

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of
Verizon Communications, Inc., and MCI
Inc., For Approval of Agreement and Plan
of Merger

NO. UT-050814

JOINT MOTION OF STAFF AND
PUBLIC COUNSEL TO COMPEL
PRODUCTION OF MERGER
SAVINGS/SYNERGIES MODELS

EXPEDITED REVIEW
REQUESTED

MOTION TO COMPEL

A. Motion to Compel

1. Pursuant to WAC 480-07-405(3) and 480-07-425(1), Public Counsel and the Staff of the WUTC (Staff) file this joint motion to compel responses by Verizon Northwest, Inc (Verizon), and MCI, Inc. (MCI), to Data Request (DRs) Nos. 134 and 135 propounded by Public Counsel in this proceeding. The data requests which are the subject of this motion are attached hereto as Appendix A. The requests seek the merger savings models developed by Verizon and MCI, including any California-specific model.
2. Although the data requests at issue were issued by Public Counsel, Staff has issued a data request asking that it be provided with copies of all data requests served on Verizon and MCI and the companies' responses thereto. In the case of these data requests, although Staff has an independent need for the material sought in developing its case, Staff chose to rely on the companies' response to Public Counsel's request rather than making a duplicative request.

B. Informal Conference with Opposing Counsel to Resolve Disputes

3. Public Counsel has made a good faith effort to resolve these matters informally by conferring with counsel for Verizon. On July 7th and 8th, 2005, in a phone and email exchange, Public Counsel inquired informally about access for its consultant to any merger

savings/synergies model. Verizon declined to provide access, claiming that no “model” existed. On July 12, Public Counsel followed up with formal Data Requests Nos. 134 and 135. On July 22, Verizon objected and again declined to provide any savings model information. (See Attachment A). Public Counsel contacted counsel for Verizon, Ms. Endejan by voice mail and email on Friday, July 22.¹ Ms. Endejan responded by email on that date, stating that she would seek direction from the client. To date, Verizon has not responded further or produced the requested information.

C. Argument

4. Verizon has publicly stated, in support of the claimed economic benefits of the merger, that it expects the transaction to result in \$7 billion in merger savings or synergies on a national basis.²
5. In order to determine how this number is calculated, PC DR 134 asks Verizon and MCI to provide “all merger savings models developed by joint petitioners.” In the merger proceeding currently pending in California, Verizon is required to provide a calculation of the specific merger savings or synergies attributable to California. *See* Cal. Pub. Util. Code § 854(b)(2). Accordingly, PC DR 135 asks Verizon to provide a copy of the “merger savings ‘Synergy’ model developed by Verizon for use in the California merger proceeding.” Both of these requests are ultimately intended to obtain information that will enable the parties, their witnesses, and this Commission develop a reasonable picture of what merger savings are attributable to Verizon and MCI’s regulated operations in Washington.
6. Verizon has responded that these requests are “neither relevant to this proceeding nor likely to lead to the production of admissible evidence.” (See Appendix A). Verizon also states that no models exist. Verizon is incorrect that the DRs request irrelevant evidence.

¹ Counsel for MCI was provided a copy of the email to Ms. Endejan, is aware of the dispute, and has advised Public Counsel that Verizon is the lead party on this issue.

² Application for Transfer of Control, Filed with the Federal Communications Commission on March 11, 2005, In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Stephen E. Smith Decl., p. 1.

7. The issue of merger savings or synergies is one which arises in virtually every merger. Savings or synergies are often cited as evidence of the economic efficiencies to be achieved by the transaction. Projections of merger savings raise significant issues, including: (1) the realistic projection of savings, and what part is attributable to individual jurisdictions such as Washington state; (2) the ratepayers' fair share of these benefits in the case of regulated telecommunications or energy companies, where ratepayers have contributed to the regulated company's rate base and revenues; and (3) the proper manner of distribution of the ratepayers share of benefits. The projection of merger savings also raises concerns about the potential for harmful post-merger cost-cutting, particularly in service and employment, designed to force out projected savings.
8. The Commission ruled in its most recent telecommunications merger proceeding, involving US West and Qwest, that merger synergies were an important part of the analysis of the public interest under Washington's merger statute:

Applicants state that the merger will provide "substantial benefits" to Washington consumers. They also claim "[t]he proposed merger will produce economies of scope and scale." Application at 10. It is appropriate to inquire into the nature and extent of the claimed benefits. *As Public Counsel pointed out at the prehearing conference, if the merger is approved, synergies may arise that lead to cost savings and enhanced revenue. Conditions may be required to ensure any such benefits are shared in a fashion that is consistent with the public interest. The transaction should strike a balance among the interests of customers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.*

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 (WUTC website pagination)(emphasis added).

9. In their public interest statement to the FCC (which accompanies their application for the FCC's approval of this merger), Verizon and MCI state that the transaction is "expected to generate synergies in the form of both cost savings and enhanced revenue opportunities that will yield a net present value of \$7 billion, which will further the companies' ability to provide new

and improved services faster and more efficiently.”³ The public interest statement goes on to say that these synergies, along with other alleged benefits, “will outweigh any potential lessening of competition in any segment of the broad communications marketplace.”⁴

³ Application for Transfer of Control, Filed with the Federal Communications Commission on March 11, 2005, In the Matter of Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control, WC Docket No. 05-75, Exhibit 1 (Public Interest Statement) p. 3.

⁴ *Id.* at p. 4. The companies’ public interest statement further states, even more specifically:

The transaction will produce substantial savings – in the form of both cost reductions and revenue improvements – that will make the combined entity a more efficient competitor in the provision of a broad range of communications services. These are the same kinds of savings that the Commission has relied upon in approving prior mergers.⁶ And Verizon has a flawless track record in achieving these efficiencies in prior acquisitions. *See* Smith Decl. ¶ 7 (Attachment 8).

Verizon has estimated – and the officers for the various segments of the business will have to commit themselves and their compensation to achieving – savings that will yield a net present value of \$7 billion. *See id.* ¶¶ 2, 5. The cost reductions will come from eliminating duplicative network facilities, staff, and information and operation systems, reducing procurement costs, rationalizing the companies’ real estate assets, and more efficiently using existing networks. *See id.* ¶ 3. The revenue enhancements will come from creating and more widely deploying innovative broadband and other services, improving the value of existing services, and spreading best practices to market more efficiently existing services. *See id.* ¶ 4; *cf. Bell Atlantic/NYNEX Order* ¶¶ 45-46 (acknowledging efficiencies from sharing best practices). These financial efficiencies will allow the combined company to improve service quality and to accelerate investment and innovation. *See* Smith Decl. ¶ 6.

Id. at pp. 14-15. Additionally, the Declaration of Stephen E. Smith, Group Vice President, Business Development for Verizon’s Domestic Telecom Group, states the following with respect to savings:

For example, the companies intend to lower costs through headcount reductions of approximately 7000 by eliminating duplicative staff, primarily in support functions such as the network engineering, IT, sales, and human resources departments. The combined companies will be able to reduce information technology costs by eliminating duplicative operating centers, modernizing outdated systems, and re-engineering other redundant information and operational systems and processes. The companies will achieve savings of more than \$100 million annually by more efficiently using existing network capacity to migrate long distance business traffic, which Verizon today transports over third-party networks, onto the network of the combined company. Further, the combined company will avoid the costs that Verizon would have incurred to build out its own long distance and out-of region networks by using the new company’s extensive combined network to meet customer demand. The new company will also be able to take advantage of Verizon’s existing vendor relationships to reduce procurement costs and achieve greater economies of scale. Finally, the new company will achieve savings by rationalizing the companies’ real estate assets.

Id., Stephen E. Smith Decl. pp. 1, 2.

10. In their petition for merger approval here in Washington state, Verizon and MCI claim many benefits. In listing the benefits to enterprise and government customers, for example, the joint petitioners state that “[t]he transaction will result in a more efficient operating structure, allowing for faster and more robust network deployment.” Joint Petition, ¶ 46. Joint petitioners have asserted that the merger will create a “far stronger company,” Joint Petition, ¶ 36, which can provide “a higher degree of stability and certainty” than either company standing alone. Id. Because they are stronger, they argue, they will be able to maintain higher levels of employment. Id. For consumers and small business, the joint petition claims that the transaction “will allow for a higher quality of service and a greater investment in the backbone than MCI could achieve as a stand alone company going forward.” Id., ¶ 48. The petitioners also assert that “the transaction will have no adverse impact on the rates or service quality[.]” Id., ¶ 38.

11. In summary, the Commission has clearly stated that the issue of synergies is an appropriate one for examination in Washington merger cases. Verizon and MCI have themselves raised the issue by their public projections of significant merger savings in the range of \$7 billion. Their claims for benefits to Washington consumers also raise the legitimate question of the relation between those benefits and the synergies and savings. Verizon has calculated, or is calculating a state-specific allocation of merger benefits for California. It may not properly refuse to provide information to parties in this case, or to this Commission, when that information is likely to assist in calculating a state-specific amount of merger savings for Washington. This information is, we submit, clearly relevant. At a minimum, it will lead to the discovery of admissible evidence, that is, a reasonable method of calculating Washington’s share of merger savings.

12. Joint movants add one final note of concern. Verizon’s refusal to make this information available delays and impairs joint movants’ ability to prepare testimony in a timely fashion on a key issue in this case. Since Verizon has developed a national synergy figure, and is developing a California number, it clearly possesses information upon which these numbers were based.

Responding to discovery requests for the information by claiming that no “model” exists is an unduly literal and uncooperative approach.⁵ If no model in fact exists, Verizon should provide, perhaps after requesting clarification, the underlying analysis that does exist, not file an objection.

13. It is worth noting that Verizon’s direct testimony and exhibits in this case are essentially silent on financial issues, focusing almost exclusively on competitive matters. This Commission, however, in the US West/Qwest merger, specifically identified financial issues generally as “proper subjects for examination” in merger review. UT-991358, Third Supplemental Order Outlining Scope of Review, p. 5 (website pagination). Indeed, at the June 22, 2005, prehearing conference in this docket, Verizon itself identified certain financial issues in its proposed issues list for the case, as did Staff. Prehearing Conference Order, Order No. 01, ¶ 11. Verizon then failed to offer any significant testimony on the area in its direct testimony filed only a few days later on June 28.

14. Because Verizon has chosen not to address the financial issues in its direct case, Public Counsel and Staff have been forced to do more wide ranging discovery on financial issues as a result, with DRs 134 and 135 being a part of that effort. The combination of Verizon’s failure to address this key set of issues, and their refusal to answer these specific data requests may create a question about the viability of the expedited schedule adopted in this case at the joint petitioners’ request, particularly if there is further litigation and delay over access to savings information, or if Verizon and MCI put on new testimony on financial issues or other matters in their rebuttal case.

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⁵ In PC DRs 119-123, Public Counsel has also requested underlying documentation for expected cost savings, and for the \$7 billion synergy figure, in more general language not tied to “models.” The responses have not been adequate to allow calculation of a Washington figure.

D. Conclusion

For the foregoing reasons, Public Counsel and Staff respectfully request that the motion be granted. Joint movants request expedited consideration of the motion pursuant to WAC 480-07-425(1).

DATED this 27th day of July, 2005.

ROB MCKENNA
Attorney General

Simon J. ffitch
Assistant Attorney General
Public Counsel

Jonathan Thompson
Assistant Attorney General
Commission Staff