BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

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| In re the Matter of the Petition of<br>MCI WORLDCOM, INC. and<br>SPRINT CORPORATION,<br><br>for an Order Disclaiming Jurisdiction, or in the Alternative, Approving the Transfer of Control of Sprint Corporation's Washington Operating Subsidiaries to MCI WORLDCOM, Inc.<br><br>In the Matter of the Petitions of<br><br>U.S. SPRINT COMMUNICATIONS COMPANY, and<br><br>MCI TELECOMMUNICATIONS CORPORATION | DOCKET NO. UT-991991<br><br>CAUSE N O. U-86-79<br><br>CAUSE NO. U-86-101<br><br>COMMISSION LEGAL MEMORANDUM ON JURISDICTIONAL ISSUES |

## I. INTRODUCTION

This memorandum is submitted on behalf of Commission Staff in opposition to WorldCom, Inc.'s and Sprint Corporation, Inc.'s (collectively, the Petitioners) request for an order of the Commission disclaiming jurisdiction over the proposed merger. The Commission should assert jurisdiction over this merger because the jurisdictional question posed here was decided by the Commission in its decision regarding jurisdiction over the proposed acquisition of PacifiCorp by Scottish Power PLC, Docket No. UE-991627, and more recently in its decision on jurisdiction in the GTE/Bell Atlantic merger proceeding, Docket No. UT-981367.

The Commission should make a finding, based on the testimony in this case that the merger will harm competition in long distance markets in Washington, and that it is therefore in the public interest to revoke its prior waiver of chapter 80.12 RCW as applied to the Petitioners.

The Commission also should dismiss the Petitioners' admonitions that – assuming unconditional approval of this merger by federal authorities – a denial of the merger would be in conflict with federal law or constitutional limitations.

## A. DESCRIPTION OF THE COMPANIES

WorldCom currently has eight wholly-owned subsidiaries registered to provide telecommunications services to the public in the state of Washington. They are: BLT Technologies, a provider of prepaid calling cards; TTI National, Inc., a reseller; Touch 1 Long Distance, Inc., a reseller; MCI WorldCom Communications, Inc., a provider of switched interexchange services; MCI WorldCom Network Services, Inc., primarily a provider of long distance to other carriers; MCI Metro Access Transmission, LLC, a provider of local exchange services; Metropolitan Fiber Systems of Seattle, Inc., a provider of intrastate interexchange, intraexchange private line, and special access services; and Teleconnect Long Distance Services and Systems Company d/b/a Telecom*USA, a reseller.

Sprint currently has five wholly-owned subsidiaries registered to provide telecommunications services to the public in the state of Washington. They are: United Telephone Company of the Northwest, an incumbent local exchange company; Sprint Communications Company, L.P., a provider of interexchange and intraexchange services; ASC Telecom, Inc., a provider of interexchange services with the authority to provide alternate

operator services and prepaid calling cards; Sprint Payphone Services, Inc., a provider of interexchange services; and US Telecom, Inc., a provider of interexchange services.

## B. DESCRIPTION OF THE TRANSACTION

Staff defers to the Petitioners' description of the transaction, except to emphasize that the result of the merger will be to consolidate under WorldCom, Inc., together with WorldCom's existing telecommunications company subsidiaries, all of Sprint's current telecommunications company subsidiaries.

# II. ARGUMENT

## A. STATE STATUTORY JURISDICTION

### 1. The Commission's decision on jurisdiction in the GTE/Bell Atlantic merger confirms the Commission's jurisdiction over this merger under the Disposition Clause of RCW 80.12.020.

The Petitioners argue that because the merger "will take place purely on the holding company level" the transaction is not within the Commission's jurisdiction under the Disposition Clause of RCW 80.12.020.[1] This identical argument was roundly rejected by the Commission in

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[1]The Disposition Clause of RCW 80.12.020 provides:

> 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 . . . .

"Public Service Company" is defined by RCW 80.12.010 to mean:

> every company now or hereafter engaged in business in this state as a public utility and subject to regulation as to rates and service by the utilities and transportation commission under the provisions of [Title 80].

its decision on jurisdiction in the GTE/Bell Atlantic merger proceeding, Docket No. UT-981367.

There, the Commission found that:

> 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.[2]

Because it is impossible to distinguish, the Joint Petitioners simply state their disagreement with this direct Commission precedent confirming the Commission's statutory jurisdiction over this merger under the Disposition Clause of RCW 80.12.020. Petitioners' Brief at p. 13, l. 5.

Adhering to the *GTE/Bell Atlantic* precedent, the Commission should assert jurisdiction over the proposed merger of WorldCom and Sprint.

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[2]*In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for an Order Disclaiming Jurisdiction or, in the Alternative, Approving the GTE Corporation-Bell Atlantic Corporation Merger,* Fourth Supp. Order Approving and Adopting Settlement Agreement, Granting Application, Subject to Conditions, at 16-17, Docket No. UT-981367 (1999).

2. The Commission should acknowledge its jurisdiction over the proposed merger under the Consolidation Clause of RCW 80.12.020 and the Acquisition Clause of RCW 80.12.040, as well.

The Commission first asserted its jurisdiction over mergers and acquisitions that are accomplished at the holding company level of Washington utility companies in its decision on jurisdiction in the proceeding to review Scottish Power's acquisition of PacifiCorp.[3]

Because the merger at issue resulted in the transfer of control of a single Washington public service company to an entity with no existing presence as a public utility providing service in Washington, the Commission in *PacifiCorp/Scottish Power* centered its analysis on the Disposition Clause of RCW 80.12.020. *PacifiCorp/Scottish Power* at 9. Likewise, in the GTE/Bell Atlantic merger proceeding, the Commission chose to analyze the question of its jurisdiction solely on the Disposition Clause of RCW 80.12.020. *GTE/Bell Atlantic* at 9. The Commission did not reach the question of its jurisdiction under the Consolidation Clause of RCW 80.12.020 or under the Acquisition Clause of RCW 80.12.040. *Id*.[4]

The merger of WorldCom and Sprint is even more emphatically within the Commission's statutory jurisdiction than was the Scottish Power/PacifiCorp merger. The reason is that, of the

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[3]*In the Matter of the Application of PacifiCorp and Scottish Power PLC for an Order (1) Disclaiming Jurisdiction or, in the Alternative, Authorizing the Acquisition of Control of PacifiCorp by Scottish Power and (2) Affirming Compliance with RCW 80.08.040 for PacifiCorp's Issuance of Stock in Connection with the Transaction,* Second Supp. Order: Commission Decision and Order Regarding Jurisdiction, Docket No. UE-981627 (1999).

[4]The Commission's reasoning, however, clearly indicates those provisions also would have applied to the GTE/Bell Atlantic merger and also should be asserted as a basis for jurisdiction over this proposed merger. That is because, as in the GTE/Bell Atlantic merger, these merging companies, through their operating subsidiaries, are both engaged in business in Washington as public utilities, *GTE/Bell Atlantic,* Fourth Supp. Order at 6, and are therefore "public service companies" within the meaning of the relevant statutes.

three separate statutory grounds for Commission jurisdiction over mergers of utility companies that the Joint Petitioners identify (citing to the Commission's order in PacifiCorp/Scottish Power), <u>all three</u> squarely apply.

The Consolidation Clause of RCW 80.12.020 states:

> no public service company shall <u>by any means whatsoever, directly or indirectly</u>, 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[.]

(Emphasis added). RCW 80.12.030 says any such sale or other disposition made without the Commission's authorization is void.

The Acquisition Clause of RCW 80.12.040 provides:

> No public service company shall, <u>directly or indirectly</u>, 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. *** Any contract by any public service company for the purchase, acquisition, assignment or transfer to it of any of the stocks or other securities of any other public service company, directly or indirectly, without the approval of the commission shall be void and of no effect.

The "directly or indirectly" language (underlined in the block quotes above) in both the Consolidation and Acquisition clauses evidences a legislative intent to sweep aside irrelevant issues of corporate form and to prevent utility companies who sell services to Washington consumers from evading the Commission's jurisdiction with devices like the holding company/operating company form of organization.

Even setting aside the "piercing the veil" analysis announced in *GTE/Bell Atlantic*, this merger is jurisdictional because it involves the indirect acquisition of one public service company by another public service company, as well as the indirect consolidation of public service

companies. As such, the Commission should assert these additional bases of authority for its review of this proposed merger.

3. Holding companies and their wholly-owned operating company subsidiaries should be deemed to comprise a single "company" within the plain meaning of RCW 80.12.010 (defining "public service company").

The Joint Petitioners' argument turns, in large part, on the definition of "public service company" as the term is used in the statutory clauses discussed above. The legislature defined public service company in RCW 80.12.010 to mean "every company now or hereafter engaged in business in this state as a public utility and subject to regulation as to rates and service by the utilities and transportation commission under the provisions of [Title 80]." To get to their contention that the proposed transaction is beyond the Commission's jurisdiction because it is "purely at the holding company level," the Petitioners are apparently equating "company," as used in the foregoing definition, with a strict definition of "corporation." This approach is inconsistent with the rule that, absent a statutory definition, words are given common law or ordinary meaning. *State v.Chester*, 133 Wn.2d 15, 22, 940 P.2d 1374 (1997).

Petitioners emphasize that "[f]ollowing the merger, the same public service company subsidiaries of the Joint Petitioners will serve the public under their current authorizations." Petitioners' Brief at 8. While this may be true, the statement obscures the practical reality that the Sprint Corporation holding company, together with its various operating subsidiaries, constitutes a single "company" within the ordinary meaning of that term. *See GTE/Bell Atlantic* Order at 16. Moreover, following the proposed merger, all the Sprint and WorldCom affiliates that provide regulated services in Washington will comprise a single "company."

On cross examination, Mr. Kapka, Sprint's Director of Regulatory Policy/Coordination, conceded:

> Yes, I believe if the companies combine, they will be one company, and they will not lose customers to each other by definition.

Tr. 282 at ll. 23-25. Additionally, while making an argument that the net effect of the merger on competition in long distance markets would not be as great as suggested by Staff, Mr. Kapka of Sprint nonetheless conceded that Sprint would "disappear" as a result of this merger. Tr. 343 at l. 19. *See also*, Tr. 362 at l. 15 (referring to the increased market share of the "combined company" in response to questioning from Public Counsel).

Similarly, Ms. McMahon, WorldCom's Vice President of Consumer Affairs and Quality had the following exchange with Public Counsel:

> Q. Well, would you agree with me – let's make a finer point of it, then – that if the merger is consummated, Sprint would not be an independent entity, separate from WorldCom, offering long distance services?
>
> A. That's a correct statement.

Tr. 608 at ll. 17-22. In short, the testimony of the Petitioners' officer/witnesses about the practical reality of the merger belie their legal arguments about corporate form. The witnesses' testimony also correctly portrays the ordinary meaning of the term "company."

4. <u>The Commission should look to antitrust law to inform its definition of "company" in RCW 80.12.010 (defining public service company) and be wary of the pitfalls of a definition that is inconsistent with the antitrust treatment of parent corporations and their wholly-owned subsidiaries.</u>

Antitrust law does not acknowledge the separate identity of a parent corporation and its wholly-owned subsidiaries urged by Petitioners. *Copperweld Corp. v. Independence Tube Corp.*,

467 U.S. 752, 771, 104 S.Ct. 2731, 81 L.Ed. 628 (1984). This is important for two reasons – one of them bearing on policy, and the other on how this Commission should properly interpret the word "company" in RCW 80.12.010 (defining "public service company").

The policy implication is that, whether WorldCom ever chose to combine the Sprint and MCI long distance operating subsidiaries is of no consequence to the effect of the proposed merger on competition in long distance markets. Antitrust law regards an operating subsidiary and its holding company parent as a single enterprise that, by definition, cannot be liable for conspiring with itself to allocate markets and set prices.[5]

The implication for the Commission's interpretation of the word "company" in RCW 80.12.010 (defining "public service company") is that the Supreme Court's reasoning for its interpretation of Section 1 of the Sherman Antitrust Act[6] should apply with equal force to a proper interpretation of the Commission's statutes as they bear on the regulation of "companies."

> Antitrust liability should not depend on whether a corporate subunit is organized as an unincorporated division or a wholly owned subsidiary. A corporation has complete power to maintain a wholly owned subsidiary in either form. The economic, legal, or other considerations that lead corporate management to choose one structure over the other are not relevant to whether the enterprise's conduct seriously threatens competition.

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[5] As even the dissent in *Copperweld* stated: "It is safe to assume that corporate affiliates do not vigorously compete with one another." *Id.* at 778 (Stevens, J. dissenting).

[6] Section 1 of the Sherman Act, 15 U.S.C. 1, provides in pertinent part:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is declared to be illegal. Every person who shall make any contract or engage in any combination or conspiracy hereby declared illegal shall be deemed guilty of a felony.

> Rather, a corporation may adopt the subsidiary form of organization for valid management and other related purposes. Separate incorporation may improve management, avoid special tax problems arising from multistate operations, or serve other legitimate interests. . . . Because there is nothing inherently anticompetitive about a corporation's decision to create a subsidiary, the intra-enterprise conspiracy doctrine [being overruled by the Court] "impose[s] grave legal consequences upon organizational *distinctions that are of de minimus meaning and effect*."

(Citations omitted, emphasis added.) *Id*. at 772-773. Just as the Court in *Copperweld* "pierced the corporate veil" to recognize parents and subsidiaries as a single enterprise within the meaning of Section 1 of the Sherman Act – thereby eliminating liability for conspiring to fix prices and allocate markets between entities within the same corporate family – this Commission should likewise ignore irrelevant distinctions within the same corporate enterprise and reaffirm that the definition of "company" in RCW 80.12.010 (defining "public service company") includes not only the subsidiary operating company but also the parent.

## B. REVOCATION OF THE COMMISSION'S WAIVER OF CHAPTER 80.12 RCW

### 1. The Petitioners posit a false standard for the Commission's revocation of its waiver of chapter 80.12 RCW as applied to the Petitioners. The Commission may require compliance with chapter 80.12 RCW if there is evidence that the effect of not applying those regulatory requirements would be to reduce competition in the market.

Contrary to Petitioners' characterization[7] of the competitive classification process set up by RCW 80.36.320, competitive classification does not result in a waiver of the Commission's *jurisdiction* over competitively classified telecommunications companies. Rather, it merely allows the Commission to relieve jurisdictional companies (on a revocable basis) of the need to

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[7]Petitioners' Brief at 2.

comply with statutory requirements that the Commission deems unnecessary for that company.

RCW 80.36.320 provides in part:

> Competitive telecommunications companies shall be subject to minimal regulation. Minimal regulation means that competitive telecommunications companies may file, instead of tariffs, price lists that shall be effective after ten days' notice to the commission and customers. The commission shall prescribe the form of notice. The commission may also waive other regulatory requirements under this title for competitive telecommunications companies when it determines that competition will serve the same purposes as public interest regulation. The commission may waive different regulatory requirements for different companies if such different treatment is in the public interest.

*Id.* at (2). The process envisioned by the statute is a very flexible one that allows for differing treatment among carriers.

The Petitioners' predecessors were granted competitive classification in the market for interexchange telecommunications services (switched and private line)[8] in September of 1986, while their competitor AT&T received its competitive classification in that market in June of the following year.[9] AT&T, as the then greatly dominant interexchange carrier in terms of market share, *AT&T* at 33-34, was relieved of fewer regulatory requirements than were either MCI or Sprint the previous year. *Id.* at 37. Notably, AT&T was *not* relieved of compliance with the transfer of property statutes, chapter 80.12 RCW,[10] at issue here. *Id.* The Commission also

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[8]*In the matter of the Petition of: U.S. Sprint Communications Co., MCI Telecommunications Corp., For Classification as Competitive Telecommunications Companies,* Commission Order Granting Petititions in Part, Cause Nos. U-86-79, U-86-101 (Sept. 1986).

[9]*In the Matter of the Petition of AT&T Comm. of the Pac. NW, Inc., for Classification as a Competitive Telecom. Co.*, Fourth Supplemental Order, Commission Order Granting Petition with Conditions and Granting Waivers in Part, Cause No. U-86-113 (June 1987).

[10]"Transfers of property" is an exceedingly broad category — a transfer of control of the whole company is the most sweeping and significant type — less sweeping types include sales of

imposed significant conditions on AT&T because of its market power which it did not impose on either MCI or Sprint. *Id.* at 33-34.

The legislature specifically provided for the easy revocation of previously granted waivers of regulatory requirements. RCW 80.36.320(4) states:

> The commission may revoke any waivers it grants and may reclassify any competitive telecommunications company if the revocation or reclassification would protect the public interest.

The statute provides a "public interest" standard of decision-making by the Commission. There is nothing to indicate that the Commission needs to make a finding that competition is no longer as effective as it was at the time the waiver was granted. Petitioners' Brief at 18. Even the basis for granting a company competitive classification is not so narrowly confined:

> In determining whether a company is competitive, factors the commission shall consider include but are not limited to:
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> (a) The number and sizes of alternative providers of service;
> (b) The extent to which services are available from alternative providers in the relevant market;
> (c) The ability of alternative providers to make functionally equivalent or substitute services readily available at competitive rates, terms, and conditions; and
> (d) Other indicators of market power which may include market share, growth in market share, ease of entry, and the affiliation of providers of services.

(Emphasis added.) RCW 80.36.320(1). By their own terms, these are not exclusive considerations. Moreover, they look both to present market conditions and to indicators of future conditions, such as ease of entry of new competitors.

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any used and useful asset. *See* chapter 480-143 WAC.

There is no basis at all for the Petitioners' assertion that the record must contain evidence that competition in the relevant market has declined *without regard to expected consequences of the proposed merger*. *See* Petitioner's Brief at 18-19. No such restraint on the Commission's authority to prevent a back-slide in the hard-won gains in competition in long distance market is apparent from the statute.

On the contrary, one of the policies that must inform the public interest standard for revoking the waiver of particular statutes is the policy of "[p]romot[ing] diversity in the supply of telecommunications services and products in telecommunications market throughout the state." RCW 80.36.300(5) (enacted in Laws of 1985, chapter 450, in the same piece of legislation as the competitive classification statute – RCW 80.36.320). Surely one of the ways to facilitate the proliferation and diversity of competitive telecommunications providers is to prevent or place mitigating conditions on the consolidation of competing firms when there is evidence that the result of a such consolidation would be competitively harmful backsliding in the diversity of suppliers and the vigor of competition.

Another policy advanced by the Commission's statutes is that of "[p]ermit[ting] flexible regulation of competitive telecommunications companies and services." RCW 80.36.300(5) (also enacted in the same legislation as the competitive classification statute). If this Commission were to recognize the constrained standard for revoking a waiver of a particular statute that is urged by Petitioners, the Commission would concomitantly have to become much more cautious in granting such waivers in the first place. This would be inconsistent with the

policy of regulatory flexibility. An “easy-in, easy-out” approach is more consistent with the Commission’s mandate.

The Commission should reimpose the Disposition, Merger or Consolidation, and Acquisition Clauses of chapter 80.12 RCW for the limited purpose of reviewing this proposed merger. The evidence for concluding that such a revocation of its previous waiver is in the public interest is the same evidence that Staff and SBC have offered through Drs. Blackmon and Hausman (which will be summarized in the brief on the merits) to show that the merger, if approved as proposed, would have anti-competitive consequences in Washington’s long distance telephone markets.

## C. FEDERAL PREEMPTION AND “DORMANT” COMMERCE CLAUSE ANALYSIS

### 1. Petitioners argument that a denial of the merger will have the effect of preventing the merged company from offering interstate long distance service is false and is not supported by evidence in the record.

The linchpin of the Joint Petitioners’ federal law arguments is that the Commission’s disapproval of this transaction (apparently assuming that the merger will be approved by federal officials without any conditions such as the divestiture of Sprint’s long distance assets) would effectively prohibit the merged company from offering presubscribed interstate service in Washington. Petitioners’ Brief at 21, ll. 18-23. The Petitioners also state that “[r]ejection of the merger, or requiring divestiture, would clearly have the effect of prohibiting the merged entity from offering competitive service in Washington.” Petitioners’ Brief at 28, ll. 8-10. The Petitioners have offered no testimony through their own witnesses on this point, and the

testimony from Dr. Blackmon that they cite in support of this conclusion does not, in fact, support their assertion:

> Q. And I believe you agreed at the deposition that the practical effect of -- I guess the choice that the petitioners would face if the merger were denied and they wanted to proceed would either be to -- assuming they didn't want to violate the order, that they would either have to stop serving intrastate customers, so they'd no longer be acting within the jurisdiction of this Commission, or, hypothetically, they could -- which means that they would have two options.
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> Hypothetically, they would either have to have their customers PICed to their service, but block intrastate calls, or, in the alternative, they would not have any customers PICed to their service, and they would have to try to market intrastate services only by means of dial-around codes; is that correct?
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> A. Are you asking me is it correct that that's what we discussed at the deposition?
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> Q. Yes.
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> A. Okay. That's not correct, because it's not complete. I don't think that you've fully stated the hypothetical under which you asked me that set of questions, because what we first went through was the fact that Staff is not recommending that the merger be denied and case closed, that's it, go away. We're recommending that the Commission determine that this merger, as proposed, is not in the public interest, and that the parties then come back with some new proposal.
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> You then said, Okay, well, hypothetically, let's assume that we go through that and we still don't get anything and, hypothetically, the DOJ actually approves this thing, then what happens. And I feel like those hypotheticals were not clearly stated enough in your question. Having said that, we did talk about that possibility. One thing that I think we didn't cover sufficiently there was the fact that the way the PICs are done intraLATA versus interLATA is within our control. And if we had a major carrier who managed to merge in this way, but also exited the intrastate market, we could look at having our two PICs be one in-state and one out-of-state, so that we could accommodate that merger and still have a company like WorldCom providing interstate service, even if it weren't able to provide intrastate.

Q. Do you know if local exchange companies have the capability within their switches to accomplish another set of two-PIC options?

A. I think that the -- I'm not talking about a third PIC; I'm talking about redefining the two PICs that exist, and I'm not aware of any technical impediment to that. They're not programmed to do it today.

Tr. Excerpt at 59-61. As Dr. Blackmon stated, Staff is advocating for a finding that this merger, as proposed, is not in the public interest. Staff has not presumed to suggest how a differently structured merger of the petitioning companies might be advanced that would still be beneficial to the Petitioners, but would also allay the long distance market concentration concerns that led Staff to oppose the merger as proposed.

Had the Petitioners offered a witness of their own on this essentially factual argument – which is largely couched in the Petitioners' Brief as legal argument – Staff would have had an opportunity to cross-examine on this point. The assertions are, in fact, wrong and Staff offers the attached declaration of Glenn Blackmon to refute the factual assertions that are couched in the Petitioners' Brief as legal argument.

WorldCom could, in a "remedy phase" of this proceeding, develop a restructured transaction or conditions that would protect its ability to offer interstate service. As stated above, Staff is not recommending that the WUTC simply deny the merger application and close the case. Rather, Staff recommends that the WUTC issue a finding that the merger, as proposed, is not in the public interest. The Petitioners could then restructure the proposed transaction or propose conditions to mitigate the harm to the public interest. The Petitioners could incorporate into such a proposal measures they believe necessary to continue offering interstate service. Blackmon Declaration at ¶ 6.

WorldCom could petition the WUTC for a change in the two-PIC ("primary interexchange carrier") system by which local exchange companies provide 1-plus access to customers. Currently, the two PICs are used to select carriers for interLATA and intraLATA calls. Blackmon Declaration at ¶ 7. WorldCom could ask that these PICs be realigned, so that one PIC is exclusively for interstate calls. WorldCom also could ask that the WUTC create an additional PIC to accomodate whatever restrictions on intrastate service it might face. Blackmon Declaration at ¶ 7. WorldCom could contract with another carrier authorized to provide intrastate service. Customers would then choose, for their interLATA PIC, a combination of WorldCom for interstate, interLATA calls and the partner carrier for intrastate, interLATA calls. Blackmon Declaration at ¶ 8. WorldCom could provide, on a wholesale or resale basis, its interstate long-distance services to one or more carriers that have legal authority to provide intrastate services in the state of Washington. Those carriers would be the customer's PIC for interLATA service and would, for interstate, interLATA calls, resell WorldCom's service. Blackmon Declaration at ¶ 9.

While the Petitioners' federal arguments (preemption and Commerce Clause) are premised on incorrect assertions that are outside the record and purely speculative, those legal arguments may nonetheless be dismissed even assuming, arguendo, that the facts on which they are based were correct.

2. Section 253 of the Telecommunications Act of 1996 does not preempt State commission review or denial of mergers affecting State jurisdictional telecommunications services. The intent of Section 253 is to promote the proliferation of competition - not to clear the way for market incumbents to consolidate their intrastate operations absent State review.

The Petitioners argue that in Section 253 of the Telecommunications Act of 1996, 47 U.S.C. 253, Congress has expressly preempted the Commission's authority to deny this merger or to condition it on divestitures of Washington jurisdictional operations of one or the other merging company.

The touchstone of preemption analysis is congressional intent. *Committee of Dental Amalgam Mfrs. and Distribs. v. Stratton*, 92 F.3d 807, 811 (9th Cir. 1996), cert. denied, 519 U.S. 1084, 117 S.Ct. 754, 136 L.Ed.2d 690 (1997). The Supreme Court has stated "We assume that the legislative purpose is expressed by the ordinary meaning of the words used." *United States v. James*, 478 U.S. 597, 604, 92 L.Ed.2d 483, 106 S.Ct. 3116 (1986). The Court has "repeatedly recognized that when the terms of a statute are unambiguous, judicial inquiry is complete, except in rare and exceptional circumstances." *Id.* at 606. In the absence of a clearly expressed legislative intention to the contrary, the language of the statute itself must ordinarily be regarded as conclusive. *Id.*

With Section 253 of the Telecommunications Act of 1996 (the Act), Congress preempted – in those states where they existed – laws that functioned to protect regulated local telephone service providers from competition. The intent was to remove regulatory barriers that prevented new carriers from entering a particular market in competition with the regulated local

incumbent.[11] Interestingly, the Washington Supreme Court already had found in *In Re Electric Lightwave, Inc.*, 123 Wn.2d 530, 869 P.2d 1045 (1994), that no such de jure restriction on competitive entry had ever existed in Washington, though for years it did on a de facto basis.

Section 253 provides:

> Sec. 253. REMOVAL OF BARRIERS TO ENTRY
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> (a) IN GENERAL.–No State or local statute or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.
>
> (b) STATE REGULATORY AUTHORITY–Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254 of this title, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.
>
> (c) STATE AND LOCAL GOVERNMENT AUTHORITY–Nothing in this section affects the authority of a State or local government to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of public rights-of-way on a nondiscriminatory basis, if the compensation required is publicly disclosed by such government.
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> (d) PREEMPTION–If, after notice and an opportunity for public comment, the Commission determines that a State or local government has permitted or imposed any statute, regulation, or legal requirement that violates subsection (a) or (b) of this section, the Commission shall preempt the enforcement of such statute, regulation, or legal requirement to the extent necessary to correct such violation or inconsistency.
>
> (e) COMMERCIAL MOBILE SERVICE PROVIDERS–Nothing in this section shall affect the application of section 332(c)(3) of this title to commercial mobile service providers.
>
> (f) RURAL MARKETS–It shall not be a violation of this section for a State to require a telecommunications carrier that seeks to provide telephone exchange service or exchange access in a service area served by a rural telephone company to meet the requirements in section 214(e)(1) of this title for designation as an eligible telecommunications carrier for that area before being permitted to

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[11]"Congress sought to foster immediate competition by stripping away many of the legal and economic impediments to entry into the local telephone markets." AT&T Commun. of the Southwest v. City of Dallas, 8 F.Supp.2d 582, 586 (N.D. Tex. 1998);

> provide such service. This subsection shall not apply - (1) to a service area served by a rural telephone company that has obtained an exemption, suspension, or modification of section 251(c)(4) of this title that effectively prevents a competitorfrom meeting the requirements of section 214(e)(1) of this title; and (2) to a provider of commercial mobile services.

The first thing one should note in reading section (b) of Section 253 is that the "reserved powers" of the States are exceedingly broad. Despite the Petitioners' references to parts of the Congressional Record in which they ask the Commission to read negative inferences into statements that the States should have authority to do one thing or another, there really is no reason to look further than the plain meaning of the all encompassing phrase "protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers." To suggest this is an enumeration of circumscribed "safe harbors"[12] or "carve outs" for State regulation is patently incorrect.[13]

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[12]Counsel for Staff was unable to locate any court decision using this term in connection with a federal preemption analysis based on Section 253 of the Act.

[13]A survey of constitutional case law decisions bears out that this phrase is no more confined than the entire "police power" that governmental bodies may lawfully exercise even in the absence of any preemption in our federal constitutional system, subject only to Constitutional protections of individual rights, such as the Contract Clause, the Right to Just Compensation, and the First Amendment. See, e.g., *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 213, 114 S.Ct. 186, 129 L.Ed.2d 157 (1994) (Commerce Clause does not preclude "police power directed to the control of local conditions and exerted in the interest of the welfare of the citizens."); *Keystone Coal Assoc. v. DeBenedictus,* 480 U.S. 470, 503, 107 S.Ct. 1232, 94 L.Ed.2d 472 (1987) (police power of states, which is paramount to any rights under contracts between individuals consists of protecting the "lives, health, morals, comfort and general welfare of the people . . . "); *Employment Division v. Smith,* 494 U.S. 872, 108 L.Ed.2d 876, 110 S.Ct. 1595 (1990) (activities of individuals, even when religiously based, are subject to police power of states "to promote the health, safety, and general welfare."); *Penn Central Transp. Co. v. New York City,* 438 U.S. 104, 148, 57 L.Ed.2d 631, 98 S.Ct. 2646 (1978) ("police power embraces regulations designed to promote public convenience or the general welfare and not merely those in the interest of public health, safety and morals" in the context of regulatory takings).

The Petitioners also exaggerate the extent of the preemptive overlay established by Section 253, from which they claim the States have only limited "carve outs" or "safe harbors" of regulatory authority. The section, after all, is titled "Removal of Barriers to Entry [emphasis added]." The Senate Conference Report, 104th Cong., 2nd Sess. 1996, S. Conf. Rep. No. 230, 1996 WL 54191 (Leg. Hist.) clarifies that the focus is indeed barriers to entry – not regulation in general.

While it is correct that the Act has effected broad change in the regulation of telephone companies, it is an incorrect and unsupported reading of Section 253 to say that Congress intended to wipe away all state commission authority with the exception of certain "safe harbors" such as making sure 911 service is provided and policing only the most egregious telco practices, like slamming. *See* Petitioners' Brief at 28-29. In *Gregory v. Ashcroft*, 501 U.S. 452, 111 S.Ct. 2395, 115 L.Ed.2d 410 (1991), the Court held that if Congress intends to preempt a power traditionally exercised by a state or local government, "it must make its intention to do so 'unmistakably clear in the language of the statute.'" The Federal District Court for Oregon cited to this principal in rejecting AT&T's similar Telecommunications Act preemption arguments and upholding the City of Portland's requirement that TCI/AT&T open its cable facilities in Portland for use by competing internet service providers as a condition of the City's approval of the merger of TCI and AT&T. *AT&T Corp. v. City of Portland*, 43 F.Supp.2d 1146, 1152 (June 1999).

There is no precedent for such a sweeping interpretation of the preemptive effect of Section 253 as applied to state public utility commissions. The cases cited by Petitioners at

pages 30 and 31 of their Brief all concern attempts by cities, not state commissions, to impose entry barriers on telecommunications carriers beyond the right-of-way provision reserved to local governments by part (c) of Section 253.

The fundamental problem with the Petitioners' preemption argument is that the Petitioners are not seeking permission to enter either the local or long distance markets. They are already there. Instead, they are asking permission to reduce by one the number of competitors in local and long distance markets by combining two very strong contenders in both markets. An order denying a merger of two entities already in the market can hardly be construed as a barrier to entry.

A federal district court considering a preemption argument under Section 253 recognized this same basic logical defect in the argument of the market incumbents who there argued that a government action toward them was preempted by the entry barrier statute:

> [T]he ordinances in question could not have acted as a barrier to entry in violation of § 253 because [the defendant companies] were already in the market providing services.
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> * * *
>
> [The defendant companies] are enlisting this Court's powers to remove a barrier that does not exist. Both were already in the telephone market and providing their services at the time the [Act] was enacted. Thus, § 253 does not preempt either ordinance.

*City of Dallas v. Metro. Fiber Systems of Dallas, Brooks Fiber Communications of Texas*, 2000 WL 198104 (N.D. Tex. Feb. 17, 2000).

Moreover, the Petitioners argument is at odds with the policies behind the Act on a more general level. As Dr. Blackmon stated in his direct testimony:

> The fundamental point of [the Telecommunications Act of 1996] was that competition should increase in both the local market and the long-distance market. Local competition would increase because legal and operational barriers to competitive entry would be eliminated. Long-distance competition would increase because the Bell operating companies would, after opening their local markets, be allowed into the long-distance business. If U S WEST simply substitutes for Sprint, consumers will get, at best, the same level of long-distance competition as they could have expected in the absence of the Telecom Act, when they had every reason to believe that the act would provide them with increased competition.

Ex. T-246 at 24, ll. 6-16.

G. The "dormant" Commerce Clause of the U.S. Constitution does not prevent the Commission from reviewing–and potentially rejecting—mergers of telecommunications companies that sell interexchange services in Washington. The statutes providing for review of such mergers are not trade-protectionist legislation designed to favor in-state firms over out-of-state firms. Moreover, the State's legitimate goal of preventing anticompetitive concentration of in-state long distance markets far outweighs any incidental burdens on interstate long distance.

Petitioners' argument is that because it is not currently possible for consumers to pre-subscribe to separate in-state and out-of-state long distance providers, the effect of a denial of this merger by the Commission would be to preclude the Petitioners from offering not only intrastate, but also interstate long distance. Petitioner's Brief at 22. As stated earlier, this argument is premised on false assumptions. However, even if those assumptions were accurate, Petitioners' arguments under the Commerce Clause of the U.S. Constitution still fall short.

The Supreme Court has distinguished between two types of state regulations burdening interstate commerce: (1) those that directly burden interstate commerce or that discriminate against out-of-state interests, and (2) those that burden interstate transactions only incidentally. Regulations that fall in the first category are generally struck down unless the state can demonstrate that a legitimate local interest unrelated to economic protection is served by the

regulation and no less discriminatory alternative exists. *Kleenwell Biohazard Waste and General Ecology Consultants, Inc. v. Nelson*, 48 F.3d 391, 395 (9th Cir. 1995).

The Petitioners' argument that it is unconstitutional, under the analysis in the first category above, for the Commission to exercise its authority under chapter 80.12 RCW to review and potentially reject mergers of jurisdictional companies in a way that would impact interstate commerce is wholly unfounded and misplaced. Petitioners take the term "in-state interests" out of its proper context at page 24 of their Brief to suggest that it is somehow unconstitutional for a State to pursue policies that advance the welfare of its citizens in a way that impacts interstate commerce. As the Supreme Court has explained:

> One of the commonest forms of state action is the exercise of police power directed to the control of local conditions and exerted in the interest of the welfare of the state's citizens. Every state police statute necessarily will affect interstate commerce in some degree, but such a statute does not run counter to the grant of Congressional power merely because it incidentally or indirectly involves or burdens interstate commerce. These principals have guided judicial decision for more than a century.

(citations omitted) *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 213, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994).

In fact, the evil that the "negative" aspect of the Commerce Clause prohibits is "economic protectionism – that is, regulatory measures that designed are to benefit in-state economic interests by burdening out-of-state competitors." *Id.* at 192.

> The paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State. * * * It violates the principal of a unitary national economy by handicapping out-of-state competitors, thus artificially encouraging in-

> state production even when the same goods could be produced at lower cost in other States.

*Id.* at 193. The Petitioners cannot seriously advance the argument that this Commission's refusal to accept their proposed merger, on exactly the terms presented, would discriminate against them (presumably as an "out-of-state" economic interest) in favor of some (unnamed) Washington telecommunications company. Instead, the Petitioners obscure the importance of a finding of <u>discrimination</u> within the Commerce Clause case law.

As the Ninth Circuit Court of Appeals said in upholding this Commission's certificate of public use and necessity statute against a Commerce Clause challenge by an interstate waste tranporter:

> This regulation suffers from none of the infirmities that plagued the regulations and statutes invalidated under the [first category] of cases. The regulation does not discriminate against out-of-state interests; in-state and out-of-state firms may both obtain certificates under the regulations.

*Kleenwell* at 398. Similarly, the Disposition, Consolidation, and Acquisition Clauses of chapter 80.12 RCW are in no way designed for the protection of in-state commercial interests against their out-of-state competitors. Rather, they are designed for the constitutionally permissible purpose of protecting the welfare of Washington consumers. The welfare interests of the consumers of a particular State should not be confused with the economic interests of in-state commercial interests that are favored by true "economic protectionist" legislation.

The Petitioners also can scarcely meet their burden under the second category by showing that "the burden the statute imposes on interstate commerce is clearly excessive in relation to the putative local benefits." *Id.* at 399. Preservation of competition in intrastate markets is, without

doubt, a legitimate State regulatory interest. *See AT&T v. City of Portland* at 1154 ("Although plaintiff's contend that the open access requirement would impose extra expenses on them, they have not shown that the incidental burden on interstate commerce caused by these expenses would outweigh the local benefits of encouraging competition."); *see also Exxon v. Governor of Maryland*, 437 U.S. 117, 98 S.Ct. 2207, 57 L.Ed.2d 91 (1978) ("controlling the gasoline retail market" within Maryland was not a discriminatory purpose under the Commerce Clause). The intrastate portion of the market for long-distance services probably accounts for approximately fifty percent (50%) of the total market for long-distance services in Washington. Tr. 204 at ll. 11-14. Thus, intrastate markets can hardly be characterized as insignificant in relation to the interstate market, nor should this Commission's legislative mandate to promote competition in that market be brushed aside as trivial.

Arguments similar to those made by Petitioners here were made by national petroleum producers and refiners (such as Exxon and Shell) in opposition to a Maryland statute that had the effect of requiring those national companies that owned retail service stations in Maryland to divest themselves of their stations and to extend all temporary price reductions on equal terms to all service stations in the State. The statute was aimed at correcting perceived inequities in the distribution of gasoline during shortage periods when stations owned by the producers or refiners (as opposed to independent stations) received preferential treatment. *Exxon* at 121. The court rejected the companies' arguments as follows:

> The fact that the burden of a state regulation falls on some interstate companies does not, by itself, establish a claim of discrimination against interstate commerce. * * * [The companies] point to evidence in the record which indicates that, because of the divestiture requirements, at least three refiners will stop selling in

> Maryland, and which also supports their claim that the elimination of company-oriented stations will deprive the consumer of certain special services. Even if we assume the truth of both assertions, neither warrants a finding that the statute impermissibly burdens interstate commerce.

*Id.* at 126-27. Additionally, the court stated: "[W]e cannot adopt the appellants' novel suggestion that because the economic market for petroleum products is nationwide, no State has the power to regulate the retail marketing of gas." *Id.* at 128.

## III. CONCLUSION

The Commission already has decided that the Disposition Clause of RCW 80.12.020 gives jurisdiction over the proposed merger. The Petitioners do not even attempt to distinguish the Commissions' *GTE/Bell Atlantic* decision – they simply state their disagreement with it. The Commission should reaffirm its jurisdiction over holding company level mergers under the Disposition Clause as well as affirming its jurisdiction under the clearly applicable Consolidation Clause of RCW 80.12.020 and the Acquisition Clause of RCW 80.12.040.

The Commission also should conclude, based on Staff and intervenor evidence of the anti-competitive consequences of the merger (that will be addressed in the merits brief), that it is in the public interest to revoke the waivers of chapter 80.12 RCW for the limited purpose of reviewing this proposed merger.

The Commission should view with skepticism the Petitioners largely extra-record factual arguments concerning the consequences of a Commission finding that is adverse to the proposed merger. This argument is not only unsupported and untested by cross-examination, it is also not ripe.

However, even assuming, for argument's sake, the grave picture presented by the Petitioners, the Commission should nonetheless conclude based on a sound understanding of the federal legal doctrines referred to by the Petitioners, that there is nothing in the Telecommunications Act of 1996 or Commerce Clause of the U.S. Constitution that forbids State Commissions from protecting the vigor of competition in state jurisdictional long distance markets. As Mr. Porter of MCI testified, the in-state market represents half of the long distance market in this country, and presumably, in Washington as well.

DATED this 7th day of February, 2000.

Respectfully submitted,

CHRISTINE O. GREGOIRE
Attorney General

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JONATHAN C. THOMPSON
Assistant Attorney General