not have jurisdiction over this service. Second, as discussed by Dr. Danner, provision of E-911 services to VoIP providers is more than a matter of unilateral actions by Verizon. E-911 for VoIP is a national issue on which the FCC has taken the lead.[177] There are ongoing negotiations and collaboration among various service providers to meet deadlines set by the FCC, and this Commission should not interject itself into that process and risk creating conflicting requirements. As Mr. Danner said, this issue "it is completely unrelated to the merger, is being addressed by the FCC, and so is not an appropriate topic for consideration as part of this proceeding."[178]

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

97 In its pre-filed testimony, Public Counsel argues that Verizon and MCI should be required to give notice of the merger to all their customers. This issue is moot – MCI and Verizon have provided notice of the merger pursuant to Order No. 6.

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

98 Public Counsel argues that Verizon should waive service establishment charges for MCI customers who switch to Verizon.[179] This condition has nothing to do with the merger and

[176] Exh. No. 23T-C at 39.
[177] Exh. No. 23T-C at 39.
[178] *Id.*
[179] In making its argument, Public Counsel criticizes Verizon and MCI because they did not engage in "post-transaction planning." This criticism, however, ignores the fact that merging companies are viewed as ***separate and***

should be rejected. Public Counsel assumes that some MCI customers might switch providers solely because of a change in the parent company ownership of their service provider, rather than because of any tangible concerns they may have about the services they receive. There is, however, no record support for such an assumption. The Commission should not presume that the transaction will create some ill-defined intangible harm for which there is no record evidence. It would be inappropriate and discriminatory for MCI and Verizon to be saddled with regulatory obligations – and the corresponding costs of compliance -- that do not apply to any other competitors in the marketplace.[180]

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

99 Public Counsel also proposes that Verizon and MCI give a "rebate" of service establishment charges to current MCI customers who switch to a different CLEC. For the same reasons it would be inappropriate and discriminatory for MCI and Verizon to be saddled with a regulatory requirement of waiving their service establishment charges, it would be equally inappropriate and discriminatory for them to have to rebate charges imposed by other carriers. As Ms. Roth testified on cross-examination, no other telecommunications companies are required to rebate such charges.[181]

100 Moreover, Public Counsel fails to explain how to implement this proposal. Verizon and MCI would have to confirm the other carrier's charges on a customer-by-customer basis, apply the relevant amount to the customer's last bill, assuming it has not already been paid, and, perhaps, send a refund check if the third carrier's service establishment charge exceeds the unpaid balance on the customer's bill. Such an impractical idea and unjustified expense should be rejected.

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independent entities until they are merged, and that they cannot engage in "gun-jumping" under the Hart-Scott-Rodino Antitrust Improvement Act of 1976. In short, Public Counsel criticizes Petitioners for following the law.

[180] Exh. No. 23T-C at 38.

[181] TR. 560:22-23 (Roth).

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

101 Public Counsel next argues that the Commission should impose a specific condition on the merger preventing Verizon from operating MCI in such a manner as to allow Verizon NW to avoid its tariff obligations.[182] As Dr. Danner pointed out, this suggestion is vague and should not be adopted.[183] It is not at all clear what Public Counsel's concern is here and its witness did not explain it in the hearings. MCI will remain a competitively classified affiliate of Verizon following the merger. If it succeeds in attracting customers, presumably those customers will have found MCI's service offerings to be attractive and will consider themselves better off. This should be viewed as a positive rather than a negative result of the merger.

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

102 Public Counsel's argument that Verizon NW should be subject to "enhanced" retail service quality reporting after the merger should likewise be rejected as unnecessary. According to Dr. Roycroft, new quarterly reporting of investment, quarterly headcount reporting, and annual service quality reports to customers should be required to ensure the merges does not cause harm.[184]

103 Dr. Roycroft's assumption that cost cutting will harm service ignores several important facts. First, as Staff witness Jing Roth testified, Staff reviewed Verizon NW's monthly service quality reports and found that Verizon NW was out of compliance with the Commission's rules only once during the last six months, and that Verizon NW had the second-lowest percentage of service quality-related complaints during that period.[185] Second, such high service quality results were achieved during a period of low earnings, demonstrating that Verizon NW did not neglect service quality when facing financial challenges. Third, Dr. Roycroft ignores the fact that this Commission has comprehensive retail service quality standards[186] and reporting requirements[187]

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[182] Exh. No. 371T-HC at 91-92.
[183] Exh. No. 23T-C at 40.
[184] Exh. No. 371T-HC at 120-122.
[185] Exh. No. 101T-HC at 33-34.
[186] *See* WAC 480-120-401, *et seq.*
[187] *See* WAC 480-120-439.

that Verizon NW must follow. As Ms. Roth testified, Verizon must continue to meet the Commission's service quality standard and file reports with the Commission, and "Staff will review those reports, monitor those reports, enforce the standards set in the rule, so that's how [Staff] will deal with [the issue] if the service quality declines from its current performance."[188] Ms. Roth also testified that Verizon has good service quality, and that the additional service quality reporting conditions that Public Counsel proposes are not necessary. Based on this record, Dr. Roycroft's speculation about Verizon Northwest's service quality is unfounded and no conditions are appropriate.

104 This case is distinguishable from the US WEST/Qwest merger to which Public Counsel makes reference. First, the order entered in that case that included service quality conditions was the result of a voluntary settlement by the parties. Second, that case involved a change in the ownership and control of the incumbent local exchange carrier, while this case does not. Third, US WEST had been experiencing systematic service quality problems, while Verizon NW has not. Fourth, unlike here, Qwest was a CLEC inexperienced in running a large local exchange company, and there were legitimate concerns about its financial strength. Verizon is a very financially strong company with extensive experience in the local exchange business and with a good track record on service quality. The US WEST/Qwest case is simply inapposite.

105 Finally, Public Counsel suggests to the Commission that it cannot determine whether the transaction will impair service quality because the Petitioners represent that no post transaction planning has begun. Dr. Danner responded to questioning on this issue during the hearing:

> [A]s of the day after the merger is concluded, the same people come to work at Verizon and provide the same service subject to the same rules that the Commission enforces and provide a level of service quality that, as you know, Ms. Roth and the Staff have characterized as fine. . . . the implication of your questions is that there is some operational void there, and I don't believe that is the case.[189]

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[188] TR. 568:23-25 - 569:1-3 (Roth).
[189] TR. 240:11-25 - 241:1-5 (Danner).

106 For all of these reasons, the Commission should reject Public Counsel's request for "enhanced" service quality reporting requirements as a condition to this Commission's approval of this transaction.

h. Sharing of Merger Savings

107 This issue is discussed in Section VI. (To save space and avoid repetition, Petitioners address them in a single section of the brief.)

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

108 Public Counsel argues that the Commission should require Verizon to deploy broadband services – interstate information services – to unserved areas on a schedule suggested by Dr. Roycroft.[190] In addition to the lack of jurisdiction over such services, there is no nexus between the condition advocated by Public Counsel and the merger because MCI does not provide mass market broadband service in Washington. Thus, there is no basis for seeking or granting any "remedial" action on broadband services by this Commission.[191]

109 More importantly, as noted above, broadband is not a specific technology. The FCC noted in its order reclassifying wireline broadband access as an information service that broadband access technologies are rapidly changing, with new products emerging quickly while existing technologies are rapidly enhanced:

> [T]he technology used to build networks, and the purposes for which they are built, are fundamentally changing, and will likely continue to do so for the foreseeable future. A wide variety of IP-based services can be provided regardless of the nature of the broadband platform used to connect the consumer and the ISP. Network platforms therefore will be multi-purpose in nature and more application-based, rather than existing for a single, unitary, technologically specific purpose. More generally, the erosion of barriers between various networks and the limitations inherent in those barriers will lead to greater capacity for innovation to offer new services and products. Both the providers of network platforms and those that utilize the platforms are in a position to capitalize on these changes. In addition, as with any evolving technology, new products and providers will continue to emerge to complement existing market offerings and participants; and these offerings will grow over time as consumers demand even

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[190] Exh. No. 371T-HC at 94-96.
[191] Exh. No. 23T-C at 40.

more advanced services, with the result that technological growth and development continue on an upward spiral.[192]

110 In light of the rapid evolution of broadband services, it would be unwise for the Commission to adopt an inflexible condition that requires Verizon to deploy a particular technology as Public Counsel urges. In sum, the condition urged by Public Counsel is not justified, exceeds the Commission's jurisdiction, conflicts with federal policy, and should be rejected.

2. XO's Proposed Conditions

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

111 As a threshold matter, the Commission should reject XO's proposal to reduce Verizon's intrastate special access rates, because XO failed to make this argument in its testimony or at the hearing. XO presented only one witness, Mr. Don Wood. Mr. Wood did not raise this issue in his pre-filed testimony, and he did not appear at the hearing. In fact, the first time Verizon and MCI learned that XO would make this argument was when the parties were discussing the joint outline for post-hearing briefs. Under these circumstances, due process precludes consideration of XO's argument.[193] If XO had concerns about Verizon's special access rates, it should have raised the issue in its testimony.

112 If, however, the Commission considers this argument, it should reject it on the merits. First, the only evidence supporting this proposal (and the only evidence on which XO can rely) is the pre-filed testimony of Staff witness Roth. As Staff discussed in the Narrative to the Joint Settlement and as Ms. Roth testified, however, the principal reason Staff proposed to reduce Verizon's intrastate special access rates was because the FCC recently eliminated high capacity and dark fiber transport and loops as required UNEs. Staff reasoned that reductions in special access were needed to offset the FCC's "delisting" of these UNEs.[194] This Staff concern was eliminated based on the evidence that only one route between two Verizon NW central offices qualifies under the FCC's delisting rule. In other words, even under the new FCC rules, Verizon

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[192] Broadband Access Reclassification Order ¶ 40; *see also id.* ¶¶33-34 (describing emerging forms of broadband access technologies in addition to cable modem and DSL).

[193] *Cf. Nicolass v. Hertz Corp.*, 120 Wn.2d 416, 426-27 (1992) (argument raised for first time on appeal will not be considered).

[194] TR. 576; Exh. No. 502 at 11-12.

NW is still required to provide high-capacity UNE transport and loops almost everywhere.[195] Staff concluded that Verizon's special access rates need not be reduced as Ms. Roth explained in testimony at the hearing.[196] XO cannot credibly rely on an argument it never made and that the original proponent has repudiated.

113 Second, Verizon's *intrastate* special access rates are actually lower than Verizon's *interstate* rates, which is unique in the industry.[197] The FCC did not require Verizon's interstate rates to be reduced as a condition for approving the merger, and therefore consistent with Staff's analysis, a reduction in intrastate rates is not warranted. Also, Verizon's intrastate DS-1 and DS-3 special access rates are equal to Qwest's rates.[198] Third, as discussed in Section VI, the Commission cannot reduce Verizon's special access rates in a vacuum, because to do so would constitute impermissible single-issue ratemaking.

b. XO's Other Proposed Conditions

114 XO proposes three other conditions: (1) it asks the Commission to ignore the FCC's TRRO by ordering Verizon to recalculate the locations where high capacity loops, transport, and dark fiber UNEs must be provided; (2) it asks the Commission to ignore the TRRO by waiving the caps on the unbundling of certain high-capacity established by the TRRO; and (3) it asks the Commission to rewrite existing interconnection agreements and ignore the FCC's rules governing when CLECs may opt into existing agreements.[199]

115 These three issues are moot. XO proposed these same conditions to the FCC,[200] and although the FCC rejected them, the FCC adopted Verizon's and MCI's voluntary commitments, including a commitment to recalculate the TRRO's impairment test for high-capacity UNEs by excluding MCI.[201] In response, XO issued a press release stating that it was "pleased" by the

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[195] TR. 576; Exh. No. 502 at 11-12.

[196] "Staff realized that there is only very limited route in the state of Washington will meet that non-impairment standard. Actually, there's only one, only for one service, in DS3 transport . . ." TR. 576.

[197] Exh. No. 23T-C at 42:12-14.

[198] Exh. No. 23T-C at 42.

[199] Exh. No. 301-T at 83-86.

[200] *See* "Comprehensive Set of Conditions" proposed by XO and others on September 22, 2005, in WC Docket No. 05-75.

[201] Verizon and MCI's October 31, 2005 letter to the FCC, filed is response to Record Requisition #5.

FCC's conditions, and that "[b]y helping safeguard competition in the wholesale market, [the] decision by the FCC is an important victory for the competitive local telecom industry – and for millions of business customers." XO also thanked the FCC for its efforts "to forge meaningful conditions designed to ensure ongoing customer choice and price competition for millions of small to medium business customers … ."[202] Given that XO applauded the FCC's order as a "victory" for CLECs that "safeguards competition in the wholesale market," it cannot credibly take the opposite position here.

116 In any event, the Commission does not have jurisdiction to impose any of these conditions. First, the Commission cannot ignore (or rewrite) the TRRO or the FCC's unbundling rules. Under Section 251(d)(2) of the federal Telecommunications Act (the "Act"), the FCC is responsible for determining when, and under what circumstances, incumbent carriers must provide UNEs. In doing so, the FCC must balance the "competing values at stake in implementation of the Act."[203] The Supreme Court has ruled that the FCC has an affirmative obligation to set and enforce a "limiting standard" on the unbundling obligations imposed in incumbent carriers.[204] Thus, once the FCC determines the conditions under which incumbents must provide high-capacity UNEs, any inconsistent state determination is preempted.[205] Likewise, this Commission cannot rewrite interconnection agreements or ignore the FCC's rules governing when a CLEC may opt into existing agreements. Section 252(i) of the Act and the FCC's implementing rules (47 C.F.R. § 51.809) address this precise issue, and the Commission is preempted from imposing additional obligations.[206]

117 Finally, XO argues that this Commission should extend current CLEC interconnection agreements because after the merger, MCI will no longer independently exist and the remaining CLEC community will not have the type of bargaining power or financial resources that MCI had to arbitrate interconnection disputes with Verizon. This request should be rejected. It

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[202] A copy of the XO press release is attached as Attachment A, and is available at XO's website, www.xo.com/news/227.html.

[203] *USTA v. FCC*, 290 F.3d 415, 428 (D.C. Cir. 2002).

[204] *AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 388 (1999).

[205] 47 U.S.C. 261(c) (state commissions cannot impose requirements inconsistent with FCC's rules).

[206] *Id.*

assumes incorrectly that MCI negotiated and arbitrated its current Washington interconnection agreement with Verizon. MCI either opted into existing Verizon interconnection agreements that were on file with the Commission or obtained the interconnection agreement as an assignee through its purchase of another CLEC.[207] The merger will not affect a CLEC's ability to opt into interconnection agreements.

3. Staff's and Integra's Proposed Conditions

118 The Joint Settlement adopts Integra's condition, and it adopts every Staff condition except Staff's proposal to reduce Verizon's intrastate special access rates.[208] As explained above, Staff withdrew this condition after reviewing the evidence. In addition to its proposed conditions, Staff's pre-filed testimony recommended that if Verizon's debt rating is downgraded as a result of the merger, "an adjustment in the cost of debt should be made for ratemaking purposes."[209] The Commission need not take any action on this issue at this time – it can address it in Verizon's next rate case. Also, this concern is mitigated (if not eliminated) by the Joint Settlement, because the Joint Settlement precludes Verizon from filing a rate case until July 2009. Finally, Staff's pre-filed testimony states that the net present value of merger synergies that should flow to Washington intrastate operations is $[redacted] million.[210] The Joint Settlement resolves this issue, and the significant benefits of the Joint Settlement are discussed above in Section III. Nevertheless, to ensure a complete record, Section VI explains why Staff's calculation is wrong.

D. Public Comments

119 Only [m1]seven e-mails were received on the merger. Each consisted of about one paragraph. Most asked for DSL service. The only substantive comment was provided by a

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[207] TR. 330-31 (Beach).

[208] To be clear, if the Commission rejects the settlement, it should not impose any of Staff's or Integra's conditions for the reasons set forth in the rebuttal testimony of Dr. Danner, Dr. Taylor, Mr. Beach and Ms. Julie Canny (she explains in detail why Integra's condition is unwarranted). These witnesses explain, among other things, that all of these conditions are completely unrelated to the merger or are based on an erroneous application of the DOJ's merger guideline es.

[209] Exh. No. 150T-HC at 3.

[210] Exh. No. 150T-HC at 4.

professor of economics at George Mason University, who spoke in support of the merger and included a study explaining why the merger should be approved. These comments speak for themselves.

VI. MERGER SYNERGIES

A. The Joint Settlement is a Reasonable Compromise Regarding Merger Synergies

120 The Joint Settlement should be approved as a reasonable compromise of contested issues relating to the sharing of merger synergies. As discussed in Section III, the Joint Settlement provides significant economic benefits and protections to ratepayers. These benefits exceed the amounts that the Commission lawfully could order Verizon NW to return to ratepayers in this proceeding. In addition, the amount of synergies properly assigned to Verizon NW's rate regulated services is smaller than the amount that will be returned to customers under the Joint Settlement. Public Counsel's contrary position is based on an inappropriate inclusion of synergies that do not relate to Verizon NW's rate regulated services and on estimates that are riddled with computational errors.

B. Absent The Joint Settlement, The Commission Could Not Condition Its Approval Of The Merger On Reductions In Regulated Rates

121 In the absence of the settlement, the Commission would lack a lawful basis for conditioning its approval of the merger on reductions in Verizon NW's regulated rates. To impose conditions on merger approval that are not necessary to ameliorate any harm that would result from the merger would be an abuse of the Commission's ostensible authority[211] to approve mergers that are otherwise in the public interest.[212] No such harms have been convincingly identified.[213] On the contrary, Petitioners have demonstrated that the merger is decidedly in the public interest.

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[211] Petitioners respectfully submit that the Commission lacks jurisdiction over this parent company merger. But if the Commission has such authority, it must exercise it lawfully by limiting conditions to those necessary to ameliorate harms created by the transaction.

[212] Exh. No. 23T-C at 4:16-5:23.

[213] As discussed at Section V.A., there is no basis for the suggestion that the merger will harm competition. In any case, Public Counsel has not shown a nexus between its claim of competitive harm and its suggestion that merger synergies should be returned to Verizon NW's ratepayers.

122 There is no precedent for mandating a rate reduction as a condition of merger approval in the absence of a demonstrated nexus to a merger-specific harm.[214] The cases on which Public Counsel relies involved settlements that have no precedential value.[215]

123 Conditioning approval of this transaction on mandated rate reductions would be particularly inappropriate. First, the record demonstrates that the merged company will be compelled by market forces to share merger synergies with customers.[216] Market forces will be particularly effective in returning synergies resulting from this transaction because the merger is focused on enterprise customers and the vast bulk of synergies relate to that line of business.[217] Competition will force the new firm to pass through merger-related cost savings to its enterprise customers in the form of lower prices and/or higher quality service.[218] Conditioning merger approval on a reduction in basic rates would force the company to return the merger synergies twice – once to enterprise customers through market forces, and a second time to mass market customers through a mandated rate reduction. This outcome would unfairly produce a windfall to mass market customers, who would receive a rate reduction based on synergies that do not affect the cost of providing service to those customers.[219]

124 Second, mandated sharing of ***revenue*** synergies would be inappropriate in any case since "sharing" of the merger benefits is inherent in any revenue synergy. Revenues result from consensual sales of services, which customers purchase only if they place a greater value on those services than the company is charging. It makes no economic sense to force the company to disgorge the benefits that it realizes from such sales, especially those that occur in the highly competitive enterprise market.[220] In a rate case, moreover, the Commission sets rates based on

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[214] Exh. No. 23T-C at 26:12-27:6.

[215] The settlement agreement resolving the GTE-Bell Atlantic Merger, Docket Nos. UT-981367, UT-990672, and UT-991164, Fourth Supplemental Order (Dec. 1999), expressly states that it is not precedential. The US WEST-Qwest settlement (page 12, ¶ D), resolving Docket No. UT-991358, Ninth Supplemental Order (June 19, 2000), contains a similar recital.

[216] Exh. No. 23T-C at 22:3-23:14.

[217] Exh. No. 86T-HC at 7: 1-8 Although Public Counsel witness King asserted that merger synergies relating to MCI's business should be included in the computation of a mandated rate reduction, he did not dispute that most of the synergies relate to MCI's business activities, particularly its enterprise business.

[218] Exh. No. 23T-C at 22:12-23:14.

[219] Exh. No. 23T-C at 27:11-16.

[220] Exh. No. 23T-C at 23:16-24:6.

the company's costs of providing service. To the extent that conditioning merger approval on rate reductions is meant to replicate a rate case methodology,[221] only merger-related cost reductions qualify for consideration.

125 Third, the Commission should consider merger-related cost savings in a rate case, not in its approval of the merger. Cost reductions that are anticipated to occur ***years in the future*** may not be used to reduce rates ***today***.[222] Under well-settled Commission precedent, rates are set based on costs actually incurred in a test year, adjusted by factors that are known and measurable ***within one year***.[223] The merger synergies do not meet this standard.[224] Indeed, management does not expect to realize any net positive synergies in Washington by mid-2007.[225] The realization of synergies affecting Washington regulated operations within one year is therefore not "known and measurable."

126 The Commission can consider synergies when it conducts the next rate case for Verizon NW.[226] At that time, the Commission can consider all of Verizon NW's costs, rather than attempting to predict one cost in isolation. The reduction in costs resulting from the merger, for example, may be offset by other costs.[227] Verizon NW's inability to earn its authorized rate of return under the existing rates strongly supports this possibility.[228] In any case, there is no need to determine how synergies will affect rates until the next rate case. Public Counsel witness King admits as much by recommending that the Commission exclude from consideration those synergies and associated costs that are expected to be realized before 2007[229] because Verizon NW's rates are frozen through mid-2007.[230] It follows that the Commission could consider any

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[221] Exh. No. 411T-HC at 7: 1-3.
[222] Exh. No. 23T-C at 26:1-3, 28:3-13.
[223] Exh. No. 23T-C at 25: 21-26:6, n. 10; see WAC 480-57-010.
[224] Exh. No. 23T-C at 26:3-6.
[225] Exh. No. 23T-C at 25 n. 9.
[226] Exh. No. 23T-C at 25:1-11.
[227] Exh. No. 23T-C at 25:5-8, 29:7-17.
[228] Exh. No. 23T-C at 28 n. 12.
[229] Exh. No. 411T-HC at 14:5-12.
[230] Exh. No. 411T-HC at 14:5-12.

merger-related cost savings in the context of the next rate case, which, in the absence of the Joint Settlement, could occur as early as 2007.[231]

C. The Joint Settlement Benefits Are Reasonable In Relation To The Synergies Properly Assigned To Verizon NW's Rate Regulated Services

127 Although there is no basis for the Commission to order Verizon NW to reduce rates to reflect merger synergies, Petitioners provided an estimate of the portion of the expected synergies that properly would be assigned to Verizon NW's rate regulated services in Washington. In light of this analysis, the benefits of the Joint Settlement are eminently reasonable. Petitioners' estimate is reasonable. Verizon witness Mr. Smith, who was responsible for coordinating the effort to estimate the synergies that would result from the Verizon-MCI transaction at a national level,[232] explained how the Washington estimate was developed. He began with the national estimate of $7.3 billion of present value arising from new revenue and expense and capital savings, net of costs to achieve those benefits and net of related taxes.[233] He then adjusted that national estimate to derive an estimate of synergies attributable to Verizon NW's rate regulated services. Mr. Smith estimated that the net present value of synergies attributable to Verizon NW's regulated intrastate operations for 2006-2009 is ███ million in net revenue synergies and ███ million in net expense synergies. These estimates underscore the reasonableness of the benefits delivered by the Joint Settlement.

1. The Assignment Of Synergies To MCI's Operations Was Reasonable

128 The first step in the adjustment process was to identify how the synergies would be distributed between Verizon and MCI.[234] Based on a functional evaluation of the synergy opportunities in the various areas identified in the national estimate, Smith determined that significant portions of the synergies relate entirely to MCI's lines of business. For example, the

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[231] It is clear that the Commission cannot reduce Verizon NW's revenues in a vacuum, as Public Counsel proposes. This Commission has recognized that an incumbent carrier's "profits," i.e., rate of return, must be legally sufficient: "incumbents' rates are regulated by the Commission and must be fair, just, reasonable, and sufficient. A decrease in [one] rate will result in either a decrease in their overall profits (which must remain "sufficient") or an offsetting increase in other rates, or some combination of the two." Docket No. UT-970325, *General Order No. R-450* at 4. This legal sufficiency can only be determined by looking at all of the company's costs and revenues.

[232] Exh. No. 86T-HC at 2:2-4.

[233] Exh. No. 86T-HC at 4:4-8.

[234] Exh. No. 86T-HC at 4:10-12.

synergy estimate for information technology was based on the opportunity to enhance the efficiency of the systems that are used to support MCI's operations.[235] The procurement cost savings were attributed to MCI's operations because they are based on the new firm's ability to purchase equipment for MCI's operations at the discounts currently enjoyed by Verizon (without any further reduction in Verizon's costs).[236] The international cost savings were attributed to MCI's operations because they relate to the divestiture of MCI's Canadian operations.[237] Headcount cost savings were similarly assigned to Verizon's and MCI's operations based on a functional evaluation.[238] Revenue synergies were allocated between the Verizon and MCI based on their relative existing revenues in those lines of business.[239]

129 The assignment of synergies to MCI's and Verizon's respective operations was based on the judgment of experts who developed the synergy estimates and will be responsible for achieving them.[240] No party credibly challenged these judgments. Public Counsel witness King asserted that all of the synergies accrue to both companies,[241] based on the hypothesis that MCI's Washington subsidiaries will be merged into Verizon NW.[242] As discussed below, this hypothesis is incorrect. But whatever the merits of King's hypothesis, it does not address Verizon's judgment that certain synergies are properly assigned to MCI's *lines of business*. The disagreement between Public Counsel and petitioners on this point centers on (1) whether MCI's and Verizon's state operating companies in Washington will be merged, and (2) if so, whether the Commission should rate regulate MCI's operations. Assuming the Commission rejects Public Counsel's position on one or both of these points – as it should, as shown below – Verizon's assignment of synergies to MCI's operations is unrebutted.

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[235] Exh. No. 86T at 4:14-17; Exh. No. 87-HC at 5.

[236] Smith Attachment at 5. King "question[s]" whether Verizon also would realize a further discount in equipment purchases, Exh. No. 411T-HC at 20:10-21:2, but Smith explained that Verizon already enjoys the largest discounts in the industry, and the modest (approximately 10%) increase in its purchases resulting from the merger would not, in the judgment of Verizon's subject matter experts, lead to further discounts. Exh. No. 86T-HC 20: 8-11.

[237] Exh. No. 87-HC at 6.

[238] Exh. No. 86T-HC at 4:22-5:13; Exh. No. 87-HC at 6-7.

[239] Exh. No. 87-HC at 7.

[240] TR 386:24-388:19, Smith.

[241] Exh. No. No. 411T-HC at 13:12-13.

[242] Exh. No. 411T-HC at 11:11-12.

2. The Allocation Of Verizon Synergies To Verizon NW Was Reasonable

130 The next step in Smith's analysis was to allocate to Verizon NW a portion of the synergies that had been assigned to Verizon in the first step, after deducting transaction costs.[243] Smith's use of cost allocation methodologies that are followed in the ordinary course of business[244] was essentially unchallenged. Public Counsel witness King adopted without change Smith's allocation factors for vendor savings and for revenue synergies.[245] King adopted a different factor to allocate headcount savings to Washington, but only because he wished to allocate headcount savings assigned to MCI.[246] (The flaws in King's approach are discussed below.) King did not critique the factor used by Smith to allocate the two categories of headcount savings that relate to Verizon.[247] That factor is based on the same cost allocation methodology that is used by Verizon to allocate headcount costs in other contexts. The resulting allocation of Verizon headcount savings to Verizon NW is reasonable.

3. The Allocation Of Verizon NW Synergies To Intrastate Regulated Operations Is Reasonable

131 The final step in Smith's analysis was the allocation to intrastate regulated operations of synergies that had been allocated to Verizon NW in prior steps, and the conversion of the result into a net present value of income over four years.[248] Verizon cost savings in the network area were allocated to the interstate jurisdiction to the extent they relate to interstate long-distance services.[249] Headcount savings were allocated between interstate and intrastate services based on

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[243] Exh. No. 86T-HC at 5:15-6:6. Staff witness Folsom erroneously suggests that transaction costs should not be offset against savings in computing net merger synergies. Exh. No. 150T-HC at 25:16-26:14. In rate cases, the Commission has permitted transaction costs to be offset against savings in computing a revenue requirement. Exh. No. 86T-HC at 11:4-9. The Commissions should adhere to this sensible policy, as transaction costs must be incurred in order to enable the synergies to be achieved. Exh. No. 86T-HC at 11:9-13. In any case, Folsom's proposed exclusion of transaction costs would not have a material impact on the overall synergy estimate or the reasonableness of the settlement. Exh. No. 87-HC at 12 (table showing transaction cost offset for Washington regulated operations of [redacted].

[244] Exh. No. 86T-HC at 5:23-6:1.

[245] Exh. No. 417-HC lines 5-6; TR 512:25, King.

[246] King Exh. No. 414-HC.

[247] Staff witness Folsom likewise accepted Verizon's allocation factor for enterprise headcount but used different factors to allocate other categories of headcount savings. Exh. 154-HC. The flaws in Folsom's approach in this respect are discussed below at Section VI.E.1.

[248] Exh. No. 86T-HC at 6:8-16; Exh. No. 87-HC at 12-13.

[249] Exh. No.87-HC at 11.

historical data.[250] Public Counsel witness King did not challenge these allocations.[251] King did claim, however, that Verizon's conclusion that an increasing percentage of enterprise revenue would result from sales of interstate services over time was "unlikely."[252] Smith's allocation of enterprise revenues between interstate and intrastate was based on the identification of the particular services that comprise the synergy opportunity. Over the next five years, the company expects a shift toward IP-based and other services that are designated interstate.[253] This judgment was reasonable. In addition, King's computation of an alternative factor to allocate enterprise revenues between interstate and intrastate services was unsupported by any workpapers and King could not reconstruct the computation on cross-examination.[254] King's adjustment therefore should be disregarded, and petitioners' allocation of synergies between interstate and intrastate services should be accepted.

D. Public Counsel's Synergy Estimates Are Unreasonable

132 Public Counsel witness King presented two estimates of synergies that he would attribute to Verizon NW's Washington regulated operations. The first estimate is based on the methodology that he claims would be used in a rate case. The second estimate is based on his unprecedented "systemic" view. Both estimates are based on erroneous principles, are internally inconsistent, and are plagued by computational errors that render them wholly unreliable.

1. <u>Public Counsel's Estimate Based On Its "Rate Case" Methodology Is Unreasonable</u>

133 Public Counsel witness King estimates that the merger will produce [redacted] million, net present value,[255] in synergies that would be considered in a rate case.[256] Even if this estimate

[250] Exh. No. 87-HC at 11.

[251] Staff witness Folsom suggests that cost savings relating to out of franchise facilities should be allocated between intrastate and interstate jurisdictions. Exh. No. 150T-HC at 24:9-25:2. But because costs and revenues from out of franchise activities would not be considered in establishing the Company's revenue requirement in a rate case, Exh. No. 87-HC: n. 1, these costs should not be included in the Washington synergy analysis. In addition, Folsom proposes to reduce the costs to achieve the intrastate network savings by a jurisdictional allocation factor. Exh. No. 150T-HC at 25:4-13. But these investments already have been reduced to the intrastate component. In any case, Folsom's proposed [redacted] adjustment in respect of these two items is immaterial to the overall synergy estimate or the reasonableness of the settlement.

[252] Exh. No. 411T-HC at 18:15-22.

[253] Exh. No. 86T-HC at 18:17-19:4.

[254] TR 513:13-517:13, King Exh. No. 149.

[255] TR 523:16-524:25 (King).

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were accepted, the benefits of the Joint Settlement are reasonable as a compromise of the claim that the amount estimated by King should be returned to ratepayers. King's estimate, however, is unreasonable.

134 First, King's estimate improperly includes revenue synergies. As noted,[257] there is no basis or precedent for ordering a rate reduction based on revenue synergies. Revenue synergies comprise over 25% of the amount that King would include in his rate case estimate.[258]

135 Second, King erroneously includes synergies attributable to MCI's operations in the amounts that he contends Verizon NW should return to ratepayers. King's inclusion of MCI synergies is based on his unsupported, speculative and erroneous supposition that "the operations of the two companies will have to be combined" in order to achieve "most of the savings from the merger."[259] Mr. Smith stated unequivocally that the realization of the synergies does not depend on a merger of the state operating companies.[260] That conclusion is entirely credible given the nature of the synergy opportunities. For example, the information technology synergy is based on the implementation of a unified interface for MCI's systems. As Public Counsel witness King explains, the merger allows this synergy to be achieved through the "financial strength that Verizon brings to the merger."[261] Clearly, Verizon's ability to invest funds in MCI's information technology does not depend on merger of the state operating companies. Likewise, the international savings, which derive from the divestiture of MCI's Canadian operations, do not depend on consolidation of state-level operations. Similarly, procurement cost savings will accrue to MCI's operations because of the volume of Verizon's corporate-wide buying, which exist regardless of whether the state operating companies are merged.

136 Revenue synergies and headcount savings can also be achieved without a merger of the state operating companies. As Smith explained, personnel in different corporate entities and lines of

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[256] Exh. No. 411-HC at 7:1-3; King Exh. No. 417-HC.
[257] CITE Internal cross-reference.
[258] See Exh. No. 417-HC, lines 4 and 9.
[259] Exh. No. 411-HC at 11:10-12; see also *id.* at 17:10-12.
[260] TR 334:18-23 (Smith).
[261] Exh. No. 411-HC at 8:16; see also Exh. No. 87-HC at 2.

business can work together to deliver services more efficiently to customers.[262] Indeed, that is how Verizon does business today.

137 King's assertion that the MCI Washington subsidiaries and Verizon NW will merge is therefore speculative, at best, and does not meet the rate case standard of costs that are "known and measurable" within one year. King fails his own standard of costs "that would show up [in] a rate case."[263]

138 Rejecting King's hypothesis that the Washington subsidiaries will be merged eliminates any support for ordering Verizon NW to reduce rates based on synergies that will be realized in MCI's operations. MCI is competitively classified and will continue to be so classified once it becomes an affiliate of Verizon NW.[264] MCI's Washington subsidiaries will be no different than other Verizon NW affiliates – Verizon Long Distance, Verizon Avenue, Verizon Select Services, and Verizon Online – all of which operate without rate regulation by the Commission. There is no requirement that profits (or losses) from these competitive operations be imputed to Verizon NW's revenue requirement; such an imputation would be unlawful and would expose ratepayers to adverse rate impacts if the affiliates fare poorly in the competitive market. Applying income from MCI's Washington subsidiaries to reduce Verizon NW's rates would conflict with this established Commission policy. King admits as much when he states that Commission rate regulation of MCI would ensue "if" MCI's Washington subsidiaries and Verizon NW merge.[265] King thus tacitly admits that such rate regulation of MCI's highly competitive operations – which is what his recommendation of sharing of MCI synergies necessarily entails – would be wholly inappropriate in the absence of a merger of the subsidiaries.

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[262] TR 336:24-338:23 (Smith).

[263] Exh. No. 411-HC at 7:2. If petitioners did decide to merge the MCI Washington subsidiaries and Verizon NW, they would be obligated to file a petition for approval from this Commission. The Commission could consider King's assertion that synergies assigned to MCI's operations should be imputed to Verizon NW's revenue requirement either in connection with such a further petition (if it were ever filed), or in a subsequent rate case.

[264] Exh. No. 23T-C at 30:1-8.

[265] Exh. No. 411-HC at 13:16-17 ("*If* the companies merge as expected, *then* MCI's intrastate operations will be regulated to the same degree as Verizon's" (emphasis added)); id. at 17:14-15 ("*If*, as appears likely, the Washington operations of the two companies are merged, *then* the result would be a company (or companies) subject to the Commission's rate base, rate-of-return regulation" (emphasis added)).

139 King's view ignores the economic reality that synergies associated with MCI's lines of business will automatically be shared with customers given the level of competition in those lines of business. Even if there were an operational merger of MCI's Washington subsidiaries and Verizon NW, the lines of business in which MCI is engaged would continue to be competitively classified and not rate regulated. This is especially true because most of MCI's operations in Washington are *outside* Verizon NW's traditional serving area.[266] Accordingly, regardless of whether there is a merger of the state operating companies, there would be no basis for reducing Verizon NW's revenue requirement based on the synergies realized in the competitive lines of business in which MCI is engaged.

140 Third, King erroneously includes headcount savings that relate to MCI's operations. King asserts that headcount reductions in MCI's operations will benefit Verizon because the costs of the remaining personnel will be spread over a larger base.[267] But as Smith explained, MCI's corporate expense per head is currently higher than Verizon's.[268] The merger will reduce MCI's corporate expense per head to Verizon's level, but will not reduce Verizon's corporate expense per head.[269] As a result, the amount of corporate headcount expense allocated to Verizon NW is not expected to change as a result of the merger.[270] The Commission can evaluate these allocations in the next rate case; there is no basis to reduce rates now based on an unsupported prediction that the allocations will change.

141 Fourth, King's methodology is internally inconsistent. King excludes headcount savings in Network and International operations because they are beyond this Commission's jurisdiction and would not be considered in a revenue requirement for intrastate regulated operations.[271] King failed, however, to exclude headcount savings in other areas that similarly relate to extra-jurisdictional services, such as Enterprise Markets and Mass Markets/Commercial.[272] Likewise,

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[266] Exh. No. 61T-HC at 5:15-17, 14:23-15:1 Exh. No. 23T-C at 15.
[267] Exh. No. 411T-HC at 13:11-12.
[268] Exh. No. 86T-HC at 15:12-13.
[269] Exh. No. 86T-HC at 15:13-15.
[270] Exh. No. 86T-HC at 15:16-19.
[271] Exh. No. 411-HC at 13:25-14:3; Exh. No. 414-HC lines 3 & 7; TR 491:19-493:5 (King).
[272] TR 498:24-499:9 (King).

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the headcount reductions in Information Technology relate to MCI's business, which is substantially weighted toward interstate and international operations.[273]

142 Fifth, King's estimate is based on an unreliable composite intrastate allocation factor. King allocated headcount cost savings to Verizon NW's regulated operations by applying a factor that is based on the intrastate revenues of Verizon NW and MCI's Washington subsidiaries as a percentage of the overall domestic telecom revenues of Verizon and MCI.[274] There are a number of flaws in this approach. Initially, it is inappropriate to allocate headcount *costs* based on a *revenue* percentage. Costs are properly allocated (e.g., in a rate case) based on the factors that cause those costs to be incurred. Headcount costs are not caused by, and bear no necessary relationship to, revenues, and it therefore violates cost allocation principles to use revenues to allocate headcount costs.[275]

143 In addition, King derives his intrastate allocation factor by recategorizing revenues as intrastate that are designated as interstate under governing FCC rules.[276] King explains that he has "not accepted the revenues as reported by Verizon to the WUTC,"[277] and instead has reclassified *revenues* as intrastate by applying the 25/75 percent interstate/intrastate allocation of subscriber line *costs*.[278] This convoluted procedure makes no sense[279] and has no precedent. It is also, by definition, inconsistent with the cost allocation rules adopted by the FCC, pursuant to which the allocation of revenues to the interstate jurisdiction does not necessarily correspond to the allocation of subscriber line costs. King is dissatisfied with this regime, particularly the freezing of the 25/75 allocation of subscriber line costs.[280] This would suggest that Verizon's reported interstate *revenues* are proper, but that (in King's view) the subscriber line costs are over-allocated to the intrastate jurisdiction. That view certainly does not justify using the 25/75 allocation factor to inflate intrastate *revenues* for purposes of developing a new allocation factor.

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[273] Exh. No. 411-HC at 4:14-17.
[274] Exh. No. 411-HC at 14:15-16:16; Exh. No. 415-HC.
[275] Exh. No. 86T-HC at 13:11-17.
[276] Exh. No. 86T-HC at 14:1-10.
[277] Exh. No. 411T-HC at 14:21-22.
[278] Exh. No. 411T-HC at 14:22-15:10.
[279] TR 364:10-365:17 (Smith).
[280] Exh. No. 411T-HC at 14:22-26.

More fundamentally, King's criticism of the FCC's rules governing the classification of revenues and costs as interstate and intrastate should be directed to the Joint Separations Board. This Commission is bound by those rules in deriving a revenue requirement in a rate case.[281] King's use of jurisdictional allocation factors that are admittedly inconsistent with the FCC's rules is therefore incompatible with a proper rate case methodology.

144 Finally, King's computation of synergies under the "rate case" methodology is infected by multiple errors. For example, King derived his allocation factor by applying the 25/75 factor used by the FCC to allocate the costs of subscriber line plant.[282] King explained that he used this factor to reclassify "local service revenues and subscriber line charges."[283] But he actually used the factor to reclassify *all* access revenues,[284] which includes not only subscriber line charges but also switched and special access revenues recovered from wholesale customers. He thus overstated intrastate revenues even under his own erroneous approach.[285] Other examples of errors appear in King's computation of revenue synergies. King inadvertently mixed up numbers from the two national synergy estimates. Thus, he included the higher gross revenue estimates from the later estimate, but the lower cost of sales estimates from the earlier estimate.[286] King also mis-matched costs and revenues in another area. As noted, petitioners' estimate of revenue synergies included only the portion of such revenues allocated to Verizon. King added revenues allocated to MCI but failed to adjust the corresponding offset for the capital costs necessary to achieve those revenue synergies. In other words, King included all of the revenues but only a portion of the costs.[287] As a result, he overstated the net revenue synergies.

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[281] Exh. No. 86T-HC at 14:7-10, TR 508:6-15 (King); *Hawaii Telephone Co. v. Public Utilities Commission*, 827 F.2d 1264 (9th Cir. 1987)

[282] Exh. No. 411T-HC at 14:24.

[283] Exh. No. 411T-HC at 15:4-5.

[284] Exh. No. 415-HC; TR 510:10-16.

[285] Exh. No. 86T-HC at 14:14-24.

[286] Exh. No. 416-HC, lines 1, 2, 8, 9; TR 520:7-8 (King). King made a similar error in Exh. No. 414-HC, in which his deduction of long-distance headcount savings was based on a different version of the national synergy estimate that the corresponding headcount savings in the network line. TR 497:7-10 (King).

[287] Exh. No. 417-HC, line 3; TR 522:17-19 (King).

2. Public Counsel's Estimate Based On Its "Systemic" Approach Is Unreasonable

145 Public Counsel witness King also recommends that the Commission cancel $1 of the scheduled rate increase for Verizon NW based on an unprecedented "systemic" approach.[288] King uses the same composite intrastate revenue factor to allocate *all* synergies that Verizon and MCI realize worldwide. The Commission should reject this approach.

146 First, King fails to provide any basis for his recommendation that the Commission reduce rates based on his systemic approach. The systemic approach is completely inconsistent with the basis for King's policy recommendation, i.e., that synergies would reduce the revenue requirement in a rate case.[289] Under this reasoning, the synergies that must be shared are *only* those that would be considered in a rate case in developing a revenue requirement. King admits, however, that his "systemic" estimate goes *well beyond* the amounts that would be considered in a rate case.[290]

147 The "benefits" that King claims that Verizon NW may realize, beyond those that would be reflected in a rate case revenue requirement,[291] are extremely speculative. For example, the notion that the sale of MCI's Canadian operations will benefit Verizon NW by freeing up capital[292] assumes that such capital is not otherwise available to Verizon NW and that the amounts saved in Canada would be invested in Washington. King's testimony provides no support for these far-fetched assumptions.

148 King never provides a policy basis to require Verizon NW to share with its ratepayers any "benefits" that it may realize that would not be reflected in a rate case. As a policy matter, Verizon NW should not be required to share with its ratepayers synergies that its affiliates realize in Canada, in New York, in interstate services, or other areas that are beyond this Commission's jurisdiction. Nor has King shown that his composite intrastate allocation factor accomplishes his stated objective of identifying the portion of merger synergies that benefit Verizon NW. As

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[288] Exh. No. 411T-HC at 21:24-22:21 and Exh. 418-HC.

[289] Exh. No. 411T-HC at 5:2-4; and 6:14-21.

[290] Exh. No. 411T-HC at 5:2-5, 21:14-21; TR 504:6-21 (King); *see also* Exh. No. 411T-HC at 21:3-11 (identifying synergies that would "never turn up in a revenue requirement").

[291] Exh. No. 411T-HC at 21:3-21.

[292] Exh. No. 411T-HC at 21:8-11.

noted, King's allocation factor purports to quantify the percentage of Verizon's and MCI's domestic telecom revenues earned from Washington intrastate services. Apart from the many flaws in that computation, described above,[293] there is no nexus between a historical percentage of revenue and the kinds of indirect benefits to Verizon NW that King discusses. There is no basis, for example, to suggest that the enhanced ability to sell local service as part of a package with long distance – one of the indirect benefits King hypothesizes[294] – would equate to 1.1898% of Verizon's interstate long-distance revenues.

149 King's composite factor is based on historical revenue and ignores the character of the synergies to be realized in this transaction. King applies his composite factor to allocate 1.1898% of synergies in interstate and international operations to Verizon NW. By definition, however, all of those synergies are extra-jurisdictional and cannot be considered a benefit to the activities of Verizon NW regulated by this Commission. King candidly admitted that synergies directly attributed to extra-jurisdictional services should be excluded,[295] and he did so in part,[296] yet he failed to carry through on that approach in his systemic view.[297] Petitioners, by contrast, followed the more traditional approach of examining each category of synergies separately. Petitioners were thus able to determine, for each synergy category, the portion properly assigned to Verizon NW's regulated services. King's "composite" factor erroneously assumes that the merger will produce synergies that flow to Washington intrastate services in the same proportion as revenues have supposedly done in the past, which glosses over the special characteristics of each category of synergies projected in this transaction.

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[293] Sec. VI.D.1. In addition, the allocation factor contains another error as applied in the "systemic" approach. Because King uses the factor to determine the percentage of *all* synergies that he would allocate to Washington, his factor should reflect the intrastate to overall revenues for *all* services that comprise the synergies. King's factor, however, purports reflects the fraction of Washington intrastate to *domestic telecom* revenue. He applies the factor to allocate synergies realized outside domestic telecom, including wireless, international, and wholesale. Under his own approach, King should have allocated all synergies to Washington based on the percentage of Washington revenue to all revenue of both companies – which would have reduced the allocation by about 50%. Exh. No. 411T-HC at 12:19-13:7.

[294] Exh. No. 411T-HC at 21:5-8.

[295] Exh. No. 411T-HC at 13:25-14:3; TR 492:5-7 (King).

[296] Exh. No. 414-HC; TR 492:21-24 (King).

[297] Exh. No. 418-HC; TR 503:15 (King).

150 King's "systemic" recommendation also would be unlawful. The Commission's authority to regulate Verizon NW's rates derives from statute. The Commission has consistently interpreted that statute to set rates based on costs incurred to provide intrastate services.[298] Those interpretations have been developed and articulated over many years and now comprise the "rate case" standards to which King earlier refers. King nevertheless asks the Commission set rates on some other free-floating basis that is not reflected in the statute. The Commission lacks legal authority to do so.

E. Staff's Synergy Estimate is Overstated

151 Staff witness Folsom initially served testimony estimating ███ million in synergies flowing to Washington intrastate operations.[299] Folsom also estimated that the Washington intrastate synergies would be ███ million if the analysis were extended into perpetuity.[300] Subsequently, Staff entered into the Joint Settlement, concluding that it was a reasonable compromise of the parties' positions with regard to synergies and other issues. The Commission should adopt the Joint Settlement on this basis.

152 Because one of the purposes of the Joint Settlement was to avoid further litigation between petitioners and Staff with respect to synergy issues, petitioners do not wish to engage in a lengthy discussion of Staff's synergy estimate. Nevertheless, petitioners feel obliged to point out some of the most significant flaws in Staff's synergy estimate, in order to ensure that this flawed estimate is not used by other parties to justify a rejection of the Joint Settlement.

1. <u>Staff's Allocation of Headcount Savings Is Flawed</u>

153 Staff witness Folsom allocates to Verizon NW a portion of all headcount savings projected from the merger, including savings attributable to MCI's operations.[301] Folsom's justification for the inclusion of MCI headcount is similar to King's: Folsom contends that the headcount costs allocated to Verizon will go down because those costs "will be spread over more operations."[302]

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[298] *See* RCW 80.36.080; *POWER v. WUTC*, 104 Wn.2d 798, 808-809, 711 P.2d 319 (1985)
[299] Exh. No. 150T-HC at 4:3-7; Exh. 151-HC.
[300] Exh. No. 150T-HC at 4:7-10; Ex. 151-HC.
[301] Exh. No. 150T-HC at 23:1-24:5; Exh. No. 154-HC.
[302] Exh. No. 150T-HC at 23:14-15.

Folsom's thesis is just as flawed as King's. As noted previously, the merger will reduce MCI's corporate expense per head to Verizon's level, but will not reduce Verizon's corporate expense per head[303] and is not expected to reduce the corporate headcount expense allocated to Verizon NW.[304] There is no reason to believe that the number of personnel required to support Verizon NW's operations will be reduced by the merger. Accordingly, the entire premise of Folsom's inclusion of MCI headcount cost savings is erroneous, and her computation of headcount savings cannot be relied upon for this reason alone.

154 In addition, Folsom does not justify her assumption that the reduction in costs allocated to Verizon NW will equal a pro rata share of the avoided MCI personnel costs. Folsom allocated the MCI headcount savings to Verizon based on the proportion of MCI and Verizon employees, but she fails to demonstrate that any reduction in the costs allocated to Verizon NW will correspond to existing employee counts of the two companies. In fact, there is strong reason to conclude that cost savings will not flow to Verizon NW in this way.[305] For example, one significant element of the headcount cost savings relates to the reduction in employees in the Information Technology area.[306] Whereas Folsom's formula would allocate 76% of those savings to Verizon, it is clear that those savings relate entirely to improved efficiency in MCI's operations and would have no impact on Verizon NW's operations or costs.[307] By contrast, Verizon's analysis directly tied the headcount savings to the functional areas in which they will be achieved and properly allocated the savings to the MCI lines of business to which they relate.[308]

155 Folsom's headcount analysis also was flawed in its use of inconsistent and inappropriate factors to allocate savings to Verizon NW. As noted, Verizon allocated headcount cost savings based on cost-causation principles consistent with cost allocations employed in the ordinary course. Folsom used the same approach to allocate headcount cost savings in Enterprise

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[303] Exh. No. 86T-HC at 15:13-15.
[304] Exh. No. 86T-HC at 15:16-19.
[305] Exh. No. 86T-HC at 16:13-16.
[306] Exh. No. 87-HC at 14: ln. 9.
[307] Exh. No. 86T-HC at 16:17-21.
[308] Exh. No. 86T-HC at 17:1-3.

Markets.[309] But Folsom used revenues as the basis for cost allocation for the Mass Markets/Commercial organization, and she used a mix of revenues and salaries and wages to allocate headcount costs in other areas.[310] The use of revenues to allocate costs, however, violates traditional cost allocation principles.[311] The inconsistency in Folsom's approach also undermines its credibility. Indeed, use of salaries and wages alone as the basis for the cost allocation factor would have reduced the allocation to Verizon NW significantly.[312]

2. <u>Staff's Suggestion That Additional Synergies Will Be Realized In The Future Is Flawed</u>

156 Folsom's suggestion that the synergy estimate would be higher if savings realized after 2010 were included provides no basis for increasing the synergy estimate for purposes of this proceeding. As noted, in a rate case, the Commission would limit its consideration to costs incurred in the test year plus changes that are known and measurable within one year. While these established principles demonstrate the inappropriateness of reducing rates at all based on projections of savings in 2007-2009,[313] they certainly foreclose consideration of synergies projected to be realized starting five years from now and continuing into perpetuity. Fixing a rate reduction now that would continue indefinitely, based on a projection of one element of costs to occur in the future, in a rapidly-changing communications marketplace, is both unprecedented and inappropriate.[314] The proper way to consider any cost reductions that the Company realizes in 2010 and beyond is through a future rate case.[315]

157 Accordingly, Folsom's testimony overstates the synergies that properly could be considered in this merger approval proceeding.

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[309] Exh. No. 86T-HC at 17:6-8.
[310] Exh. No. 86T-HC at 17:10-18.
[311] Exh. No. 86T-HC at 17:12 and at 13:11-17.
[312] Exh. No. 86T-HC at 17:15-17.
[313] *See* Section VI.B.
[314] Exh. No. 23T-C at 33:1-13.
[315] Exh. No. 23T-C at 26:3-6.

VII. CONCLUSION

158 The Joint Settlement, together with the DOJ and FCC orders, ensures that the Verizon-MCI merger is in the public interest, and Joint Petitioners respectfully request that the Commission approve the Joint Settlement without change.

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