[Service Date December 23, 2005]

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of	)	DOCKET NO. UT-050814
	)	ORDER NO. 07
VERIZON COMMUNICATIONS INC. AND MCI, INC.	)	
	)	ORDER ACCEPTING SETTLEMENT, ON CONDITION; APPROVING MERGER, ON CONDITION
For Approval of Agreement and Plan of Merger	)	
. . . .	)	

1 ***Synopsis:*** *The Commission has jurisdiction over the proposed merger and accepts a proposed multiparty settlement agreement on condition that the parties to the agreement accept changes proposed by the Commission. Proposed changes include rejection of a settlement condition proposed by the settling parties, acceptance of certain conditions proposed by Public Counsel, and acceptance of a condition proposed by the Commission, including the expansion of a fund proposed by Verizon and MCI to respond under Commission direction to public needs to be determined. The decision will not be effective unless the ordered changes are accepted by parties to the settlement.*

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2 **Nature of Proceeding.** Docket No. UT-050814 involves a proposed Agreement and Plan of Merger between Verizon Communications, Inc., and MCI, Inc.[1] Applicants on May 27, 2005, filed a request that the Commission decline jurisdiction or, in the alternative, approve the proposal. Subsequently, the parties agreed to defer the jurisdictional question for argument with the merits.[2]

3 **Procedural History:** Hearing was held in this matter on November 1 and 2, 2005, before Chairman Mark Sidran, Commissioners Patrick Oshie and Philip Jones, and Administrative Law Judge C. Robert Wallis at Olympia, Washington, pursuant to due and proper notice to all interested parties.

4 On October 21, 2005, four parties—Applicants, Commission Staff, and Intervenor Integra—filed a proposed settlement agreement. As other parties—Public Counsel, Covad, and XO Communications—opposed the proposed settlement, the agreement is by definition a "multiparty settlement agreement" under terms of WAC 480-07-730. Pursuant to WAC 480-07-740, such agreements are subject to review in a setting affording proponents an opportunity to support the proposal and opponents an opportunity to contest it.

5 **Hearing.** The Commission convened a hearing on November 1 and 2, 2005, for the presentation of evidence and received briefs on November 23, 2005, for the presentation of argument. The record is now complete and ready for decision on the questions of jurisdiction and whether the proposed multiparty settlement agreement should be accepted, rejected, or accepted subject to settling parties' willingness to accept Commission-directed changes to the proposal.[3]

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[1] For convenience we will refer to the companies proposing merger as the Applicants.
[2] The Applicants seek a declaratory ruling on the issue of jurisdiction pursuant to RCW 34.05.240 and WAC 48-07-930. This order will address the request below.
[3] If settling parties decline to accept such modifications, the settlement is deemed rejected and the matter returns to litigation mode for a hearing on the merits of the original pleading. *WAC 480-07-740(3).*

6 **Parties.** Parties were represented as follows: Judith Endejan, attorney, Seattle, represents petitioner Verizon. Also representing Verizon are Charles H. Carrathers, general counsel, Irving, TX, and Henry Weissman, attorney, Los Angeles, California. Arthur A. Butler, attorney, Seattle, represents petitioner MCI, Inc. Also representing MCI is Michel Singer Nelson, attorney, Denver, CO. Gregory J. Kopta, attorney, Seattle, represents intervenor XO Communications Services, Inc.; Jay Nusbaum, attorney, Portland, OR, represents Integra Telecom of Washington, Inc.; and Gregory T. Diamond, attorney, Denver, CO, represents intervenor Covad Communications Company.[4] Intervenor Citizens Utility Alliance of Washington (CUA) was not represented during the proceeding.[5] Simon ffitch, Assistant Attorney General, Seattle, WA, represents the Public Counsel Section of the Washington Office of the Attorney General (Public Counsel). Jonathan C. Thompson, Assistant Attorney General, Olympia, Washington, represents the Commission's regulatory staff ("Commission Staff" or "Staff").

7 **Confidentiality.** Much of the information in this docket, especially information relating to the operations and customer bases of operating companies, has been designated as confidential or highly confidential pursuant to a protective order. The Commission respects the need for confidentiality, but also believes that its orders should be comprehensible and transparent to readers.

8 In this order, we will quote confidential information only in generalities when precise information could have competitive sensitivity. In conjunction with this order, we have prepared a work paper showing the derivation of results based

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[4] Covad Communications Company sought leave to withdraw from the proceeding on October 20, 2005, prior to the scheduled hearing.
[5] CUA did not participate in any manner beyond presentation of its petition. This order will dismiss its intervention.

on confidential information. We designate that work paper Exhibit No. 531HC and admit it to the record.

I. EXECUTIVE SUMMARY

9 This Order deals with a proposed merger between Verizon Communications, Inc., and its subsidiaries, and MCI, Inc., and its subsidiaries. Because both companies have subsidiaries providing telecommunications services in the state of Washington that are subject to regulation, we have been asked to determine that we have no jurisdiction over the proposed transaction or to approve it. Four parties have reached a proposed settlement, which is opposed by other parties. In this order, we consider whether we have jurisdiction over the transaction and whether the proposed settlement is consistent with pertinent legal requirements and Commission policies.

10 We find that Washington statutes grant us jurisdiction to consider the proposed merger. The appropriate standard for review of the proposed settlement is whether the transaction is consistent with the public interest, and whether the proposed settlement conditions adequately protect against harm from the transaction. We find that the transaction will cause harm by increasing the already dominant position of Verizon NW, Inc., within its service territory, by reducing the strength of competition, and by imposing costs and financial risks that will be borne by consumers. We find that the asserted benefits of the transaction, principally an increase in Verizon's competitive ability, do not adequately mitigate the harm nor do the proposed settlement conditions. We reject a proposed condition that would require Verizon NW to extend its service territory to include a small number of potential customers, but accept the Applicants' and Commission Staff's proposal to create a fund with equivalent and additional monies to benefit a broad range of public telecommunications

needs. We accept, accept with modification, or find moot the remainder of the settling parties' proposed conditions.

11 Public Counsel and XO Communications proposed numerous additional or alternative conditions. We review those, finding some appropriate and some inappropriate for adoption, and of the latter we defer several matters for consideration in a pending docket. We identify Commission conditions for approving the settlement. These include supplementing the proposed mitigation fund to reflect the net present value of a limited portion of Verizon's net anticipated synergies and savings, and protecting the rate payers from any increase in the cost of debt that is shown to result from the merger, and (DSL).

12 The Commission approves the proposed settlement, on condition that the parties accept the modified and additional conditions no later than 10 business days after date of this order. If the settling parties fail to accept the changes directed in this order, the matter will be rescheduled for the completion of any necessary hearing on the merits.

II. THE PARTIES TO THE TRANSACTION

13 Verizon Communications, Inc. (Verizon) is a holding company that wholly owns (among others) the following subsidiary companies:

a. Verizon Northwest Inc. (Verizon NW), Washington State's second largest local exchange company. Verizon NW offers a broad range of telecommunications services in the state of Washington, including high capacity private line services and long distance service.

b. Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance (VLD), an interexchange carrier offering long distance services pursuant to a price

list on file with the Commission.

c. Verizon Avenue Corp., a "full service" competitive local exchange company (CLEC). It resells local and long distance services pursuant to a price list on file with the Commission.

d. Verizon Select Services, Inc., an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

14 Each of these subsidiaries, except Verizon NW, has been classified as a competitive telecommunications company pursuant to RCW 80.36.320.

15 MCI, Inc. (MCI) is a holding company that wholly owns (among others) the following subsidiary companies:

a. MCI Worldcom Communications, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

b. MCI Worldcom Network Services, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

c. MCImetro Access Transmission Services, a full service CLEC that offers local exchange services pursuant to a price list. This company serves less than two percent of the access lines in Washington State.

d. Teleconnect Long Distance Services and Systems d/b/a Telecom USA, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

e. TTI National, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission. This company no

longer offers service in the state of Washington.

16 All of these MCI subsidiaries have been classified as competitive telecommunications companies pursuant to RCW 80.36.320.

III. DESCRIPTION OF THE TRANSACTION

A. The Proposed Transaction

17 If the transaction is allowed to proceed, Verizon, a holding company, will purchase 100% of the holding company MCI, Inc. MCI, Inc. will merge into a Verizon subsidiary called ELI Acquisition, LLC, which will be renamed "MCI, LLC." Thus, all of the Commission-regulated subsidiaries of Verizon and MCI will be owned by a common parent, Verizon Communications, Inc.[6] Verizon expects savings and synergies to result from its use of MCI network facilities, bundling of Verizon and MCI products and services, and staff reductions, largely at MCI, which will enable the new firm to provide shared administrative services more efficiently to its subsidiaries.[7] Specifically, the Verizon financial, legal, and human resources personnel will serve not only the Verizon affiliates but the former MCI affiliates as well.[8]

B. Regulatory Context

18 A number of other jurisdictions and review bodies have reviewed the proposed transaction and have acted on it. All of the decisions released to date have approved the proposed merger. Three are among the more notable (referenced by the parties to this proceeding): 1) The consent decree of the Department of

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[6] Folsom, Exh. 150T-HC at 5.
[7] *See id*. at 8.
[8] King, Exh. 411T-HC at 13.

Justice (DOJ),[9] which required divestiture of certain assets related to the provision of special access lines; 2) The order of the Federal Communications Commission (FCC),[10] which attached conditions relating to DSL lines and special access, among others; and 3) The order of the California Public Utilities Commission (CPUC),[11] which found little harm likely to result but established conditions to assure benefits for citizens of the state, including establishment of a fund for broadband access and an increase in charitable giving.

IV. JURISDICTION

A. Must the Commission Address the Issue of Jurisdiction?

19 Applicants petitioned for a declaratory order that the Commission lacks jurisdiction to review the transaction. By agreement of the parties, the issues were deferred for briefing and consideration at the time of a decision on the merits.

1. Form of Relief

20 Applicants petitioned for a declaratory order under RCW 34.05.04.240.

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[9] *United States v. Verizon Communications Inc. and MCI, Inc.,* Civil Action No. 1:05CV02103, Proposed Amended Final Judgment (District Court for D.C., Nov. 28, 2005). Case filings are accessible at http://www.usdoj.gov/atr/cases/verizon.htm.

[10] *In re Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control,* WC Docket No. 05-75, Memorandum Opinion and Order, FCC 184, Adopted October 31, 2005. The FCC adopted its order on the merger on October 31, 2005, and released it on November 17. http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-05-194A1.pdf.

[11] *In re the Joint Application of Verizon Communications, Inc. (Verizon) and MCI, Inc. (MCI) to Transfer Control of MCI's California Utility Subsidiaries to Verizon, Which Will Occur Indirectly as a Result of Verizon's Acquisition of MCI,* Application 05-04-020, Decision 05-11-029, November 18, 2005. The decision is available at http://www.cpuc.ca.gov/WORD_PDF/FINAL_DECISION/51527.DOC. Verizon is no longer rate of return-regulated in California.

21 The Commission has previously ruled that it will not enter a declaratory order when on a topic that is the subject of an adjudication.[12] It is preferable to enter an adjudicative order, as the necessary parties and the standards of process are clearly defined. So the record is clear, the Commission denies the petition for a declaratory order and makes a ruling on jurisdiction as an element of its adjudicative order.

2. Must the Commission Address Jurisdiction?

22 The Applicants urge that the Commission only address the jurisdictional issues if it makes a substantial modification to the proposed settlement agreement. Here, however, the issue of jurisdiction is contested by parties who do not join in the settlement agreement (as well as Commission Staff, who does join in the agreement). Consequently, it is a contested issue of law that the Commission must address. See RCW 34.05.461(3), requiring findings and conclusions on all material issues of law.

23 Therefore, we address the jurisdictional issue to determine whether we have authority to consider the settlement proposal.

B. Does the Commission Have the Jurisdiction to Review and Approve the Transaction?

24 The Applicants argue that the Commission has the authority only to take such action as the legislature allows it.[13] They assert pertinent statutory provisions do

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[12] *In re Unbundled Loop and Switching Rates; the Deaveraged Zone Rate Structure; and Unbundled Network Elements, Transport, and Termination,* Docket No. UT-023003, Tenth Supplemental Order (June 2003).

[13] *Washington Indep. Tel Ass'n v. TRACER*, 75 Wn. App. 356, 363, 880 P.2d 50 (1994); *Kaiser Aluminum v. Labor & Industries*, 121 Wn.2d 776, 780, 854 P.2d 611 (1993) "([A]dministrative agencies are creatures of the legislature without inherent or common law powers and they exercise only those powers confirmed either expressly or by necessary implication.")

not apply to their transaction, either because of their corporate structure and the nature of the transaction or because certain exemptions apply.

1. Does the Transaction Involve a Property Disposition of a Public Service Company Under RCW 80.12.020?[14]

25 The threshold question is whether the transaction falls within the authority contained in the Transfers of Property statute, chapter 80.12 RCW, under any of the following provisions:

1. Sale, lease, assignment or disposition by a public service company of its franchises, properties or facilities which are necessary or useful to the performance of the company's duties to the public. *RCW 80.12.020 (the "Disposition Clause")*

2. Merger or consolidation by a public service company of its franchises or facilities with any other public service company. *RCW 80.12.020 (the "Merger Clause")*

3. Purchase or acquisition by any public service company of the franchises, properties, facilities, capital stocks, or bonds of any other public service company. *RCW 80.12.040 (the "Acquisition Clause")*

26 In addition, the Applicants argue that because MCI's local exchange subsidiary serves less than two percent of the access lines in the state, it is specifically

[14] RCW 80.12.020 reads in part as follows: "No public service company shall sell, lease, assign or otherwise dispose of the whole or any part of its franchises, properties or facilities whatsoever, which are necessary or useful in the performance of its duties to the public, . . . without having secured from the commission an order authorizing it so to do. . ."

exempted from Ch. 80.12 RCW, and therefore the transaction is exempt from the law.[15]

27 Third, the Applicants note that every MCI and Verizon subsidiary operating in the state, except Verizon NW, has been classified as a competitive telecommunications company, and the Commission has, by rule, waived for such companies the requirement that transfers of property involving competitive companies be reviewed or approved.[16] Applicants argue that the rule therefore applies and that the transaction is not subject to review.

28 The Commission Staff and Public Counsel oppose the applicants, contending that as to each of the potential statutory bases on which to examine the proposed of merger, the Commission does have jurisdiction.

29 **Applicability to Public Service Companies.** The Applicants argue that the statute applies only to "public service companies," and that neither of the holding companies proposing to merge are public service companies.[17] Because neither is itself subject to regulation as a public utility[18] nor supplies services for use by the public.[19] Applicants cite to decisions in other states that adopt their rationale.[20]

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[15] RCW 80.12.045.
[16] WAC 480-121-063.
[17] "Public service company" under RCW 80.04.010 "includes every . . . telecommunications company." A "telecommunications company" is defined to include every company "owning, operating or managing any facilities used to provide telecommunications for hire, sale or resale to the general public" in this state.
[18] RCW 80.12.010
[19] *Inland Empire Rural Electrification, Inc. v. Dep't. of Pub. Serv.*, 199 Wash. 527, 537, 92 P.2d 258 (1939)
[20] *Indiana Bell Telephone Company v. Indiana Utility Regulatory Commission*, 715 N.E. 2d 351 (Ind. 1999). Applicants also cite Missouri and Nebraska commission decisions to support the same proposition. *SBC Communications, Inc.*, Case No. TM99-76, 1998 WL 996180 (Mo. P.S.C. Oct. 20, 1998) and *In re Jurisdiction to Authorize Acquisitions, Mergers or Other Transfers of Control*, 186 P.U.R.4th 36, 1998 WL 406789 (Neb. P.S.C. Mar. 10, 1998).

30 Public Counsel and Commission Staff oppose the Applicants' position. Staff argues that MCI, Inc., is transferring not only itself as an entity, but also the control of its public service company subsidiaries to Verizon, which constitutes a "disposition" within the statutory language, "sell, lease, assign, or otherwise dispose of."

31 Public Counsel argues that the Commission's decision *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation, Docket No. UT-981367, Fourth Supplemental Order,* is dispositive of the jurisdictional issue. The *GTE/Bell Atlantic* merger, a stock transaction, was structured as a merger between GTE Corporation, the parent of GTE Northwest, the regulated operating subsidiary in Washington, and the Bell Atlantic holding Company. As a result of the merger, GTE Corporation and its subsidiaries became wholly-owned subsidiaries of Bell Atlantic. Verizon, the renamed successor parent corporation arose out of the merger.

32 Public Counsel notes that the Commission found jurisdiction over the GTE/Bell Atlantic merger, using the following language at pages 9-10:

> [T]he interpretation urged by Applicants is inconsistent with the both the terms and meaning of RCW 80.01.040 and RCW 80.12.020. We do not believe that the Legislature meant under RCW 80.12.020 to allow companies to avoid scrutiny of transfers of control over their jurisdictional enterprises by the simple expedients of erecting particular corporate structures or using stock rather than cash as consideration. Such a rigid and mechanistic reading of the statute "is counter-intuitive in this context and would subvert the purposes underlying the Commission's delegated powers." *In the Matter of the Application of PacifiCorp and Scottish Power PLC*, Docket

> No. UE-981627, Second Supplemental Order, mimeo at 10, 192 PUR 4th 143 (March 1999). Indeed, it strains credulity to suggest that the Legislature intended that functionally identical transactions should be treated differently simply because one transaction involves entities that have erected a hierarchical corporate structure including holding companies, while the other transaction involves similar entities that rely on more simple corporate structures. In this case, GTE Northwest is a wholly-owned subsidiary of GTE Corporation. There is a perfect identity between the corporations for purposes of a decision to effect a complete transfer of control such as would result under the subject transaction. Indeed, as Public Counsel points out, wholly owned subsidiaries (e.g. GTE Northwest) of major international telecommunications companies "do not merge independently of their parent corporation." Public Counsel brief at 5. In like vein, Staff points out that "GTE-NW cannot dispose of control on its own, it is dependent on the parent to accomplish that end."

33 Applicants note that the principal subject of the merger with reference to Washington State operations in each of three prior proceedings[21] was a large operating company coming under new ownership and control. They argue that, because Verizon NW will remain under Verizon ownership, there is no basis for exercising jurisdiction. We disagree.

34 It is true that this transaction involves the disposition of smaller, competitive operations of MCI, rather than larger, regulated firms that were the subjects of prior orders. Nonetheless, MCI's companies are affected with a public interest and no less subject to regulatory review

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[21] The *GTE/Bell Atlantic* and *PacifiCorp/Scottish Power* orders, above, and *Application of U S WEST Communications, Inc. and QWEST Corporation*, 9th Supp. Order, Docket UT-991358 (June 2000).

than a larger fully-regulated company.[22] We believe that the issues relating to corporate structure were properly resolved in the *GTE/Bell Atlantic* and *PacifiCorp/Scottish Power* proceedings cited above. We acknowledge that there are distinctions between the fact patterns in those proceedings and the facts here, but do not find the distinctions lead to a different result.

35 This proceeding highlights the concerns arising from a corporate merger. Each of the merging corporations owns and controls subsidiaries that ostensibly provide competition to incumbent telecommunications providers, including Verizon NW. Effects on competition, given the policies of Washington[23] and those of the federal government under the Telecommunications Act of 1996[24] are of significant concern. Through common corporate ownership a business enterprise can establish, define, alter, and dissolve telecommunications companies operating as ostensible competitors.

36 As the Commission observed in the quotation cited above, the individual businesses do not have autonomy. Their decisions are governed—to whatever degree the holding company determines—with a view toward the success of the overall enterprise and cannot be made independently or without reference to the needs of other elements of the enterprise.[25] The

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[22] Insofar as Verizon companies are a part of the merger, although not subject to "disposition into a new or different corporate structure at the time of the merger," they are put into a new milieu with new synergies, likely new administrative costs, new upper management decisions affecting competition and operations, and the possibility of a new corporate structure.

[23] RCW 80.36.300

[24] *In the Matter of Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, FCC 04-290 (rel. Feb. 4, 2005).

[25] While the initial post-merger operations of the two enterprises were slated to continue virtually without change, the ultimate configuration of businesses had not been determined as of the close of the record.

holding company reserves the right to exercise the management authority of the individual corporate elements of the enterprise. In its *GTE/Bell Atlantic* order the Commission recognized that it is the actual exercise of control and management authority that matters:

> With respect to the act of 'disposing' of control over a public utility, the act of the parent corporation is the act of the subsidiary where the parent has exclusive authority to undertake the act. We also find identity between the parent and subsidiary corporations, to the extent of shared operations and decisions that affect directly the provision of services to customers in Washington State. In effect, we pierce the corporate veil and conclude that GTE Corporation and GTE Northwest are a single telecommunications company falling within the definition of 'public service company' for purposes of considering a transaction that involves the disposition of the whole of GTE Northwest's property and facilities used to provide regulated telecommunications services in Washington State.[26]

37 Each of MCI's telecommunications companies operating in the state have "otherwise dispose[d] of the whole or any part of its franchises, properties or facilities whatsoever"[27] through a decision made by the holding company exercising management authority of the subsidiary. For purposes of this transaction, there is identity between the subsidiary and the parent and therefore it is within the ambit of the "public service company" provisions of RCW 80.12.020.

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[26] *GTE/Bell Atlantic* order, Page 16
[27] RCW 80.12.020

2. Is There a "Merger or Consolidation" Between Public Service Companies Under RCW 80.12.020?

38 RCW 80.12.020 reads in part, "No public service company . . . shall, by any means whatsoever, directly or indirectly, merge or consolidate any of its franchises, properties or facilities with any other public service company, without having secured from the commission an order authorizing it so to do."

39 Applicants argue that the Merger Clause covers only the merger or consolidation of "franchises, properties or facilities" with another public service company. They urge that no franchises, properties or facilities are being merged or consolidated here, because 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.[28]

40 Commission Staff responds that the "directly or indirectly" language of the Merger Clause shows a legislative intent to sweep aside irrelevant issues of corporate form and to prevent utility companies that sell services to Washington consumers from evading the Commission's jurisdiction.

41 Public Counsel notes that there is evidence in the record that demonstrates that post-merger consolidation of operations will occur. It includes unified management permitting more effective provisioning of services and better quality control of the network,[29] combined product lines, joint use of networks,

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[28] Applicants cite to a Commission Staff legal memorandum in a prior proceeding that the Commission rejected in its order (Applicants' brief on jurisdiction, page 6). That Staff in a different proceeding made different arguments is irrelevant to this proceeding. The Commission rejected the Staff argument in that proceeding and we find that the prior, discredited Staff argument carries no weight in this matter.

[29] Danner, Exh. No. 23T-C, p. 19.

and consolidation of administrative functions.[30] All agree that post-merger planning has not been completed—so the exact structure of post-merger operations isn't defined—and Applicants argue that they are prohibited by law from completing post-merger planning prior to receiving approval to merge.[31]

42 Applicants argue that the reference to stock transactions in the "Acquisitions" provisions of RCW 80.12.040,[32] and the absence of such reference in the Merger Clause means by negative implication that mergers and consolidations accomplished by stock transfers are excluded from the Merger Clause. We find no such negative implication. Instead, in light of the policies these provisions help to protect and the consistently broad language used to express the legislative desire to encompass all relevant transactions, we see the Disposition, Acquisition and Merger Clauses as overlapping to ensure that the Commission is not inadvertently kept from exercising its review powers.

43 We find this transaction subject to Commission review under the Merger Clause of RCW 80.12.020. The statutory language regarding direct or indirect consolidations indicates a legislative intention to address transactions such as this one, where enterprise consolidations occur that will unquestionably affect the operations of regulated companies, but the details of implementation are not known at the time of the merger. The consolidation of operations under one corporate umbrella means that the operations are merged for competitive purposes, and subject to the holding company's direction the existing subsidiaries will be altered, expanded, contracted, disbanded, or otherwise changed in structure, function, or mission within the corporate family to suit the

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[30] Folsom, Exh. No. 150T-HC, p. 9.
[31] Applicants' brief, page 37, footnote 179.
[32] RCW 80.12.040 reads in part as follows: "No public service company shall, directly or indirectly, purchase, acquire, or become the owner of any of the franchises, properties, facilities, capital stocks or bonds of any other public service company unless authorized so to do by the commission."

needs of the holding company. This is indeed an indirect merger "by any means whatsoever," in which a new enterprise entity is created that includes the corporate bodies of the regulated companies as essential parts of the enterprise unity.

3. If the Commission Would Otherwise Have Jurisdiction, is the Transaction Exempt Under RCW 80.12.045?

44 Applicants argue that the transaction is exempt from Commission review because RCW 80.12.045 excludes local exchange companies serving less than two per cent of the telephone lines in the state from operation of the chapter.[33]

45 Commission Staff acknowledges that MCImetro Access Transmission Services (MCImetro) under that definition would be exempt from seeking approval under the Disposition Clause. It argues, however, that the Commission may nonetheless exercise jurisdiction over the merger transaction under the Merger Clause of RCW 80.12.020 or the Acquisition Clause of RCW 80.12.040. Public Counsel also acknowledges MCImetro's status and exemption from the need as an independent regulated company to seek approval of its disposition.

46 Public Counsel points out that post-transaction, MCImetro will be a Class A company and will not qualify for the exemption, citing Ms. Roth's testimony.[34] Public Counsel also notes that the Commission in the past has found jurisdiction when at the time of the application, only one of two merging companies was a public service company. He argues that by extension, the same principle should apply. The Commission has previously ruled that it has jurisdiction to review a merger transaction when it has jurisdiction over only one of the two parties, to

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[33] "Subject to RCW 80.04.530(1), this chapter does not apply to a local exchange company that serves less than two percent of the access lines in the state of Washington." *RCW 80.12.045.*

[34] Roth, Exh. 101T-HC, page 38, lines 10-13.

evaluate the effects of the transaction on the jurisdictional entity.[35] We also accept Public Counsel's argument that in light of MCImetro's post-merger status as a Class A company, as well as Verizon NW's present and post-merger status as a Class A company fully subject to chapter 80.12 RCW, the Commission may examine the post-merger effects of the transaction involving service provided by MCImetro.

4. If the Commission Would Otherwise Have Jurisdiction, is the Transaction Exempt Because of the Waivers of Regulatory Requirements Set Forth in WAC 480-121-063 for MCI's Regulated Subsidiaries in Washington?

47 Applicants argue that the exemptions in WAC 480-121-063 bar the Commission from considering the transaction[36] citing a docket notation at the closure of Docket No. UT-020279, regarding the acquisition of AT&T by Comcast. There, a Staff member stated that closure was due in part to an apparent lack of jurisdiction because of waivers (presumably those in WAC 480-121-063). They cite other dockets to the same effect, and argue that there is no basis for the Commission to deviate from its precedent in this matter.[37]

48 Public Counsel points out that subsection (2) of the rule provides for the revocation of any waiver when necessary to protect the public interest.[38] Public Counsel argues that the Commission should revoke the waiver of chapter 80.12 RCW to protect the public interest. Commission Staff argues that legislative policy promotes diversity in telecommunications services and that the laws and

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[35] *PacifiCorp/Scottish Power*, Docket No. UE-981627, Second Supplemental Order, p. 12.
[36] WAC 480-121-063 reads in part as follows: "(1) The following regulatory requirements are waived for competitively classified companies: . . . (k) Chapter 80.12 RCW (Transfers of property); . . ."
[37] Applicants also argue that there is no basis in the record to reclassify their subsidiaries as noncompetitive. As no other party asks this result, and we do not propose it, we do not respond to the argument.
[38] Subsection (2) reads as follows: (2) The commission may by order revoke waivers of regulatory requirements if it determines that revocation is necessary to protect the public interest.

rules should be read to effect that policy. It argues also that the Commission should revoke any relevant waiver granted by rule, contending that a low threshold should apply for revocation to promote widespread application of the waiver as consistent with the public interest.

49 We reject the Applicants' contention that existence of the rule bars the Commission from considering the merger. The rule itself provides for revocation when required to protect the public interest.[39]

50 The Commission finds, for reasons articulated later in this order, that the proposed merger will cause harm to competition in Washington and to the public. We also find that this harm will adversely affect the public interest, and that to address and mitigate the harm it is necessary to revoke the waiver.

51 Applicants' argument that administrative docket notations by Commission Staff constitute precedent that binds the Commission in future proceedings is wholly without merit.

52 Even if there has been a prior Commission decision in an analogous case, the doctrines of precedent and estoppel do not bar the Commission from making different decisions on a different record when all parties have the opportunity to participate and when the Commission's decision considers the record and states reasons for the result.[40]

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[39] Verizon NW's status as a regulated entity and the post-merger status of MCImetro as a class A company could suffice to overcome an exemption under WAC 480-121-063 for the same reasons we rejected exemption under RCW 80.04.530(1) *supra*.

[40] *Hanson Processing, LLC v. Cascade Natural Gas Corporation*, Docket No. UG-980860, Order Dismissing Complaint (February, 1999); Gellhorn and Levin, *Administrative Law and Practice*, 4th Ed., 1997, p. 97.

5. Other Jurisdictional Issues.

53 Both Commission Staff and Public Counsel argue that provisions of RCW 80.12.040, the "Acquisitions Clause," offer a basis for asserting jurisdiction over the transaction.[41] They argue that the result flows from the Commission's *GTE/Bell Atlantic* merger order, cited above, by piercing the corporate veil. Here, they argue, Verizon NW is regulated and the corporate parent is acquiring the assets of other regulated companies. Merely "piercing the corporate veil," they argue, requires the result.

54 We noted above that in terms of disposition, the parent exercises control over the assets of the subsidiary that the subsidiary is not empowered to exercise. MCI's subsidiaries cannot dispose of themselves; it is their authority that the parent exercises. Similarly, in terms of merger, only the parent can make the decision to merge (acquire) and, once merged at the holding company level, it is the parent that decides on behalf of all subsidiaries how to allocate resources and to structure the resulting organization to best achieve corporate aims. The parent exercises power and keeps that power from its subsidiaries. As the *GTE/Bell Atlantic* order stated, for this purpose there is identity between the parent and the subsidiary.

55 In terms of the acquisition statute, it is clear that Verizon has reserved to itself the power to allocate resources of the acquired companies and to manage their deployment. In this sense, it is acting on behalf of its subsidiaries – acting as the subsidiaries -- and has withheld from them the power to do so independently. In doing so, we rule that there is, functionally, an acquisition by Verizon NW of MCI subsidiaries' assets.

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[41] RCW 80.12.040 reads in part as follows: "No public service company shall, directly or indirectly, purchase, acquire, or become the owner of any of the franchises, properties, facilities, capital stocks or bonds of any other public service company unless authorized so to do by the commission."

V. PERTINENT STANDARDS

A. If Commission Review and Approval of the Transaction Is Required, What Is the Standard for Approval?

56 The standard set in the Commission's rule is a "public interest" standard.[42] In a recent merger proceeding, the Commission held that this standard requires 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."[43]

57 In the *US West/Qwest* Merger Order,[44] the Commission stated:

> There is no bright line against which to measure whether a particular transaction meets the public interest standard. As we observed in another recent merger case, "the approach for determining what is in the public interest varies with the form of the transaction and the attending circumstances." As in prior merger cases, we must be concerned here with whether the transaction might distort or impair the development of competitive markets where such markets can effectively deliver affordable,

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[42] WAC 480-143-170 reads as follows: If, upon the examination of any application and accompanying exhibits [under chapter 80.12 RCW], or upon a hearing concerning the same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application.

[43] *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).

[44] *In Re Application of US WEST Inc. and Qwest Communications International, Inc.,* Docket No. UT-991358 (9th Supplemental Order, June 19, 2000) at pages 8-9.

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

58 Public Counsel notes that the Commission in its *US WEST/Qwest* order identified the following factors for review in a merger proceeding:[45]

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

59 In summary, the Commission determines whether the transaction is consistent with the public interest, balancing the costs and the benefits for the public and for affected customers. If the costs outweigh the benefits, the result is harm and the Commission should deny or condition the approval so no net harm results.

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[45] *Id*., pp. 4-5.

B. What is the Standard for Approval of a Settlement?

60 The standard by which the Commission evaluates a proposed settlement is set out in WAC 480-07-740: "The commission must determine whether a proposed settlement meets all pertinent legal and policy standards." This involves the consideration of a record, the weighing of evidence often including oral testimony, and an evaluation of whether the proposal is consistent with the public interest.

1. The Commission's Settlement Rules

61 The Commission's settlement rules provide guidance for both process and substance in evaluating proposed settlements. They are set out in WAC 480-07-730 and -740.

62 Settlements are defined in WAC 480-07-730. In this matter, some of the parties reached settlement, while others did not. This is called a "multiparty settlement." [46]

63 Multiparty settlements must be reviewed through a process that allows proponents to support the proposal and nonsettling parties to oppose it. Opponents must have the opportunity, among other rights, to see and cross-examine the evidence in support of the proposed settlement, and to present evidence or an offer of proof opposed to the settlement.[47]

2. Review of Settlement and Challenges

64 In this docket, we review the proposed settlement to determine whether it is consistent with the public interest and whether it is otherwise lawful. The

[46] WAC 480-07-730(3).
[47] WAC 480-07-740(2)(c).

parties assisted the Commission by providing an extensive record on which to base a decision.

65 The record contains considerable information about the transaction itself, and permits us to evaluate the transaction and its effects as a backdrop to the evaluation of the proposed settlement and possible alternative provisions. The record also reflects reservations about and challenges to the proposal offered by Public Counsel, and Counsel's recommended alternative or additional conditions.

66 The settling parties propose that the transaction be allowed. The record discloses that the transaction will have costs and benefits. Costs include one-time and continuing costs, and include expenditures that will be capitalized. Savings include cost savings from combining some operations, especially administrative services, and synergies that will be possible when some of the merging operations and administrative services are combined. The parties differ on their evaluations of the levels of costs, savings and synergies available from the merger. The parties also disagree about the time frame during which merger effects should be considered in this docket.

VI. EFFECTS OF THE MERGER

67 In order to evaluate the propriety of the settlement, we must first evaluate the effects of the transaction. The parties presented considerable evidence about those effects which we review to determine whether harm will result.

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

1. Intermodal Competition and Other General Issues

68 The Applicants contend that there are few or no negative effects, and that the transaction will benefit affected companies, their present and future customers, the economy and the public. They argue that extensive intermodal competition reduces the effect of any reduction in traditional telecommunications competition; that regulation is an adequate remedy for competitive harm; that MCI cannot be considered a substantial competitor because of its low market share; and, that no harm can result from the merger because MCI's local exchange business is declining without hope of recovery, due to various political, economic, and technological developments.

69 It is clear that the backdrop to today's merger is an increasingly unsettled marketplace, with growing convergence[48] and growing options for telephone customers. That does not mean, as Applicants contend, that the existence of real and potential or emerging competitors on other platforms has produced mature markets with predictable relevant competition. Neither does it mean that this transaction is without negative effects, nor that positive effects will outweigh the negative.

70 Intermodal competition has not reached maturity. The parties dispute whether wireless telephony is a substitute or a supplement to wireline service. Based on the evidence, evaluated in light of our experience, we find that while wireless telephony is growing, it for the most part supplements and does not displace

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[48] "Convergence" is a term that expresses the developments in technology that allow cable television companies, wireline telecommunications companies, wireless telecommunications companies, and operators of other platforms to offer similar products. Convergence permits intermodal competition among their technologies.

wireline. VOIP[49] may eventually be a technology capable of displacing wireline telephony among a class of customers, but the broadband connections needed to support VOIP are not universally available and carry a pricetag that may limit penetration among some population segments. Wi-fi and wi-max are emerging technologies and are not shown to pose any realistic competitive challenge to incumbent local exchange carriers such as Verizon NW.

71 Finally, while we respect the functions of the Federal Communications Commission and the Department of Justice, they did not closely review this merger in the context of Washington State as we have been tasked with doing. They acted on a different record, with different players and different evidence. We have carefully considered their decisions on interstate issues, but we are not bound by their opinions in deciding matters within our purview.

2. Market Competition Issues

72 Applicants contend that the high degree of market concentration existing in Verizon NW's service territory, plus MCI's asserted decision to fade from the mass consumer market for local exchange service, render the merger irrelevant and inconsequential. Staff notes that Verizon NW's average market share for residential local exchange service is greater than 98% and that MCI—while Verizon's biggest competitor—still holds less than 1% of the local exchange market.[50] Staff notes that the harm suffered is largely a prospective harm.[51] That does not mean that the transaction is without harm. As the *Qwest/U S WEST* order states,[52] "[W]e must be concerned . . . with whether the transaction might . . . impair the development of competitive markets . . ."

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[49] VOIP stands for "Voice Over Internet Protocal."
[50] Wilson, page 14, lines 4-7 and lines 15-16.
[51] Roth, Exh. 101T-HC at 17.
[52] *In Re Application of UW WEST Inc. and Qwest Communications International, Inc.*, Docket No. UT-991358 (9th Supplemental Order, June 19, 2000), at page 9.

73 Public Counsel notes that the merger results in Verizon's absorbing the operations of the largest CLEC competitor in its residential market.[53] Public Counsel cites testimony presented by Mr. Beach demonstrating that MCI's residential local market share in Verizon's service area increased by over 35% between July, 2004 and August, 2005.[54] This increase in market share indicates that consumers will face a definite competitive loss in the marketplace as a result of the merger, and it provides some indication that MCI's "irreversible decline" may not be a phenomenon in Verizon NW territory.

74 We are reluctant to accept uncritically the suggestion that MCI had adopted a fade away strategy with regard to local service prior to contemplating merger.[55] We recognize many factors have increased the challenges for competitive carriers, including FCC decisions, such as no longer requiring incumbent carriers to offer competitors the unbundled network element platform at total element long run incremental cost.[56] However, the evidence in this docket is that well into this year, when the merger was in its formative stage, MCI was a robust competitor, substantially increasing its market percentage in Verizon's service area. We are unpersuaded that MCI's only option was to forego expansion and eventually to abandon its local exchange customers.

75 Both Dr. Roycroft and Mr. Wilson demonstrate that while Verizon NW now exerts great market power with the existing level of competition, its market

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[53] Roth, Exh. No. 101T-HC, p. 17; Roycroft, Exh. No. 371T-HC, p. 65, p.76.
[54] Beach Exh. No. 61T-HC, p. 12 lines 2-4 row Verizon, cols. July 2004 and August 2005.
[55] *See, e.g.*, Dissent of Commissioner Geoffrey Brown to the California order, at p. 7:
Consumer groups alleged that MCI still provides mass market services in California and that there is no evidence that MCI would exit this segment rather than, for example, seeking to sell its mass market customer base to another CLEC, if the merger is not approved. In addition, MCI's decision to reduce its mass market services marketing efforts appears to have been motivated by its goal of merging with a large carrier.
[56] Beach, Exh. 60T-HC, page 10, lines 196-198.

power for both residential and business local exchange service[57] will increase when MCI becomes an affiliate. [58]

76 Dr. Roycroft identifies factors that cause Verizon NW to be dominant in its local exchange market. These include Verizon's ability, outside of regulatory control, to coordinate pricing in the local exchange market because of its dominant position in the retail market and its continued role as a monopoly provider of wholesale inputs to Competitive Local Exchange Carriers.[59] Dr. Roycroft also noted the lack of viable rivals that might replace the independent source of supply that will be lost once Verizon finalizes its acquisition of MCI.[60] Dr. Roycroft also noted that continuing barriers to entry in the local exchange market reduce the likelihood that new rivals will be able to make up for the lost competition resulting from the merger.[61]

77 Mr. Wilson identified Verizon's market dominance.[62] Ms. Roth identified both current and prospective harm, stressing that the prospects for future moderation of Verizon NW's extremely high market share will be lessened considerably if the merger proceeds. In addition to eliminating MCI's prospects for increased market penetration, the merger would weaken the ability of small CLECs to negotiate and arbitrate interconnection agreements with Verizon NW. The absence of a stronger competitor such as MCI with the resources to forge more favorable interconnection agreements with Verizon NW is likely to increase barriers to entry for the remaining CLECs.[63]

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[57] Roycroft, Exh. 371T-HC, pp. 100-101, Roycroft Exh. 375, Chart 6, and Wilson, Exh. 121T-HC, page 16, lines 14-16.
[58] Roycroft, Exh. 371T-HC, pp. 100-101 and Roycroft Exh. 375, Chart 6
[59] Roycroft, Exh. 371T-HC, p. 77.
[60] Roycroft, Exh. No. 371T-HC, p. 78.
[61] Roycroft, Exh. No. 371T-HC, p. 79.
[62] Wilson, Exh. No. 121T-HC.
[63] Roth, Exh. No. 101T-HC, page 20, lines 4-6.

78 We acknowledge that Verizon NW's market share is extremely high, but we conclude that the proposed merger will harm the competitive scene by removing Verizon NW's largest competitor for local exchange service—and more importantly, by eliminating prospects for significant future competition.

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

79 The Applicants argue that not only will the transaction have no effect on the mass market for long distance service but that there is no longer a market for such service. They cite Dr. Taylor's testimony that the bundling of toll and local services has eliminated the market for stand-alone long distance.[64] Applicants urge that even with the loss of MCI as the largest independent toll carrier, there are numerous providers of stand-alone toll, and Verizon's control of a substantial majority of the market poses no threat of harm.

80 Public Counsel notes that, while MCI's market share has been decreasing, the merger increases Verizon's share and removes MCI's independent share from the market, which is an immediate and negative consequence of the merger.

81 Verizon's post-merger market share will be substantial. It will control, through Verizon NW and its competitive long distance subsidiaries, a substantial majority of the presubscribed traffic, which is a concern. However, we agree that given the availability of other long distance options, Verizon will not have the ability to control prices or services in the marketplace. On balance, we cannot say unequivocally that there will be no harm, but in terms of market behavior, harm is unlikely.[65]

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[64] Roth, Exh. No. 101T-HC at 76:2-7; 77 1-16.

[65] The consequences of the relationship between Verizon Northwest and its existing affiliate, Verizon Long Distance, remain a concern for review in an appropriate rate case setting. See, *AT&T v. Verizon NW*, Docket No. UT-020406, 11th Supplemental Order, Page 17, fn 18. With MCI companies as affiliates, the concerns will grow.

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

82 Applicants argue that the market for enterprise services will remain robust, noting DOJ conclusions and citing the presence in that market of large international suppliers. Verizon also notes that its services and resources complement rather than overlap those of MCI with regard to this market segment, as evidenced by the very low number of instances—four per cent—in which they bid against each other for projects.

83 Verizon also argues that there is no adverse effect from the merger on competition for service to medium-sized business enterprises. First they argue that there is no such identifiable market segment, then they conclude that there is no evidence that loss of MCI as an independent entity will have adverse effects. It notes that this is not a customer base that MCI pursues, preferring to concentrate on larger enterprise business. Public Counsel argues that MCI serves a considerable number of business customers, for whom the merger may be seen as harmful, but also notes that it is a relatively small supplier of such services and offers no suggestion or quantification of harm.

84 Commission Staff notes that MCI does serve business clients in Verizon NW territory, but it is not the largest provider of that service. Staff states that MCI's departure as an independent supplier of the service "will increase concentration by a measurable amount," that it would be "unacceptable in an unregulated market," and that it will "likely prolong the need to regulate Verizon's business rates." Staff does not quantify harm, and offers no specific remedial suggestions.

85 On balance, we believe that a small level of harm exists. In light of the degree of existing competition and the number of alternative suppliers, however, the harm is not a significant factor in our decision on the merger.

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

86 The Applicants argue that there is little competition between Verizon and MCI for this business, and with sufficiently robust competition from other providers, there will be no adverse effects from the merger on this market. Among other indicators, they stress the Department of Justice determination that the merger needed no conditions in markets, such as Washington State, where there are minimal situations in which the merging companies have facilities to compete for service. The Applicants also argue that there are adequate competitors for the special access business. They state that most of the few commonly-served locations also are served by—or within yards of—facilities of competing carriers.

87 The FCC order notes that each building is a separate market for special access services. It also notes that the barrier to entry is substantial, even where trunks are available, and involves securing rights to enter the building and installing facilities into the building or acquiring the right to use such facilities.[66] Applicants' contention that other CLECs are competitive because they have facilities within a fraction of a mile from the building does not consider the actual barriers to entry that both Verizon and MCI will retain after the merger.[67]

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[66] FCC order, *In re Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control,* WC Docket No. 05-75, Memorandum Opinion and Order, FCC 184, Adopted October 31, 2005, page 17, paragraph 28, page 20, paragraphs 27 and 39, and page 26 footnote 131, among other places.

[67] Commissioner Adelstein made the following comment in his concurrence with the FCC order, at pages 148-149:

> Although business users tend to have more options than residential users, the Commission concludes that there is still a high level of concentration in the enterprise market in most areas of the country today, and the record makes clear that AT&T and MCI are two of the largest sources of choice for business users and largest suppliers of wholesale special access services to competitive carriers. Indeed, the record suggests that even the mere presence of AT&T or MCI in the competitive bidding process results in lower wholesale prices. Based on these competitors' national positions and ability to apply competitive pressure to wholesale prices, I believe that a more substantial

88 Commission Staff argues on brief that the merger will concentrate more special access service concentration in Verizon and likely result in a need to prolong regulation of Verizon's special access service, but does not argue that the concentration results in harm or requires mitigation.

89 On balance, we have concerns about the reduction of competition in this area. Although Verizon's market dominance is not overwhelming and facilities-based providers do offer alternatives, the barriers to building entry are real and the merger will result in a likelihood of harm to competition.

E. Other Harm From the Transaction

90 The parties did not argue the existence of other harm. We note that the testimony indicates the existence of merger costs, which may well burden Verizon customers,[68] and few offsetting benefits, apart from those that strengthen Verizon economically. We will discuss the nature and the timing of these costs and benefits, below.

VII. PROPOSED SETTLEMENT

91 The settlement proponents filed a settlement agreement and descriptive narrative on October 21, 2005. The Commission scheduled a hearing on the proposal to begin on November 1, 2005.

> divestiture of overlapping facilities would have been appropriate with this merger. I am not convinced that the relatively minor number of facilities where the Applicants are required to lease high-capacity lines – representing far less than one percent of their commercial buildings – is sufficient by itself to remedy this significant loss of actual and potential competition. The Department of Justice's action leaves 99.9% of commercial buildings in SBC and Verizon territory wholly unprotected from the loss of competition that AT&T and MCI brought to bear.

[68] As we note below, merger costs may in part be capitalized, earn a return, and be depreciated.

92 At the hearing, the settling parties presented the settlement. Witnesses were cross-examined on their testimony and exhibits offered in support of the settlement proposal which the Commission received in evidence. Supporting witnesses included, for the Applicants, William E. Taylor, Carl R. Danner, Michael A. Beach, and Steven E. Smith; in addition, the exhibits of witness Julie A. Canny were received in evidence. Witnesses for Commission Staff included Jing Roth and Kathy Folsom; the exhibits of witness Thomas L. Wilson were received in evidence. Jason Koenders appeared for intervenor Integra. Parties opposing the proposed settlement included Public Counsel, who presented witnesses Trevor R. Roycroft and Charles W. King. In addition, XO presented the written testimony of its witness Don J. Wood. The parties waived cross-examination of Dr. Wood, whose exhibits were received by stipulation. Intervenor Covad asked leave to withdraw prior to the evidentiary hearing, and neither presented its witness nor offered its witness's prefiled evidence into the record.

93 Witnesses addressed the proposed settlement and responded to questions about both the settlement proposal and the proposed merger. Testimony also addressed a consent decree of the Department of Justice and recent orders related to this proposed merger of the Federal Communications Commission and the California Public Utilities Commission.

A. Mitigating Terms

94 The proposed settlement would have the Commission approve the transaction subject to Verizon (the surviving entity) taking certain actions, making certain expenditures and foregoing revenues.

1. Condition 1: Line Extension

95 The first condition agreed by the settling parties would require Verizon NW to extend service lines to 12 or fewer potential customers located near Index, a rural community located on the western side of the Cascade mountains in Snohomish County. The provisioning of service to these potential customers is the subject of a pending proceeding.[69]

96 While Public Counsel does not oppose the provision, he criticizes it on two grounds.

97 First, he points out that the harm of the merger will touch all of Verizon's customers. He notes that this condition would allocate a significant proportion of the settlement's benefit to a very small number of individuals. Commission Staff responds, citing the testimony of Ms. Roth that, while the primary beneficiaries will be few, the settlement will further the interests of universal service to the benefit of all ratepayers.

98 Next, Public Counsel points out that in at least one recent proceeding[70] the Commission granted Verizon's petition for exemption from the rule requiring it to extend service within its designated service territory. Public Counsel urges that this casts further doubt on the wisdom of using the settlement to confer a benefit on a small group of residents. Commission Staff responds that the issues in the *Rupp* proceeding differ from those in *Taylor*. The earlier matter, Staff argues, involved a line extension within exchange boundaries, was subject to a Commission rule (from which Verizon NW sought and received a waiver), and involved a larger sum per person.

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[69] The matter is docketed as UT-050778, *Rupp, et al., v. Verizon Communications, Inc.*

[70] Docket No. UT-011439, *In re the Petition of Verizon Northwest, Inc. for Waiver of WAC 480-120-071(2)(a)*, Twelfth Supplemental Order (April 23, 2003). This is sometimes referred to as the *Taylor* case, after one of the persons seeking the extension of service. Verizon there petitioned for exemption from the rule requiring it to extend service.

99 We find that the Rupp petition should not be resolved as a condition of the merger. It is the subject of a pending docket, and contains issues that should be resolved on the basis of facts and legal issues to be determined in that proceeding. Furthermore, we believe that this condition would allocate too high a portion of settlement benefits to too small a group who are not yet Verizon customers. We reach this decision by balancing the benefits of universal service with the costs of providing it to reach a decision that is fair to the public and reasonable to the company.

100 In conclusion, we condition approval of the settlement on deletion of this condition. The Applicants and Commission Staff anticipated this possibility, and committed to making available the funds allocated to this condition for other purposes.[71] We address this later in the order.

2. Condition 2: Rate Center Consolidation and Elimination of Rate Adders

101 The second condition agreed by the settling parties is to consolidate rate centers in outlying portions of Skagit County, which would allow all Verizon local exchange customers in that county to call other county numbers without incurring toll charges.[72] The proposed condition would also remove optional rate adders from several rural exchanges in eastern Washington[73] so all customers in those exchanges could call nearby commercial/government centers without toll charges. Finally, the Arlington, Darrington, Granite Falls, and Marysville exchanges would be combined into a single rate center to allow toll-free calling in Snohomish County.

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[71] Applicants brief, page 5; Staff brief, page 9.
[72] The three rate centers primarily affected are Anacortes, Mount Vernon, and Sedro Woolley.
[73] Fairfield, Farmington, Latah, Oakesdale, Rockford, Rosalia, and Tekoa. The adders ($15 per month for residential customers and $30 for business customers) allow customers access to the equivalent of extended area service to nearby areas that would otherwise require toll calls.

102 The reconfiguration would have three principal consequences. First, it would enhance communication, principally for outlying customers but also for the body of commercial and residential customers in and immediately surrounding Everett. The typical result in such settings is that the number of calls expand rather markedly, which could require additional capital investment to handle the traffic.

103 Second, the reconfiguration would reduce Verizon's intrastate toll revenues by approximately $500,000 per year. While Verizon NW would be entitled to pursue a rate increase to offset the anticipated revenue reduction, a proposed stay-out condition would delay any filing for increase in basic rates until July 1, 2009. Verizon could not recoup foregone revenue from this interim. Any required capital investments could not be considered for recovery until a subsequent rate case.

104 Finally, the reconfiguration could accomplish a significant reduction in the rate at which Verizon uses telephone numbers. In other words, it would promote "number conservation," which aims to reduce the number of telephone numbers committed for use in certain exchanges, and thereby delay the need for an additional area code.

105 Public Counsel expresses reservations about this proposed condition. He points out that the primary beneficiaries of the measure include substantially less than one-quarter of Verizon's customer base. He notes that the Commission recently declined to pursue extended area service for one or more of these rate centers, based on a staff analysis that there is an insufficient community of interest between the rate centers and the population center to proceed under the relevant rule.[74]

106 Commission Staff responds that the proposal benefits all customers—those who would call others without a toll charge, and those who would be called—whether the need for calls is frequent or seldom. Staff argues that the standards of the rule are inapplicable when a company provides service voluntarily rather than under mandate.

107 We find this condition acceptable, for two reasons. First, as Staff points out, the reduction in toll rates will benefit a substantial number of Verizon customers in a growing area. The direct benefit will be enjoyed not only by outlying subscribers, but also by government, business, and residential customers with need to reach people and businesses within the affected exchanges, without paying a toll charge. The indirect benefit will extend throughout these counties, which will benefit from improved communication for commercial, governmental, educational, and social purposes.

108 Second, we know from experience that number exhaustion and the resulting need for a new area code involves a time- and resource-consuming process. A regulated company such as Verizon NW may incur substantive expenses in planning, engineering, and public education activities, and affected customers must revise contact information, often at considerable cost and inconvenience.

109 We note that on expiration of the stay-out period discussed below, the Company will have the right to file for a change in rates to reflect lost revenues and any capital expended to provision the services contemplated in this condition.

3. Condition 3: Extension of the Stay-out Period

110 The third settlement condition requires, with certain provisions that are not essential to our discussion, that

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[74] TR. 607:20-608:8. WAC 480-120-265.

> Verizon [NW] will not raise its basic residential or business rates above the levels set in the rate case settlement in Docket No. UT-040788 until June 30, 2009.

111 The referenced docket was a Verizon NW general rate case in which all parties of record chose to settle (or not to oppose the settlement). One element of that settlement was that Verizon NW would not file for a rate increase prior to July 1, 2007. The order said, "The Company agrees that it will not file tariffs to implement a rate increase, except in certain very limited circumstances, before July 1, 2007." [75]

112 The settlement provision here cites a date almost two full years later, but there are distinctions between the two provisions. First, the earlier provision barred the Company from *filing for* a rate increase before the stated date, while the current proposal bars it from *increasing* its rates prior to the stated date. Second, the proscription is slightly different in the current proposal, and bars the Company only from increasing its *basic residential and business rates*, but not other rates.

113 This provision drew concerns from Public Counsel, who does not formally oppose the condition. First, Public Counsel notes the differences between "filing for" and "increasing" basic telephone rates. He argues that, because the maximum time allowed between filing and increasing a rate that is suspended is 11 months, the proposal would extend the stay-out date established in the rate case by only 13 months although it was represented to be a two-year extension in the narrative and the settling parties' testimony.

114 Public Counsel also stated concerns that the provision has little measurable value to consumers, as the benefit of the provision is at best speculative, according to

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[75] Order No. 15, Docket No. UT-040788, *WUTC v. Verizon Northwest*, entered April 12, 2005, paragraph 31, page 20.

the testimony of Ms. Roth.[76] Finally, Public Counsel points out that the settlement does not incorporate Ms. Folsom's recommendation that the Commission remove from future rate proceedings any increase in debt costs attributable to the merger and any transition costs assigned to Verizon NW.[77] His implicit argument is that those provisions would add value to the settlement.

115 Commission Staff in its brief refers to the provision as "an additional two-year rate cap."[78] Verizon is more specific, saying, "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." (Emphasis added.)

116 Commission Staff submitted an answer to this Public Counsel argument. We read the answer to be consistent with Commission Staff's and Verizon's statements in their briefs: that the parties intended the agreement to require a two-year (minus one day) extension in the stay-out provision. So the result is clear, we interpret the settlement agreement to mean that the Company will not *file for* an increase in basic residential or business rates until June 30, 2009.[79] We approve this condition, as interpreted, as a proper element of the settlement.

117 As public Counsel noted, witness Kathleen Folsom also suggested in her testimony that the Commission protect ratepayers from harm from possible increases in debt costs that might result from the merger.[80] Folsom notes that Verizon is considered more credit worthy than MCI,[81] and that credit rating agencies perceive the merger as a potential negative for Verizon's debt.[82] Staff opines that the stay-out period meets this need for ratepayer protection. We

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[76] Public Counsel brief, paragraph 31, page 14, citing TR 595:15-23.
[77] Ms. Folsom, Exh. 150, page 3, lines 14-18, Public Counsel notes this at page 14 of its brief.
[78] Staff brief, paragraph 33, page 12.
[79] That does not mean to say that Verizon NW could not work with potential parties prior to filing, to achieve a proposal that could be allowed to become effective without suspension.
[80] Exh. 150T-HC, page 13, lines 13-18.
[81] Exh. 150T-HC, page 10, lines 4-5.
[82] Exh. 150T-HC, page 10, lines 6-11.

disagree. Any increased long-term debt costs resulting from the merger would be embedded in the cost of debt and would remain a factor until the debt is retired. Depending on timing, the cost of short-term debt could also be affected.

118 The ratepayers should be protected from this potential negative consequence of the merger, and we condition our approval of the merger accordingly.

4. Condition 4: Wholesale Service Quality Reporting.

119 Under this condition, Verizon NW will continue to report on the quality of its service to wholesale customers such as competitive local exchange carriers (CLECs) who in turn serve the public. Verizon NW will do so under now-expired *GTE/Bell Atlantic* merger condition metrics until it implements California Joint Partial Settlement Agreement measures. Verizon estimates that it will begin using the new measures in Washington in December, 2006.

120 Commission Staff describes these provisions as important to ensure fair treatment of competitive carriers and to avert concerns of discrimination that Integra has raised.[83]

121 No party opposes this condition, and in general we find it acceptable. Verizon must file a notice of any changes in this docket and serve a copy on parties to this proceeding, including Commission Staff. Changes will be deemed accepted if neither the Commission nor any other person objects to the modified term within 14 days following filing and service. Any objection may be heard as an open meeting item or adjudicated in this docket, in the Commission's discretion.

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[83] Staff brief, pages 13-14, paragraph 38.

5. Condition 5: Retail Service Quality

122 This term acknowledges that Verizon NW and MCImetro are subject to and agree to the Commission's retail service quality standards, thus providing an additional and independent avenue for enforcement. The condition also acknowledges the effect of WAC 480-120-084(3), which requires inclusion of lines served by affiliates in determining a local exchange company's classification.[84]

123 Public Counsel argues that the provision "requires absolutely nothing of the Joint Petitioners beyond what they are already required to do—comply with the Commission's service quality rules." He argues that Ms. Roth's testimony asks that the Applicants "guarantee" service quality performance to prevent deterioration following the merger. He argues that this provision falls short of reaching that necessary goal and, in fact, adds nothing to existing requirements.

124 We find this provision adequate, and accept it. Verizon NW has a history of satisfactory performance, and nothing in this record indicates that its service quality performance will decline following the merger. Should that happen, the settlement adds an element of enforceability that is not present without the agreement and the effect of this order. We are satisfied that the measures will allow prompt discovery and prompt corrective measures if service quality deteriorates after the merger. Maintaining high levels of service quality from the Public Service Companies we regulate is one of our most important responsibilities today, and will continue to be in the future.

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[84] WAC 480-120-034(3) reads as follows: For purposes of classifying a company as Class A or Class B, the number of access lines served by the local exchange company includes the number of access lines served in this state by any affiliate of that local exchange company.

6. Condition 6: LPIC Credits

125 Condition six requires Verizon NW to file a promotional tariff for its local exchange service customers who use an MCI subsidiary as their intrastate toll provider. The 60-day tariff will waive the LPIC (local primary interexchange carrier) charge that is imposed for verifying Verizon NW's customers' request for a change of provider for local toll service. Upon request of customers who also use an MCI affiliate for interstate toll service, Verizon will also waive these customers' interstate PIC charge during the promotion period.

126 Public Counsel agrees that these elements are appropriate, but would go much further in crediting or reimbursing costs for changing service to a non-Verizon local exchange carrier. Noting that the same loss of choice may occur for MCI's local exchange business, Public Counsel urges reimbursement of local service initiation charges imposed by a potential carrier.[85]

127 Public Counsel stresses the loss of choice and Verizon NW's concentrated market share in support of this request. He urges that the merger is not within the control of customers, and that those who want non-Verizon NW affiliate service should not be put to an expense for a circumstance for which they are not responsible.

128 Staff responds that Public Counsel's suggestion would require Verizon NW to pay customers to leave MCI local service. Applicants point to Ms. Roth's prefiled testimony, in which she notes that Verizon affiliates' market share for toll services will increase appreciably as a result of the merger while its local service—already very highly concentrated—will not increase significantly. Staff also asserts that waiving initiation charges would be inappropriate, stating that the current rules for such charges should apply equally to all carriers and that carriers should be able to recover their own charges from customers.

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[85] We deal below with Public Counsel's claims regarding local service initiation charges.

129 We accept the proposed condition, without change. It addresses a significant consequence of the merger, the increased concentration of intrastate long distance supply, and deals with a Verizon NW charge for which a credit is a relatively simple and effective remedy.

7. Condition 7: Commercial Agreement Availability

130 Under this condition, Verizon NW agrees to make available to comparable competing local exchange carriers the terms of its Wholesale Advantage Services Agreement for Washington for a period of two years following the merger. With the FCC ruling that incumbent local exchange companies need not provide an unbundled network element platform, MCI contracted with Verizon for comparable service on a commercial basis. This provision would allow other competitors to enter into commercial agreements with terms similar to those of MCI.

131 Public Counsel argues that this condition is meaningless, because MCI's management will lose its independence after the merger and as such any changes to their agreement would not be the result of arm's-length negotiation.

132 We find the term appropriate. It will assist in maintaining competitive equity and will help to ensure that Verizon cannot discriminate against its independent competitors.

8. Condition 8: Special Access Rates

133 This provision would have required repricing of special access service, depending on action by the FCC. The FCC has renamed this provision moot by

not reducing Verizon's interstate special access rates.[86] We will discuss special access issues below in conjunction with Public Counsel and XO proposed conditions.

B. Sufficiency of the Proposed Settlement

134 Having reviewed the proposed transaction, we find that it offers few benefits to Washington, but imposes significant harm or risks of harm. Harm will result from the reduced competition for local exchange service. Harm may also result from the reduced competition for toll services and increased concentration of the service in a single enterprise. While Verizon NW has a very high proportion of the local exchange business, the record shows that MCI was growing. That growth indicates that it had the potential to become a more significant challenger to the incumbent's market share. By the merger, Washington not only loses the existing level of competition, it loses the opportunity to benefit from ore vigorous competition in the future.

135 Additional harm may result from the allocation of merger costs among Verizon subsidiaries, and from the ability of the enterprise to pursue revenues and incur costs in ways favoring the enterprise that would not be available to stand-alone entities.

136 The Applicants cite to potential benefits from the merger, noting that the merged company will be a stronger competitor in some settings, including its ability to pursue business from the largest enterprise customers. Applicants' witnesses cite several perspectives on synergies, but state that—in the grand scale of the

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[86] We intend to more thoroughly consider special access rates and other topics related to local exchange competition in Washington in light of the FCC's *Triennial Review Remand Order (TRRO), In the Matter of Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers,* WC Docket No. 04-313, CC Docket No. 01-338, Order on Remand, FCC 04-290 (rel. Feb. 4, 2005). We have established Docket No. UT-053025 *as* a generic inquiry to analyze the impact of the *TRRO* on competition in Washington State.

merger—the synergies devolving to portions of the enterprise operating in Washington State are relatively few.

137 The stay-out provision offers some protection to Verizon's Washington customers from the burdens of merger costs, though Ms. Roth noted in her testimony that the extent is uncertain.[87]

138 The settlement conditions focus the most significant mitigation measures on relatively small groups of customers. The majority of customers who are harmed or put at risk of prospective harm by the merger would receive little benefit. The line extension provision—which we reject—focused on a dozen or fewer customers. The rate center consolidation and rate adder elimination affect a larger proportion of customers and offer community benefits, but still reach fewer than half of Verizon NW's customers and confer the largest financial benefit on a small portion of those customers. Some of the proposed conditions offer little more protection to affected persons than already exist under applicable rules and statutes. Measures benefiting customers of Verizon's and MCI's competitive subsidiaries are almost nonexistent.

139 In short, we find that the settlement as proposed fails to adequately mitigate the potential harm to customers and inadequately shares merger synergies to offset the risk of harm.

140 Consequently, we will review Public Counsel's proposed conditions and others that we consider, to determine whether they will adequately supplement the acceptable conditions of the settlement and warrant our approval of the merger.

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[87] Ms. Roth, TR 595-lines 4-25, 596 lines 1-18.

VIII. OTHER PROPOSED CONDITIONS

A. Public Counsel's Proposed Conditions

141 Public Counsel has proposed nine additional merger conditions. We have discussed some previously and now consider each to determine whether we should adopt any as proposed modifications of the settlement agreement.

1. Public Counsel Proposal 1: Stand-alone DSL

142 Public Counsel's first proposal is that Verizon be required to offer stand-alone DSL service[88] to existing and new customers in its service area. He notes that MCI is Verizon's largest competitor for local exchange service, and suggests that a viable way to mitigate the harm would be to require the provision of stand-alone DSL that would allow customers the option of VOIP service—voice over internet protocol.

143 Public Counsel argues that it is critical for the availability of VOIP and for the preservation of competition that the Commission follow the lead of the FCC and several states in requiring this provision. However, he urges us to impose a requirement longer than that of the FCC's 24-month limit, and to restrict Verizon against limiting customers to a Verizon VOIP product.

144 Commission Staff responds that the FCC decision to require stand-alone DSL renders the issue moot and, the FCC having determined that it has exclusive jurisdiction, the Commission has no authority to venture into the area.

145 Applicants state the issue more bluntly:[89]

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[88] "DSL" stands for digital subscriber line, a feature that allows existing telephone circuits to carry additional signals, including relatively high band width.
[89] Applicants brief, page 42, paragraph 97.

> 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.[90]

146 Applicants also point out that Verizon is working to provide stand-alone DSL in larger portions of its territory.

147 We agree with Public Counsel that the importance of stand-alone DSL has been recognized at both state and federal levels.

148 We agree with Public Counsel that it is important to address this issue in our Order. Verizon NW's extremely high market share of wireline customers, and the increasing barriers to CLEC entry which are exacerbated by this merger, warrant opening alternatives for competitors to provide local service to Verizon NW-territory residents.[91] We disagree, however, that it is necessary or prudent for us to exceed the parameters of the FCC requirement.[92]

149 Intermodal competition may well provide a check on future anticompetitive outcomes in the local exchange market, but for this to be a viable check in a consolidating and converging industry, consumers must have unfettered access

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[90] In support of its proposition, Applicants cite a local zoning effort to control radio frequency emissions and a decision involving state conditions on nuclear waste disposal. (Applicants' brief, page 36, footnote 173). Neither decision is, to our view, precedent for the propositions Applicants cite.

[91] Applicants reply on intermodal competition to support their perspectives on merger harm. This provision will help to ensure access that permits such competition.

[92] We acknowledge that if our jurisdiction to act independently were clear, we might take a more expansive view. The action we take is consistent with and in furtherance of Washington's telecommunications Regulatory Policy Act of 1985, RCW 80.36.300, directive to "Promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state." RCW 80.36.300(5).

to competitive VOIP services. Customers' access to competitors' VOIP over Verizon's DSL service is crucial to protecting consumer choice as intermodal competition increases. Ensuring this access is central to this Commission's obligation to support state policy to advance the efficiency of telecommunications service and to promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state.[93]

150 We adopt the terms of the FCC order FCC 05-184 on this issue as our own for purposes of this order.[94] Specifically, Verizon must deploy stand-alone Asymmetric Digital Subscriber Line (ADSL) services in its service territory as quickly as possible and at the latest, within twelve months of the merger closing date to the extent stated in the condition of the order.

151 Furthermore, we require Verizon NW to report to us on or before February 28, 2006, stating the status of its compliance with the terms of this FCC order and WUTC orders in Washington, and thereafter to file with us, at the time it files its reports to the FCC, either a copy of its FCC report, if it contains Washington-specific information, or a comparable report containing Washington-specific information.

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[93] RCW 80.36.300(1) and (5).

[94] FCC decision page 130. **ADSL Service**: 1. Within twelve months of the Merger Closing Date, Verizon will deploy and offer stand-alone ADSL within the local service areas of Verizon's incumbent local telephone companies. Stand-alone ADSL means ADSL service on ADSL-equipped lines without requiring customers to also purchase circuit switched voice grade telephone service. This service will be available both for existing Verizon voice and ADSL customers who wish to port their voice service to a VOIP provider or to another facilities-based provider such as cable or wireless, and for new customers who wish to subscribe only to Verizon's ADSL and not to its voice service. This service will remain available in a given state for two years after the "implementation date" in that state. For purposes of this condition, the "implementation date" for a state shall be the date that Verizon can offer this service on eighty percent of Verizon's ADSL-equipped lines in Verizon's local service area in that state. Within twenty days after meeting the implementation date in a state, Verizon/MCI will file a letter with the Commission certifying to that effect. In any event, this commitment will terminate no later than three years from the Merger Closing Date.

2. Public Counsel Proposal 2: VOIP E-911 Platform Deployment

152 Public Counsel proposes that Verizon be required to deploy in Washington the Voice over Internet Protocol E911 platform that it currently has deployed in the New York City area.

153 Public Counsel notes the FCC's efforts to require availability of E911 to VOIP customers, but urges that the proposed condition is needed to provide speedy implementation of a fully adequate and vibrantly competitive VOIP product.

154 Commission Staff responds that the FCC decision renders action unnecessary by this Commission, and that the FCC's declaration of preemption forecloses Commission action.

155 Applicants note the danger of exceeding the Commission's jurisdiction. They also urge that multiparty negotiations are proceeding regarding an effective platform for VOIP E911 capability, and caution against interference in a way that could impede rather than advance the common goal of effective E911 access by VOIP customers.

156 Applicants note the importance of making fully-advised decisions. We believe this matter was not adequately developed on the record. Consequently, we decline to adopt this proposed condition.

157 However, we do agree with the policy statements that underlie Public Counsel's proposal. Public safety is of the highest importance so we address this concern consistent with our record.

158 Given Verizon's high market share within its service territory in Washington, it is essential to public safety and the advancement of competition that other

providers have reasonable access to public safety infrastructure controlled by Verizon. We urge Verizon to deploy the most advanced technology available for interconnection of providers to the E911 infrastructure in Verizon NW's service areas[95] and to work closely with other affected parties to ensure that infrastructure, numbers and E911 service can be provided as quickly as practicable to all consumers in its service territory.

159 We require Verizon to report to the Commission by February 28, 2006 on its progress in working with all telecommunications service providers to provision E911 service. This report should include a listing of all requests from such providers for interconnection necessary to provide E911 service.

3. Public Counsel Proposal 3: MCI Customer Notice of Merger and Right to Choose

160 Public Counsel urges that Verizon be required to notify MCI customers that Verizon will be taking over the operations of MCI and that they have the option to choose another service provider should they prefer not to take service from Verizon.

161 Public Counsel argues that it is critical that MCI customers be made aware that, following the merger, the Company they will be doing business with is actually Verizon so that they can make an informed decision about their service. He urges that all Washington consumers, including those in Qwest service territory currently purchasing service from MCI should be notified that Verizon is acquiring MCI. He suggests that notification be accomplished through a customer billing insert, which clearly explains the facts to the consumer. In addition to the bill insert, he recommends that a message be printed directly on

[95] An E911 call is always a local call, regardless of provider. While we applaud and encourage the FCC's steps taken to close gaps in E911 access for VOIP consumers, we do not concede the FCC's claim of jurisdiction over VOIP E911 calls and need not address the jurisdictional issue here.

the customer bill that calls the customer's attention to the bill insert. For MCI customers residing in Verizon's Washington service area, he urges that the customer notice indicate to consumers their rights, including the right to switch to a provider other than Verizon.

162 Staff notes that the settlement, in Condition 6, provides for notice to customers, and reiterates its opposition to fee waivers or reimbursements. Applicants argue that the issue is moot, inasmuch as they have published notice of the merger pursuant to Order No. 6 in this docket.

163 We believe it is important to provide specific and useful information to MCI customers of their rights and opportunities following the merger. The notification of merger previously supplied by publication merely invited comment, and did not accomplish the purposes Public Counsel seeks to achieve.

164 We find that MCI's customers should be notified that the merger has occurred, that they are now being served by a Verizon subsidiary, that they have the right to move to a different provider if they wish to do so, and that some costs will be waived if they choose to do so. Verizon may satisfy this requirement by inserting the information in the customer's bill, but imposing a requirement for a direct statement on the bill is not necessary. Verizon should work with Staff and Public Counsel to reach agreement on the form and the timing of notice, as quickly as possible.

4. Public Counsel Proposal 4: Waiver of Service Establishment Charges

165 Public Counsel argues that within Verizon's Washington service area, Verizon should be required to rebate service establishment charges for current MCI subscribers who decide to take service from Verizon. Applicants oppose the

suggestion, urging that it would be inappropriate and discriminatory to require them to waive their own service initiation fees.

166 We do not believe that waiver of local service initiation charges is necessary to afford MCI customers an adequate opportunity to switch carriers. Consequently, we decline to direct Verizon to accept responsibility for those charges.

5. Public Counsel Proposal 5: Rebate of Service Establishment Charges

167 Public Counsel seeks a condition requiring Verizon to refund service initiation fees to MCI local service customers who choose to switch to a competitive local exchange carrier (i.e., not Verizon NW). Similar to Public Counsel's proposal to waive service establishment fees for customers switching to Verizon NW, we do not believe the rebate of service establishment charges is necessary to afford MCI's customers an adequate opportunity to switch carriers. Further, we are concerned that this proposal could result in Verizon bearing significant administrative costs caused by hand-processing rebate requests, could pose questions about verification, and could impose a financial responsibility on Verizon for customer behavior not a direct result of the merger.

6. Public Counsel Proposal 6: Prohibition Against Operations Circumventing Verizon Tariffs.

168 Public Counsel argues that Verizon should be prevented from operating its MCI subsidiary within Verizon's Washington service area in a manner which would allow Verizon to circumvent Verizon's Washington tariffs.

169 Public Counsel notes that Verizon has not yet determined the details of its post-merger enterprise operations, and urges that the Commission order it, in the operation of competitive telecommunications companies, not to contravene requirements imposed by law on Verizon NW. In particular, he is concerned

that MCI's CLEC subsidiary, MCImetro Access Transmission Services, be reviewed to determine whether it will retain its competitive classification.

170 Public Counsel also calls attention to provisions in the order granting competitive classification to MCI. According to the order, the Commission will automatically reconsider competitive classification if the company is acquired by a company subject to rate regulation. Here, consistent with our jurisdictional analysis above, we find that acquisition by Verizon, Inc., and operations under common control with Verizon NW call into play the provisions of the earlier order.

171 While we recognize Public Counsel's concerns, we decline to condition the merger as suggested. We believe it is premature to initiate such a proceeding in advance of Verizon's determinations regarding future structure and operations of its enterprise. We direct Verizon NW to file in this docket a summary of its plans for conducting its merged operations in Washington State within 60 days after those plans are determined but not later than January 1, 2007.

172 While we recognize Public Counsel's concerns, we believe it premature and unnecessary to condition the merger as suggested. We are sensitive to concerns that arise when a competitive affiliate of a regulated company operates in competition with the company subject to regulation. Verizon NW at present competes with three Verizon, Inc., affiliates that are classified as competitive telecommunications companies.[96] We expect to have the opportunity to examine the interplay of company operations in an appropriate proceeding—which may include, if circumstances require, a complaint proceeding.

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[96] See, *e.g.*, Finding of Fact No. 16 at paragraph 166, page 48, 11th Supplemental Order in *AT&T Communications of the Pacific Northwest, Inc., v. Verizon Northwest, Inc.*, Docket No. UT-020406 regarding the operations of Verizon NW and Verizon Long Distance.

7. Public Counsel Proposal 7: Enhanced Service Quality Reporting, and Annual Report to Customers

173 Public Counsel suggests that, as merger-related cutbacks are implemented, Verizon be required to maintain its retail service quality, adopt enhanced service quality reporting, and provide its customers an annual report of its service quality performance for a five year period.

174 Public Counsel states concerns about pressures on the merged operation to achieve savings, largely through head count reductions , and believes these measures are necessary to track Verizon NW's performance and to encourage the company to maintain an appropriate service quality level.

175 Commission Staff responds that the proposal is unnecessary because Verizon NW is performing capably at present, its management is expected to continue largely without change, and the Commission's recently revised service quality rules are adequate to address the concerns. Applicants express pride in Verizon NW's service quality performance and point to differences between their circumstances and those in prior proceedings that involved service quality concerns.

176 We find it unnecessary to accept this proposed condition, and believe our prior statement in approving conditions in the settlement agreement addresses this point.

8. Public Counsel Proposal 8: Sharing of Merger Savings

177 Public Counsel urges that Merger savings should be shared with consumers in the manner specifically described in Charles King's testimony. He recommends

that the Commission require Verizon NW to forego $1 per month of the $1.47 per month rate increase scheduled for July 1, 2007, or about $8.7 million annually.[97]

178 We reject this specific proposal as excessive and not consistent with the public interest. However, we agree that certain merger savings should be used to create a public service fund which should be drawn on to mitigate merger-related harms and to benefit Verizon and MCI customers generally. We discuss this fund and the reasons for its creation below.

9. Public Counsel Proposal No. 9: Broadband Deployment

179 Public Counsel urges that Verizon be required to deploy DSL, or other high-speed Internet access,[98] in areas of Verizon's Washington service area that are currently unserved by Verizon's DSL service. Verizon, he says, should be required to identify how, when, and where advanced broadband services will be deployed, through the filing of broadband investment and deployment reports. Verizon should refrain from red-lining the availability of these services.

180 Public Counsel points out that the Applicants cite enhanced deployment of broadband services as a benefit of the merger[99] but that the Applicants do not commit to achieving enhanced deployment.[100] Consequently, he proposes this deployment and reporting condition. He notes that many of the assets used to deploy broadband are also used in providing telecommunications services under regulation and that the Commission has the authority to order improvements in plant.[101]

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[97] King, Exh. 411, page 24, lines 3-7.
[98] The record contains references to Verizon's efforts to extend fiber to the premises ("FTTP") of its customers as an alternative method of delivering broadband signals.
[99] Public Counsel Brief, pages 50-51, citing Exh. No. 21T, p. 3, ll. 9-10 (Danner).
[100] Public Counsel brief, page 51 generally, and citations therein to the record; Brief, page 53, citing Roycroft, Exh. No. 371T-HC, p. 26.

181 Staff argues that the Commission lacks jurisdiction in this area. Applicants argue lack of jurisdiction, and also that there is no nexus between the merger and this proposal because MCI was not involved in providing broadband. Finally, Applicants argue that directives specifying a particular technology would be unwise because of the variety of technologies presently available. It would be inappropriate, they argue, to focus on an area that might become obsolete or to interfere with future plans to implement broadband widely.

182 We reject this condition. While the lack of specific information about future deployment is discouraging, it is also understandable given the nature and the status of the merger. We believe it would be premature to establish requirements or reporting requirements.

183 However, as we have noted elsewhere in this order, the speedy and universal deployment of broadband access is critical to a complete telecommunications service. Just as reliable and universal roads are highways for the transportation of people and goods, reliable and universal broadband "pipes" are highways for the transportation of communication and information. We encourage Verizon to build out its network as expeditiously as possible.

B. XO Proposed Conditions

184 XO offered the testimony of its witness, Mr. Don Wood, who was excused from cross examination, and filed a post-hearing brief. XO's concerns—securing and maintaining CLEC entry into Verizon NW territory—are very important to a future competitive marketplace for telecommunications services. We agree with XO that it is essential to address the concerns expeditiously.

185 We are not satisfied that the record in this proceeding is sufficient to make the kinds of decisions XO asks. As noted above, we have opened Docket No. UT-

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[101] RCW 80.36.260.

053025 as our follow-up to the *Triennial Review Remand Order (TRRO)* to address these issues.

1. XO Proposal No. 1: Reduce Prices for Intrastate Special Access Services to Cost-Based Levels

186 XO proposes that Verizon be required to reduce prices for intrastate special access services to cost-based levels. This proposal is similar to Public Counsel's proposed condition number eight, discussed below. We reject it for the same reasons cited there and encourage XO's participation in the TRRO docket, where we intend to address this issue.

2. XO Proposal No. 2: Recalculation of Locations where High-Capacity Loop, Dedicated Transport, and Dark Fiber UNEs Must Be Provided

187 XO proposes to recalculate locations where high capacity loop, dedicated transport, and dark fiber UNEs must be provided. We note that the FCC has included this provision in its conditions on Unbundled Network Elements in its merger order. We adopt by reference this condition.[102] We urge Verizon NW to carry out this recalculation as quickly as possible for the relevant wire centers in our state, in order for these to be reviewed by staff and other parties in the TRRO docket.

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[102] *In re Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Memorandum Opinion and Order*, FCC 184, Adopted October 31, 2005., Page 129:

> "Within 30 days after the Merger Closing Date, Verizon/MCI shall exclude fiber-based collocation arrangements established by MCI or its affiliates in identifying wire centers in which Verizon claims there is no impairment pursuant to section 51.319(a)-(e) of the Commission's rules. Verizon/MCI shall file with the Commission, within 30 days of the Merger Closing Date, revised data or lists that reflect the exclusion of MCI collocation arrangements, as required by this condition".

3. XO Proposal No. 3: Waiver of TRRO's 10 DSL Loop and Dedicated Transport Circuit Cap for Buildings and Routes

188 XO proposes that Verizon make UNEs more broadly available by waiving the FCC-imposed caps on the number of DS1 loops and DS1 transport circuits that Verizon is required to provide. MCI provides little facilities-based competition, although it provides other competitive benefits to the mid-sized market. The record is insufficient to determine, in specific locations, whether a cap of 10 is too restrictive or no cap is too permissive. We defer this issue to the TRRO docket.

4. XO Proposal No. 4: Reinitialize existing Interconnection Agreements and make current Verizon-MCI Interconnection Agreements available for adoption for 3-5 years

189 XO proposes to "reinitialize" existing interconnection agreements (that is, consider them to be renewed so their terms will extend longer and make the current Verizon-MCI interconnection agreements available for adoption for five years. This proposal relates to Public Counsel's comment to Settlement Condition 7, discussed below, and we reject it for the same reasons.

190 We intend to address this in the TRRO docket.

C. Condition Required by Commission

1. Analysis of Cost and Benefits

191 As discussed above, we agree with Staff's pre-filed analysis that the merger will provide relatively modest benefits to the two companies and virtually no social benefits. This must be weighed against the risk of significant harm to Washington's competitive environment. Both today and in the future, we conclude from the record before us the merger will reduce competition and

customer choice[103] in the areas where Verizon is the dominant provider of telecommunications services.[104]

192 Applicants argue that the transaction offers many benefits to Washington consumers.

193 First, they postulate that achieving the transaction's principal purpose—increasing Verizon's ability to compete for enterprise business—will bring improvements to the economies in which the served enterprises operate. They urge that this activity will also produce business solutions that offer revenue opportunities to Verizon while making new solutions available to mid-sized businesses. The public and consumer benefits they cite are not direct benefits, but are derived from Verizon's enhanced competitive ability resulting from the merger. These benefits arise in a setting where we identify harm resulting from that increased competitive ability, through damage to the competitive environment.

194 Next, Applicants argue that the merger will provide other benefits to consumers, and cite as an example the use of available capacity in MCI circuits as an alternative to Verizon's purchase of the service from third-party providers.[105] So stated, it appears that the benefit would be free to consumers. On closer examination, however, such a benefit may be illusory at worst or indirect at best. If the companies retain their existing structure, a typical transaction would involve an intercompany purchase, and fees previously paid to a third party

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[103] MCI has for many years been an important competitor to the incumbent local and long-distance companies operating in Washington. Roth Exh. 1T-HC, page 11, lines 2-3. Verizon's acquisition of MCI will eliminate its largest single competitor in the market for residential local exchange service. Roth Exh. 1T-HC, page 17, lines 1-6.

[104] Roth Exh. 1T-HC page 4, lines 9-12.

[105] "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." *Applicants' brief, page 39, paragraph 90.*

would be paid instead to an affiliate. If MCI's assets are transferred to Verizon NW to provide the service, it would be depreciating the assets and earning a return on its investment. It is not clear how the merger would benefit Washington consumers except indirectly through increased company competitive strength and increased profitability. Especially as to Verizon's competitive services, where prices are driven by competition, inadequate competition would permit Verizon to maintain prices and retain savings.

195 In sum, Applicants' basic position is that the transaction will cause no harm and that it would create benefits by increasing Verizon's presence in the enterprise market, allowing increased investment in MCI facilities, and providing synergies that will ultimately benefit customers and the economy. We think that this analysis is incomplete.

196 We find that there is a significant risk of prospective harm. Wile the synergies may result in cost savings to the enterprise, there is no indication that they would benefit ratepayers, except perhaps indirectly. Finally, we cannot conclude that the combined companies would operate to the benefit of Washington consumers, as Verizon has stated that it has not completed its planning for post-merger operations.[106]

197 Specifically, we find that the merger will decrease the number of suppliers in certain segments of the market, which runs counter to the public policy of promoting competition.[107] Verizon's acquisition of MCI will increase its already high market share of the business local exchange service market and will likely prolong the need to regulate Verizon's business rates.[108] Furthermore, Verizon's acquisition of MCI will increase its already high market share for special access/private line services significantly and will likely prolong the need to

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[106] Folsom, Exh 150T-HC, page 6, lines 4-5 and other citations.
[107] Roth, Exh. 101T-HC, page 13, lines 4-6; RCW 80.36.300(5).
[108] Roth, Exh. 101T-HC, page 17, lines 7-11.

regulate those rates.[109] In addition, Verizon's share of the residential long distance market will increase significantly.[110] Finally, we note the merger's adverse effect on the ability of small CLECs to negotiate and arbitrate interconnection agreements without MCI's presence, and conclude that the merger will increase barriers to entry.[111]

198 Neither Commission Staff nor the settling parties clearly link the proposed merger conditions with remedies for merger harms. As noted earlier, expanded local calling and removal of flat and measured Premium Plus Adders benefit certain local customers, and to a lesser degree, other Verizon customers.[112]

199 The proposed stay-out provision offers some protection to ratepayers from exposure to increased expenses, but it is likely that much of the costs will be capitalized and remain on the books until fully depreciated. In addition, Verizon NW could seek permission to amortize one-time extraordinary expenses associated with the merger, a remedy that the Commission has allowed in the past for unusual one-time expenses. Other merger conditions that we have approved will benefit some customers and address some potential harm from the merger.

200 On balance, we find that the likely harm from the merger will exceed the expected benefits from the conditions approved thus far. Therefore, we must provide another means of mitigating harm to ensure that the result of the merger is consistent with the public interest.

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[109] Roth, Exh. 101T-HC, page 17, lines 12-16.
[110] Roth, Exh. 101T-HC, page 17, lines 17-18.
[111] Roth, Exh. 101T-HC, page 20, lines 4-6.
[112] Roth, Exh. 101T-HC, page 25, lines 11-14.

2. Public Counsel Proposal to Share Synergies and Savings

201 Public Counsel in supporting his proposed condition No. 8 argues that the Commission has established a principle that merger savings should be shared with consumers. He cites language in the Commission's order in the *Qwest/U S WEST* proceeding:[113]

> As Public Counsel pointed out at the prehearing conference, if the merger is approved, synergies may arise that lead to cost savings and enhanced revenue. Conditions may be required to ensure any such benefits are shared in a fashion that is consistent with the public interest. The transaction should strike a balance among the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.

202 He points out that all witnesses agreed that the merger should produce synergies and cost savings that would allow for immediate ratepayer benefits. The Applicants state the merger will produce over $7 billion in merger synergies for the entire merged enterprise.[114] Public Counsel finds that such savings would be significant in the period 2007-2009, and very large for the period 2010-2014.[115] He argues that because the proposed settlement does not recognize any synergy savings, the Commission should accept the recommendations of witness Charles King, who would require the Company to forego $1 of the $1.47 approved for effect on July 1, 2007, thus limiting the increase to $0.47. The resulting savings to customers would be more than $15 million over two years.

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[113] *In Re Application of U S WEST, Inc. And QWEST COMMUNICATIONS INTERNATIONAL, INC. For An Order Disclaiming Jurisdiction, or in the Alternative, Approving the U S WEST, INC.--QWEST COMMUNICATIONS INTERNATIONAL, INC. Merger*, UT-991358, Third Supplemental Order Outlining Scope of Review, p. 5.
[114] Declaration of Stephen E. Smith, FCC WC Docket No. 05-75, p. 1, as cited by Roth, Exh. 101T-HC, page 9, lines 6-8 and Folsom, Exh. 150T-HC, page 17, lines 4-10.
[115] King, Exh. 418, October 28, 2005, Corrected.

203 Commission Staff witness Kathleen Folsom performed an analysis analogous to that of Mr. King, also based on Verizon information,[116] which shows that the merged entities would enjoy total Washington intrastate savings and synergies over the 2006-2009 period that are very similar to Mr. King's results.

204 Applicants, on the other hand, dispute both the degree of savings and the need to share savings with customers in the manner Mr. King recommends. Verizon's analysis shows a net present value of merger synergies for Washington over four years,[117] although less than one-fifth of Mr. King's and Ms. Folsom's results. The Applicants' analysis does not include the allocation to Washington intrastate operations of net present value of merger synergies over 4 years[118] from headcount reductions,[119] network synergies[120] and nonrecurring transaction costs.[121]

205 Balancing the harm likely to flow from the merger against the benefit provided by the sharing proposals advocated by Mr. King and presented in Ms. Folsom's testimony, we find that adoption of any of the three would provide an excessive benefit to Verizon NW ratepayers and we reject them.

3. Public Purpose Fund

206 Applicants and Commission Staff suggest that, if the Commission rejects the line extension proposal in Settlement Condition No. 1, a fund should be established

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[116] Folsom, Exh. 151-HC.
[117] As described by Folsom, Exh. 150T-HC, page 20, lines 10-13. Try to get the Verizon original cite.
[118] Folsom, Exh.151-HC, line 26, col. H.
[119] Folsom, Exh. 150, page 23, lines 3-16, and page 24, lines 1-4. Exhibit KMF-5HC, lines 23 and 25, cols. H-K.
[120] Folsom, Exh. 154-HC, lines 17 and 19 cols. H-K. Folsom, Exh. 150T-HC, page 24, lines 10-19 and page 25, lines 1-2, 5-13.
[121] Folsom, Exh. 154-HC, line 27, cols. Folsom, Exh. 150T-HC, page 26, lines 9-14.

with the monies that otherwise would be allocated to that project, to be used for activities to be determined by the Commission. We agree, but believe that amount is insufficient to adequately balance the anticipated harm from the merger. The proposed fund should be expanded to include the present value of a portion of the short term synergies and cost savings. Therefore, we condition our acceptance of the settlement on creation of a fund of $1,250,000, to be disbursed at the Commission's direction through orders entered no later than June 30, 2009.

207 Two primary factors influence our decision.

208 First, we think it is appropriate for ratepayers to share the net of savings and synergies above costs when necessary to mitigate both quantified and unquantified merger harm.

209 While it is true that some projected savings may be reflected in future results of operations, we believe that the merger costs would be "front-loaded" and are more likely to be reflected in results of operations if the Company files a general rate case in 2009.[122] This would not be true for anticipated synergies and savings that had been realized prior to the test year.[123] Consequently, we find it likely that early synergies and cost savings will be underrepresented in rate proceedings and that it is appropriate to capture a portion of those savings now.

210 The second factor we consider is that the conditions in the proposed settlement distribute the settlement benefits unequally among Verizon's and MCI's customers. We correct this imbalance by adopting a mitigation measure that will benefit consumers who are underrepresented in the proposed settlement.

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[122] See paragraph 7.
[123] We note that Verizon NW would have few incentives to file a rate case for the purpose of capturing savings and reducing rates.

211 In reaching this decision, we reject Staff's argument that the settlement satisfies the need to share benefits of the merger, and adequately mitigates the harm from the merger. We particularly disagree with Staff's contention that any financial consequences in a merger proceeding must be held to a "known and measurable" standard to be considered by this Commission. It is the nature of mergers that final planning cannot be accomplished pending the merger.[124] The Applicants are seeking approval of the merger, and have provided information about costs, savings, and synergies for consideration in merger approval. Their underlying information is the best information available on this record. Adopting Staff's proposed standard would prevent us from using every reasonable means to mitigate foreseeable harm.

212 We agree with Staff that the test for approval of a merger is the absence of harm, reflected in the phrase, "in the public interest." However, we believe that in this proceeding it is necessary to allocate some merger benefits to a public use in order to mitigate harm resulting from the merger.

213 Applicants argue that the merging parties are not required to pass benefits to consumers under Washington law.[125] We need not decide whether that is so where a merger causes no harm. Here we find harm, and the public interest requires mitigation beyond that proposed in the settlement agreement.

214 To calculate the appropriate benefit level, we use the approach suggested by Charles King, Public Counsel's witness. He starts from Verizon's estimated consequences of the merger, which are the best figures available on the record, and produces an analysis that accounts for costs and synergies on a system-wide basis, including an adjustment by which synergies attributable exclusively to

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[124] See, Applicants brief, page 37, footnote 179.

[125] "Washington law does not require Verizon and MCI directly to flow through monetary benefits of the transaction to Washington consumers." Applicants' brief, paragraph 89, page 39. Applicants cite no authority for this statement.

interstate operations are excluded. Ms. Folsom also produces such an analysis, beginning with the Applicants' statement of synergies attributable to Verizon, adjusted to include synergies at MCI having benefits that accrue to Verizon's intrastate operations. In other respects, her results are similar to and corroborate Mr. King's analysis.

215 Applicants object to this analysis, arguing that it is not tied specifically to the expected actual experience of Verizon Northwest. They argue that taking the derived, unallocated Washington intrastate figure shows neither what costs Verizon Northwest will incur nor what synergies or savings it will experience.

216 Approval of the merger depends on some reasonable expectations of costs savings and synergies for the Washington intrastate operations of Verizon Northwest. In advance of even an implementation plan for the merger—let alone information about actual experience—it is impossible to determine these values with any precision. What we do have on the record is the best information Verizon can supply for the Washington intrastate operations of Verizon Northwest, which was available for cross examination and for analysis by all other parties and which supports the witnesses' testimony.

217 We identified concerns above about Verizon's discretion in allocations of costs, savings and synergies; Mr. King's approach recognizes the discretion and controls for it in a neutral manner.

218 We also control for uncertainty by using only the cost and synergy information relating to 2007. Verizon NW's 2008 results will be available for use in a test year for a rate case filed in 2009 at the end of the stay-out period. We consider 2007 estimates more reliable than estimates for later years because of its nearness and the reduced likelihood that other factors, now unforeseen, will affect the results. Limiting the consideration to a portion of the stay-out period containing both costs and savings/synergies supports, in part, the value of the stay-out period by

considering merger-related costs and benefits during the period that would otherwise be unrecognized.[126]

219 We believe that our approach and the result is prudent, indeed conservative. We note that the Staff and Public Counsel direct cases recommend cost-saving and synergy benefits that are considerably higher, and encompasses more additional time. On a more complete record, that answered more of our questions, we might conclude that Public Counsel and Staff were closer to the mark. On the record we have before us, we desire to order the minimum mitigation necessary to produce a fair and just result.

220 Therefore, as noted above, we accept the Applicants' alternative proposal for funding in settlement condition No. 1, but increase the total amount to $1,250,000.

221 Our intention is to use the fund for purposes that would mitigate merger effects, improve telecommunications services, make services more readily available to the public, or for other purposes benefiting a broad range of Verizon customers. We will convene a conference to prepare an order in this docket that will identify characteristics of projects for possible funding and a simple mechanism for qualification and award. It is our intention that the funds be totally disbursed by the end of the stay-out period. Verizon shall retain custody of the funds but need not segregate them. It must make disbursements, up to the total amount, by direction of the Commission.

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[126] Other mitigating factors in the merger settlement adjustment package that we adopt include revenue reductions from rate center consolidation and toll "adder" elimination.

4. Public Comments

222 Pursuant to agreement among the parties, the Applicants published a notice to customers in several newspapers in and near Verizon NW's service territory that announced the merger and publicized the opportunity to comment.

223 Public Counsel on Dec. 20, 2005, presented late-filed Exhibit No. 503, consisting of all public comments received. He notes that eleven comments were received—four in favor, three against, and three addressing DSL availability. The Commission also received an unsolicited policy study from Prof. Richard Wagner.

224 We thank the citizens who made the effort to comment.

D. Conclusion

225 In summary, we find few benefits in this transaction for Washington State customers of any of the affected subsidiaries, but do find harm to the public interest. Verizon and MCI cite a stronger enterprise, with a heightened ability to compete. This benefit will primarily reach shareholders, and its benefit to customers is largely incidental. In Washington, Verizon NW already has an overwhelming market share for local exchange service in its service territory, and with this transaction it will effectively acquire its largest and fastest-growing competitor. The result of Verizon's heightened competitive strength will be a reduction in the potential for competition.

226 In addition, the costs of the merger will be borne in part by Washington affiliates, while it is not shown that cost savings and synergies will be tracked or passed through to ratepayers.

227 We accept some—XO and Public Counsel—proposed merger conditions and reject others. We have identified several changes that we believe are necessary to mitigate the harm of the transaction, and to mitigate the costs among groups that do not share the reduction in toll charges. One such measure is an expansion of the Applicants' suggestion to create a fund from which projects addressing diverse telecommunications needs may be funded. A second is the requirement that there be a reasonable sharing of near-term net savings and synergies as a basis for establishing its level of funding. A third is insulation of Verizon NW rate payers from any increases in debt cost that are directly attributed to the merger. With these modifications and conditions, we approve the multi-party proposed settlement.

228 The settling parties must accept the changes proposed in this Order within ten business days following entry of this order, or it becomes void and the matter will return to litigation.

229 If a settling party rejects the conditions proposed in this order, the matter will revert to litigation and a prehearing conference will be convened for the purpose of identifying remaining necessary procedural steps and setting a schedule to accomplish them.

IX. FINDINGS OF FACT

230 Having discussed above all matters material to our decision, and having stated specific findings and conclusions, the Commission now makes the following summary findings of fact. Those portions of the preceding discussion that include findings germane to the ultimate decisions of the Commission are incorporated by this reference.

231 (1) The Washington Utilities and Transportation Commission is an agency of the State of Washington, vested by statute with authority to regulate rates, rules, regulations, practices, accounts, securities, property transfers, and mergers of public service companies, including telecommunications companies.

232 (2) Intervenor Citizens Utility Alliance did not participate in this docket except to file a petition for intervention that was granted. Prior to the evidentiary hearing, Covad Communications Company asked leave to withdraw from the proceeding.

233 (3) Verizon Communications, Inc. (Verizon) is a holding company that wholly owns (among others) the following subsidiary companies: Verizon Northwest Inc. (Verizon NW), Washington State's second largest local exchange company; Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance (VLD), an interexchange carrier offering long distance services pursuant to a price list on file with the Commission; Verizon Avenue Corp., a "full service" competitive local exchange company (CLEC) that resells local and long distance services pursuant to a price list on file with the Commission; and Verizon Select Services, Inc., an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

234 (4) MCI, Inc. (MCI) is a holding company that wholly owns (among others) the following subsidiary companies: MCI Worldcom Communications, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission; MCI Worldcom Network Services, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission; MCImetro Access Transmission Services, a full service competitive local exchange company that offers local exchange services pursuant to a price list. This company serves less than

two percent of the access lines in Washington State; Teleconnect Long Distance Services and Systems d/b/a Telecom USA, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission; and TTI National, an interexchange carrier offering long distance services pursuant to a price list on file with the Commission.

235 (5) On May 25, 2005, Verizon Communications, Inc. and MCI, Inc. (The Applicants) jointly petitioned for a declaratory order from the Commission disclaiming jurisdiction over their proposed merger transaction or, in the alternative, approving the merger.

236 (6) Under the terms of the Applicants' Merger Agreement, Verizon Communications, Inc., will purchase 100% of the holding company MCI, Inc. and will survive as the parent corporation. MCI, Inc., will merge into a Verizon subsidiary called ELI Acquisition, LLC, which will be renamed "MCI, LLC." Upon completion, all of the WUTC-regulated subsidiaries of Verizon and MCI will be owned by a common parent, Verizon Communications, Inc.

237 (7) On October 21, 2005, the Applicants, Commission Staff, and Integra Telecom of Washington, Inc., filed a settlement agreement (Exhibit No. 501C) by which they proposed to resolve the issues among them, and a Narrative explaining their agreement. The remaining parties opposed the settlement agreement.

238 (8) MCImetro is a competitive local exchange company serving fewer than two per cent of the access lines in Washington State.

239 (9) The proposed merger transaction will result in harm to competition for local exchange service, business long distance service, and special access service. Costs of the transaction include legal, administrative, and other costs that will be shared by subsidiaries, including Verizon NW. Benefits

of the transaction, including cost reductions and synergies, will chiefly benefit the Verizon enterprise and its subsidiaries. Indirect benefits for customers and the public include Verizon's stronger competition for enterprise business.

240 (10) The line extension proposed as Condition 1 of the Settlement Agreement inappropriately uses a significant benefit to serve a small number of persons on a topic that may better be addressed in pending litigation.

241 (11) Conditions 2 through 7 of the Settlement Agreement will provide benefits or will mitigate harm from the merger.

242 (12) Condition 8 of the Settlement Agreement is moot because a condition precedent to its effect did not occur. The Commission will address related concerns in another docket.

243 (13) The benefits of the proposed Settlement Agreement fail to offset the prospective harm of the merger transaction. The proposed benefits in the settlement agreement fail to offset costs adequately and fail to provide benefits for adequately representative portions of Verizon NW's customers and the public. The Settlement Agreement as proposed does not fully and fairly resolve the issues pending in this proceeding, and is not in the public interest.

244 (14) Public Counsel proposed condition 1 relating to DSL availability recognizes significant public concerns about telecommunication competition. Proposed condition 3 relating to customer notice identifies an appropriate customer need.

245 (15) Public Counsel proposed conditions 2 and 4 fail to add significant protections from the harms of the proposed merger or involve administrative burdens or costs inappropriate to the purpose. Reports

from Verizon on the status of efforts to *provision* E-911 service would assist the Commission in meeting its public interest and regulatory obligations.

246 (16) Public Counsel proposed condition 8, relating to sharing of merger savings, would not produce a sharing of costs and benefits consistent with the public interest. Some sharing of savings and synergies is appropriate to mitigate harm.

247 (17) Public Counsel proposed condition 9 relating to broadband deployment reporting requirements is unnecessary and premature.

248 (18) XO proposed conditions 1, 3, and 4 address matters of concern to the Commission but lack a sufficient record to support adoption in this docket. These matters should be deferred for consideration in Docket No. UT-053025 concerning effects of the FCC's *Triennial Review Remand Order.* Consistent with XO proposed condition 2, the commission should require Verizon to recalculate and report on locations where high-capacity loops, dedicated transport, and fiber UNEs must be provided, consistent with its obligation to the FCC.

249 (19) Reports about stand-alone DSL, E-911 and VOIP, and Verizon's post-merger corporate and management structure will provide information to the Commission on matters about which it is authorized to inquire and that relate to its intrastate regulatory responsibilities.

250 (20) Creation of a public service fund as described in the text of this order will mitigate, in part, the significant risks of harm resulting from the merger and will facilitate broad participation in settlement benefits. Sharing of merger savings and synergies in the manner identified in this order will offset the significant risk of harm from the proposed transaction and provide a means of distributing the offsetting benefits among a broad cross-section of Verizon customers.

251 (21) The proposed settlement agreement, if supplemented and modified as proposed in this order, would appropriately balance the harm of the merger transaction with offsetting benefits.

X. CONCLUSIONS OF LAW

252 Having discussed above in detail all matters material to our decision, and having stated findings and conclusions, the Commission now makes the following summary conclusions of law. Those portions of the preceding detailed discussion that state conclusions pertaining to the ultimate decisions of the Commission are incorporated by this reference.

253 (1) The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of, and all parties to, this proceeding. *Title 80 RCW.*

254 (2) Intervenors Citizens Utility Alliance and Covad Communications Company should be dismissed from the proceeding. *RCW 34.05.443(3).*

255 (3) The Commission has jurisdiction to review the effects of a transaction involving involving MCImetro despite MCImetro's exemption from chapter 80.12 RCW under the provisions of RCW 80.12.045

256 (4) The Commission should revoke the waiver of Chapter 80.12 RCW contained in WAC 480-121-063 for MCI Worldcom Communications; MCI Worldcom Network Services; MCImetro Access Transmission Services; Teleconnect Long Distance Services and Systems d/b/a Telecom USA; TTI National; Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance (VLD); Verizon Avenue Corp.; and Verizon Select Services, Inc. for

purposes of this docket to allow the Commission to protect the public interest from harm resulting from a merger.

257 (5) The proposed merger transaction should be denied unless conditions are accepted that would provide benefits to offset harm resulting from the transaction and render the overall transaction in the public interest. *WAC 480-143-170.*

258 (6) Condition 1 of the proposed Settlement Agreement should be rejected. Conditions 2 through 7 should be accepted. Condition 8 is moot and is therefore rejected.

259 (7) The Settlement Agreement (Appendix A to this Order), as presented, does not fully and fairly resolve the issues pending in this proceeding and should be rejected unless the parties to the settlement accept additional conditions as set out in this order. *WAC 480-143-170*.

260 (8) Public Counsel conditions 1, 3 and 8 should be accepted, in part, as modified in the body of this order. Public Counsel proposed conditions 2, 4, 5, 6, 7, and 9 should be rejected.

261 (9) XO-proposed conditions 1, 3, and 4 should be rejected and the issues raised should be considered in Docket No. UT-053025. Condition 2 should be accepted as specified in the body of this order.

262 (10) Creation of a public purpose fund as set out in the body of this order is consistent with the public interest, mitigates the significant risk of harm from the proposed merger, and should be a condition of approval of the proposed settlement agreement and of the proposed Plan of Merger.

263 (11) The proposed Settlement Agreement should be accepted and the Plan of Merger approved, if the settling parties accept the additional and

modified conditions proposed in this order within ten business days after the date of this order. If considered modified in accordance with the terms of this order, the proposed settlement agreement will constitute a full and fair resolution of the issues presented.

264 (12)_ Parties to the Settlement Agreement should be seven business days from the date of this order to file a statement of acceptance of the modifications proposed herein. Failure of those parties to accept the proposal should result in this order becoming void.

265 (13) The Commission should retain jurisdiction over the subject matter of and the parties to this proceeding to effectuate the provisions of this Order.

266 Based on the above findings of fact and conclusions of law, the commission makes and enters the following Order:

XI. ORDER

267 (1) The Commission denies the petition of Verizon and MCI for a declaratory order on the issue of jurisdiction.

268 (2) Citizens Utility Alliance and Covad Communications Company are dismissed from the proceeding.

269 (3) The Commission revokes the waivers of Chapter 80.12 RCW granted by WAC 480-121-463 to MCI Worldcom Communications; MCI Worldcom Network Services; MCImetro Access Transmission Services; Teleconnect Long Distance Services and Systems d/b/a Telecom USA; TTI National; Bell Atlantic Communications, Inc., d/b/a Verizon Long Distance (VLD); Verizon Avenue Corp.; and Verizon Select Services, Inc.

270 (4) The Commission rejects Conditions 1 and 8 of the parties' proposed settlement agreement. Conditions 2 through 7 are accepted, as noted in the text of this order.

271 (5) The Commission accepts Public Counsel proposed condition 1, as modified, conditions 3, in part, and 8, in part, as modified. Other Public Counsel proposed conditions are rejected.

272 (6) The Commission rejects conditions 1, 3, and 4 proposed by XO Communications. Verizon must report as specified in the body of this order regarding the recalculation of certain unbundled network elements (UNEs).

273 (7) The Commission conditions acceptance of the settlement on Verizon's creation of a public purpose fund as described in the body of this order.

274 (8) The Commission approves the Joint Application of Verizon Communications, Inc., and MCI, Inc., for approval of their Plan of Merger, subject to the conditions stated in the body of this Order, including those conditions set forth in the Settlement Agreement, attached to this Order as Appendix A.

275 (9) If any party to the settlement agreement in this docket fails to accept the conditions under which the Commission accepts the proposed settlement and approves the proposed Plan of Merger, by filing with the Commission its written statement of acceptance, this order is void and of no effect and the Commission will schedule a prehearing conference to set a schedule for resuming litigation.

276 (10) The Commission retains jurisdiction over the subject matter of and the parties to this proceeding to effectuate the provisions of this Order.

DATED at Olympia, Washington, and effective this 23rd day of December, 2005

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARK H. SIDRAN, Chairman

PATRICK J. OSHIE, Commissioner

PHILIP B. JONES, Commissioner

NOTICE TO PARTIES: This is a final order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this order pursuant to RCW 34.05.470 and WAC 480-07-850, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-07-870.

[Service Date December 23, 2005]

Appendix A