BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI") to Transfer Control of MCI's California Utility Subsidiaries to Verizon, Which Will Occur Indirectly as a Result of Verizon's Acquisition of MCI.	Application 05-04-020 (Filed April 21, 2005)

ASSIGNED COMMISSIONER'S RULING DENYING MOTIONS FOR HEARINGS AND DETERMINING THE APPLICABILITY OF §854 TO THE PROPOSED TRANSACTION

I. Introduction

Application (A.) 05-04-020 was filed on April 21, 2005, and amended on May 9, 2005, by Verizon Communications Inc. (Verizon) and MCI Inc. (MCI) (collectively, the Applicants). The Applicants seek authorization to transfer control of MCI's California utility subsidiaries to Verizon, which will occur indirectly as a result of Verizon's acquisition of MCI.

A prehearing conference was held on June 21, 2005 and a Scoping Memo and Ruling of Assigned Commissioner was issued on June 30, 2005. On July 13, 2005, a group of Intervenors filed a motion asking that the hearing schedule set out in the Scoping Memo be amended[1]. On July 26,

[1] Motion for Partial Reconsideration of Scoping Memo and Ruling of Assigned Commissioner, filed July 13, 2005, by the Office of Ratepayer Advocates (ORA), Telscape Communications, Qwest Communications Corporation (Qwest), the Utility Reform Network (TURN), Level 3 Communications, LLC (Level 3), Cox California Telcom, LLC, Pac-West Telecomm, Inc., and Covad Communications Company.

2005 the Assigned ALJ issued a ruling granting the moving parties additional time to file reply testimony and making certain other changes in the schedule of the proceeding.

The Commission conducted six Public Participation Hearings on August 15, 16 and 18, 2005, in Whittier, Long Beach and San Bernardino to take comments from consumers on the proposed merger.

Motions regarding the need for hearings were filed on September 14. TURN, ORA, Level 3, Qwest and Disability Rights Advocates (DRA) filed motions asking for hearings. Replies were filed on September 16 by TURN, ORA, Qwest, Greenlining and the Applicants.

Pursuant to the Scoping Memo issued on June 30, 2005, this Assigned Commissioner's Ruling determines the procedural treatment of this application and, in light of this ruling, the necessity of holding evidentiary hearings. This ruling on the applicable law for this application and procedural path foreward should serve as a guide in the preparation of briefs.

In summary, this ruling finds that under a plain reading of Pub. Util. Code §854, this application is subject to review under §854(a); Pub. Util. Code §§854(b) and (c) do not apply to this transaction. Moreover, based on the specific circumstances of the instant application, this transaction would clearly qualify for exemption from review under §854(b) and (c) pursuant to the Commission's authority under §853(b)[2].

In particular, this ruling finds that, based on the specific circumstances of this case, subjecting this transaction to a lengthy review

[2] Until 1985, § 853(b) permitted us to grant an exemption only from PU Code §§ 851 and 852. In 1985, our exemptive authority was extended to cover the entire Article 6, including § 854.

under §854(b) "is not necessary in the public interest."[3] The Commission has ample authority under §853(b) and §854(a) to impose any requirements deemed necessary to protect consumers and the public interest. This ruling also concludes that regardless of whether the $500 million threshold of Pub. Util. Code §854(b) has been triggered, it would be appropriate to grant this transaction an exemption pursuant to the Commission's authority under §853(b). Accordingly, we will review the proposed transaction under the "public interest" standard of § 854(a).

Pub. Util. Code § 854(c) sets forth eight factors that this Commission must consider in making its public interest determination in cases where any entity that is a party to the transaction has gross annual California revenues exceeding five hundred million dollars ($500,000,000). Pub. Util. Code § 854(f) precludes consideration of the revenues of Verizon's California affiliate ('Verizon California") because the affiliate was not formed to effectuate the transaction. Thus even if Verizon California has annual California revenues in excess of five hundred million dollars, § 854(c) does not apply to the instant application. However, the Commission in prior decisions has used the criteria set forth in §854 (c) as a guide in determining whether a transaction meets the public interest test under §854(a) and we conclude that it is appropriate to do so here. Accordingly, this ruling concludes that, although §854(c) is not applicable to the instant application as a matter of law or pursuant to a Commission exemption under §853(b), we will consider each of the criteria listed in §854(c), to determine, on balance, whether the transaction is in the public interest.

[3] §853(b)

Finally, there is no need to hold evidentiary hearings in this proceeding, and rule that the case will be deemed submitted upon the submission of briefs.

II. Applicability of §854 to this transaction.

A. Background

The scope of this proceeding is governed by Pub. Util. Code §§ 851-856.

B. §854(a) Applies to this Transaction

Pub. Util. Code § 854(a) specifies that, "No person or corporation, whether or not organized under the laws of this state, shall merge, acquire, or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from this Commission. The Commission may establish by order or rule the definitions of what constitute merger, acquisition, or control activities that are subject to this section of the statute."[4]

In the Scoping Memo, the Assigned Commissioner directed the Applicants to continue to provide all the information they believed necessary and appropriate to demonstrate compliance with all of the provisions of Pub. Util. Code §§ 854(a), (b) and (c) to ensure that there would be no unnecessary delay in processing of the application. There is no dispute as to the applicability of §854(a) to this transaction.

[4] §854(a)

C. Application of §§854 (b) and (c) to this Transaction

The plain language of the statute, its legislative history and prior Commission decisions guide our application of this statute to this transaction, specifically the applicability of §§854 (b) and (c).

Pub. Util. Code §854(b) states:

> Before authorizing the merger, acquisition, or control of any electric , gas, or telephone utility organized and doing business in this state, where any of the utilities that are parties to the proposed transaction has gross annual California revenues exceeding five hundred million dollars ($500,000,000), the commission shall find that the proposal does all of the following:
>
> (1) Provides short-term and long-term economic benefits to ratepayers.
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> (2) Equitably allocates, where the commission has ratemaking authority, the total short-term and long-term forecasted economic benefits, as determined by the commission, of the proposed merger, acquisition, or control, between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits.
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> (3) Not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result.[5]

1. §854(b) does not apply to this application because no party to the transaction is a utility with California revenues of at least $500 million within the meaning of §854(b).

Review of a transaction under Pub. Util. Code §854(b) may be triggered when at least one party to the transaction is a "utility" with gross annual California revenues above $500 million. Verizon is a holding company and not a utility within the meaning of 854(b). Although

[5] §854(b)

Verizon California is a utility with annual California revenues above $500 million, Verizon California is not acquiring MCI.

Pub. Util. Code §854(f) directs that:

> "In determining whether an acquiring utility has gross annual revenues exceeding the amount specified in subdivisions (b) and (c), the revenues of that utility's affiliates shall not be considered unless the affiliate was utilized for the purpose of effecting the merger, acquisition, or control."[6]

Verizon California was not organized for the purpose of acquiring MCI. Pursuant to §854(f), its income may not be considered in determining whether Verizon, the acquiring company, meets the $500 million annual California revenue threshold of §854(b). Without the inclusion of Verizon California's annual gross California income,, Verizon does not meet the revenue threshold that would trigger application of §854(b). Thus even if we were to treat Verizon as a utility for purposes of this transaction, the acquisition would still not trigger review under §854(b).

MCI is also a holding company and not a "utility" within the meaning of 854(b). MCI's California affiliates, which are being indirectly acquired in this transaction, include a utility, but none meets the threshold of $500 million in annual California gross revenue.

The Legislature's intent to limit this Commission's review under §854(b) and (c) to specific circumstances where a "very large" California utility was the subject of an acquisition could not be more clear. Amendments to §854 added by Senate Bill 52 in 1989 clearly delineate the

[6] §854(f)

rationale for adding §854(f) barring the consideration of affiliate revenue for purposes of calculating the $500 million threshold:

> "…this Bill as now written would require the CPUC to make certain findings before authorizing any acquisition by a very large utility of another utility, while other entities which are not utilities could acquire the same utility without the same level of CPUC oversight (unless the company to be acquired was a very large utility). This amendment would make CPUC authorization under the requirements of this legislation necessary *only when a very large utility was being acquired*, whether it was a utility or a non-utility company doing the acquiring" (emphasis added).[7]

Several protestants argue that according to company data filed in connection with the merger application, the combined gross annual revenues of each merging company's California utility subsidiaries exceed $500 million and Verizon California by itself has gross annual California revenues in excess of $500 million.

However, subsidiaries are affiliates[8] for purposes of our review and, as stated above, §854(f) directs that revenues of an affiliate of an acquiring utility that was not organized for the purpose of effecting the merger "shall not be considered" in determining whether the acquiring utility meets the $500 million threshold of §854(b). It is irrelevant whether the combined revenue of Verizon's affiliates meets the threshold or not.

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[7] Amendments to Senate Bill No. 52 (As amended in Senate April 19, 1989)

[8] The Commission's affiliate transaction rules define affiliate as follows:

> "Affiliate" means any person, utility, corporation, partnership or other entity 5 percent or more of whose outstanding securities are owned, controlled or held with power to vote, directly or indirectly, either by a utility or any of its subsidiaries or by that utility's controlling corporation…"

Accordingly, all subsidiaries are affiliates.

Our interpretation of the applicability of §854(f) is also consistent with Commission precedent. In D.99-03-019, the Commission concluded:

> "*Pub. Util. Code §854(f)* precludes consideration of the revenues of AT&T's California utility affiliates because none of them is being used to effectuate the merger, and because they are affiliates of the acquiring company[9].

As to whether MCI's California affiliates would meet the $500 million threshold if their revenues were combined for purposes of calculating the trigger, a plain reading of §854(b) indicates that the revenues of "any" utility that is party to the transaction should be considered separately.

Again, we turn to the legislative history of the relative amendments to §854 for clarification. As discussion of the amendments in the Senate made clear:

> "The inclusion of this language in SB 52 would clarify what revenues the CPUC is expected to look to in determining the application of this law. For example, in Pacific's situation this would make it clear that when PacTel Cellular is involved in an acquisition, it is PacTel Cellular's revenues and not Pacific Bell's that would determine the application of the requirements in this bill to the transaction."[10]

Thus, we conclude that the revenues of MCI's California affiliates should be considered separately in determining whether any utility meets the revenue threshold under §854(b).

2. Exemption under §853(b) makes consideration of affiliate revenues irrelevant.

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[9] Re. joint application of AT&T and Tele-Communications Inc. March 4, 1999 at n11

[10] Amendments to Senate Bill No. 52 (As amended in Senate April 19, 1989)

As the law makes clear, this Commission has broad authority under §853(b) and §854(a) to exempt transactions from review under §§854(b) and (c) regardless of the $500 million threshold. Pub. Util. Code §853(b) states:

> "The commission may from time to time by order or rule, and subject to those terms and conditions as may be prescribed therein, exempt any public utility or class of public utility from this article if it finds that the application thereof with respect to the public utility or class of public utility is not necessary in the public interest."[11]

As established by D. 97-052-092, D.97-07-060 and D. 98-05-022, the Commission has consistently exercised its broad authority under §853(b) to exempt transactions from review under §§854(b) and (c) regardless of the presence of gross annual revenues in excess of the $500 million threshold when a very large ILEC is not the subject of an acquisition or when the subject of an acquisition is an NDIEC or CLEC.

In the MCI-BT case (D.97-07-060) the Commission recognized the sweeping authority granted to the Commission by the Legislature in this regard: "…the extent of our broad exemptive powers in §853(b) is clear on the face of that statute..." The Commission further concluded that "We think this evinces a legislative intent to permit us to use our powers under both §853(b) and §854(a) to exempt transactions from review under §§854(b) and (c), regardless of the presence of gross annual California revenues in excess of $500 million."[12]

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[11] §853(b)

[12] D. 97-07-060 (at *24)

Thus, based on the unambiguous authority granted to the Commission under §853(b), the Commission has clearly and consistently exercised its authority to exempt transactions involving the acquisition of NDIECs and CLECs, regardless of whether the $500 million revenue threshold has been met.

3. It is not reasonable to "pierce the corporate veil" as Verizon California is hot the subject of the acquisition and is not "key to the merger."

In D.97-03-067, the SBC acquisition of Pacific Telesis, the Commission determined that "Although the transaction is technically structured as a merger between SBC and Telesis, the practical result of the proposed transaction…is that it involves Pacific." The Commission found that, since SBC, an out of state corporation, was acquiring California's largest provider of basic local exchange service, it was in the public interest to "pierce the corporate veil" in order to consider the transaction based on "substance rather than form."

The Commission concluded that Pacific was a party to the transaction within the meaning of §854(b) based on the reasoning that the very large California utility being acquired was "key to the merger." Specifically the Commission reasoned that:

- Pacific represented 90% or more of Telesis' assets.
- The economic benefits to be realized from the transaction were based on the joint and combined operations of Pacific and Southwestern Bell Telephone.

- One of the principal reasons SBC pursued the transaction was to add the 15.8 million access lines in California to its existing 14.2 million telephone access lines.

Applying the same criterion used in the SBC-Telesis merger to the instant transaction leads to the opposite conclusions:

- Verizon California is not the subject of the acquisition in this application.

- Verizon subsidiaries in California do not account for a majority of the holding company's assets. In fact, Verizon's California subsidiary accounts for a relatively small portion of Verizon's assets. Public information indicates that Verizon California accounts for approximately 3% of Verizon's annual revenues and proprietary information in the record contains the exact amount.

- The economic benefits to be realized from the transaction are not based on the joint and combined operations of Verizon California and MCI's California affiliate. In fact, the operations of the two entities will not be combined.

- The principal reason stated by Verizon for pursuing the acquisition of MCI is the addition of MCI's national and global enterprise market and fiber network, only a small percentage of which is located in California. The number of MCI access lines in California to be added to Verizon's access lines through this transaction is *de minimis.*

Applying the criteria used in the SBC-Telesis merger, it is clear that because Verizon California is neither the subject of the acquisition nor "key to the merger," there is no reason to "pierce the corporate veil". .

4. Prior applications of §854(b) to transactions involved the acquisitions of ILECs, not NDIECs or CLECs

In prior decisions, the Commission has distinguished between the application of §854(b) to transactions involving the acquisition of California's largest incumbent local exchange carriers (ILECs) and transactions involving competitive carriers (CLECs) or non-dominant inter-exchange carriers (NDIECs), choosing not to apply this section of the Public Utilities Code to the latter. [13] Each of MCI's California subsidiaries is a CLEC or an NDIEC.

A review of past decisions demonstrates that this Commission has clearly and consistently exercised its authority to exempt transactions not involving the acquisition of a California ILEC from application of §854(b). In all cases over the past 15 years this Commission has exempted transactions involving the acquisition of NDIECs, CLECs, and other non-ILECs, including the following transactions: AT&T-Comcast; AT&T-Media 1; Qwest-US West; AT&T-TCI; MCI-WorldCom; AT&T-TCG; MCI-British Telecom;

In D. 98-08-068 the Commission clearly articulated the historic application of 853(b) authority when acquisition of a large California ILEC is not involved: "As in the BT/MCIC and AT&T/TCG mergers, the acquisition of a heavily-regulated local exchange carrier is not the reason for the instant merger."[14] In the footnote to the above citation, the Commission noted: "While AT&T was once more heavily regulated as a

[13] See, e.g., Re AT&T Corporation, D. 99-03-019, 85 CPUC 2d 249 (March 4, 1999), pp. 254-55

[14] D. 98-08-068 Section VI par. 5

dominant carrier, by the time of the TCG merger we had accorded it nondominant status."[15]

Accordingly, and for the same reasons, we conclude that because all California subsidiaries of MCI are CLECs or NDIECs, it is not necessary in the public interest to apply §854(b) to this transaction.

5. Legislative history demonstrates that the Legislature intended to give the Commission flexibility in the application of §854(b) where traditional cost-of-service utilities are not involved in the transaction.

Prior to 1995, Pub. Util. Code §854(b) required the Commission to review acquisitions, mergers and changes of control in instances where "the acquiring or to be acquired utility has gross annual California revenues exceeding five hundred millions dollars."[16] Both subsections (b) and (c), known as the "Edison Amendments," were added to §854 in 1989 following a series of proposed mergers in the electric industry.

At the time, the applicability of §854(b)(1) rested on the assumption that a regulated utility subject to an acquisition or merger operated under a traditional cost-of-service ratemaking scheme and that any savings resulting from a merger that were not anticipated at the time the utility's rates were set would not flow through to ratepayers without regulatory action by the Commission.

The pre-1995 statute was historically interpreted by this Commission to require all transactions, regardless of whether a utility was a party to the transaction, to be analyzed according to the provisions in §854 (b) and (c),

[15] Ibid, footnote n4

[16] §854(b) as amended by SB 52 in 1989

unless exempted pursuant to the Commission's authority under §853(b) or §854(a), with 100 percent of quantified economic benefits allocated to ratepayers.

In 1995 the Legislature amended §854(b) and (c) limiting the applications of Section 854(b) to transactions to which a large, traditionally-regulated California utility is a party.[17] These amendments were proposed by the CPUC and adopted by the Legislature in response to the Commission's adoption of the "New Regulatory Framework" ("NRF") in which the Commission moved away from traditional cost-of-service ratemaking for telephone service providers and toward a regulatory framework that recognizes the benefits to consumers of increased competition in the telecommunications industry.

Assembly Bill 119 amended Section 854(b)(1) in order to "provide the CPUC with the flexibility needed in the current regulatory environment, where, increasingly, rates are set through a price cap or incentive based mechanism, rather than through traditional command and control method."[18] The Commission's analysis in support of the bill indicates the reason the CPUC sponsored the legislation:

> "This amendment modernizes' sec. 854 in light of changes in the regulatory environment since 1989. It recognizes that, increasingly, large utilities are being regulated under 'price cap' mechanism or a 'performance based' system rather than the 'command and control' system of traditional, 'cost-of-service' regulation. In this new regulatory environment utility cost recovery is not guaranteed to the same extent but innovative, cost-cutting behavior is better rewarded.

[17] Amended Statutes 1995 Chapter 622 Section 1 (AB 119).

[18] Report of Assembly Committee on Utilities and Commerce, April 3, 1995 at 1

> The idea is to better balance utility risk and reward and to bring lower costs to ratepayers (without decreasing service), by moving toward a 'carrot' approach to regulation and away from a 'stick' approach. Under these so-called 'incentive-based' regulatory systems, ratepayers and shareholders share costs, savings and profits in varying degrees."

The Commission-sponsored amendments to §854(b): (i) removed the requirement that the Commission find that the proposal provides net benefits to ratepayers, and instead require the Commission to find that the proposal provides short-term and long-term economic benefits to ratepayers; and (ii) equitably allocate the short-term and long-term forecasted economic benefits of the proposed transaction as determined by the Commission between shareholders and ratepayers ***where the Commission has ratemaking authority*** (emphasis added). In those cases where merger benefits are allocated by the Commission through its ratemaking authority, it requires ratepayers receive not less than 50 percent of the benefits.

The Legislature's intent to provide the Commission with the flexibility to determine which transactions are subject to these requirements and to determine how best to allocate the benefits of those transactions is clear in the statements that were made at the time the amendments were added: "If rates are not regulated because the industry is competitive, it may not be appropriate to require any sharing of benefits."[19]

We conclude that even if this transaction were not exempt from §854(b) pursuant to §854(f), Legislative history confirms that the

[19] Senate Committee on Energy, Utilities, and Communications, July 11, 1995 at 3

Commission is well within its discretionary authority to exempt the transaction from the allocation of economic benefits vis a vis a traditional ratemaking mechanism contemplated under §854(b). We also conclude that these amendments were not intended to countermand the statutory obligation that any such transaction be approved only if it is in the public interest.

6. Exempting this transaction from §854(b) is in the public interest pursuant to the authority granted in §853(b) and consistent with Commission precedent.

After passage of the 1996 Telecommunications Act[20] and adoption of the New Regulatory Framework in California[21], the Commission consistently relied on a three-part test for telecommunications mergers and acquisitions to guide the determination as to whether a transaction warranted exemption from §854(b) pursuant to §853(b) or §854(a).

Beginning with the British Telecom-MCI merger in 1997,[22] the Commission applied three principal questions to transactions involving telecommunications companies where the application of §854(b) was considered:

- Does the transaction involve putting together two traditionally or incentive regulated telephone systems?
- Does the Commission exercise the type of ratemaking authority that would facilitate an allocation of the merger benefits as contemplated under 854(b)?

[20] U.S. 47

[21] D.XX-XX-XXX

[22] Re MCI Communications Corporation, D. 97-05-092, 72 CPUC 2s 656 at 664-665

- Has the acquired company grown under competitive forces at the sole risk of its shareholders?

In the MCI-BT case the Commission concluded:

> "The instant application does not involve putting together two traditionally regulated telephone systems, nor are contiguous or nearby service territories involved….The acquisition does not involve merging any BT operations into MCIC operations. No consolidation of MCIC subsidiary management with BT management is contemplated….We do not have traditional ratemaking authority over MCIC's operations. Competitive market forces will distribute any benefits of this merger to ratepayers, therefore, to review this transaction under PU Code §854(b) would be a futile exercise. MCIC has grown under competitive forces at the sole risk of its shareholders without a captive ratepayer base and guaranteed franchise territory to buffer risk and reward. Review of this particular transaction under §§854(b) and (c) will stifle competition and discourage the operation of market forces and is contrary to the main thrust of our telecommunications policy and the Telecommunications Act of 1996."[23]

Asking these three questions of the instant application leads to similar answers.

First, the instant application does not involve putting together two traditionally regulated telephone systems. The subject of the acquisition, MCI, is a nondominant interexchange carrier and a CLEC that operates primarily in the heavily competitive and rapidly declining long distance market. The Commission has never exercised traditional ratemaking authority over MCI's California affiliate, MCIC.

[23] In the matter of the Joint Application of MCI Communications Corporation and British Telecommunications, D. 97-07-060 1997 Cal. PUC LEXIS 557, Finding of Fact 15

Moreover, Verizon California is an ILEC no longer subject to traditional cost-of-service rate regulation. It is subject to regulation under the Commission's New Regulatory Framework, designed for transition to a competitive market, with significant or complete pricing flexibility for all services other than basic local exchange service.

Neither MCI nor its California subsidiaries have ever been subject to traditional cost-of-service regulation that would facilitate an allocation of the merger benefits as contemplated under §854(b). Further, although the Commission distributed merger benefits via a surcredit following the acquisition of GTE by Bell Atlantic, five years have passed since that action, and NRF ratemaking and the new regulatory environment do not facilitate an equitable distribution of merger benefits through a traditional ratemaking mechanism as contemplated under §854(b).

Indeed, as contemplated under NRF and the federal Telecommunications Act, the telecommunications industry has become more competitive since 1996. Attempting to mandate the distribution of economic benefits of a merger or acquisition of this type using traditional rate regulation mechanisms today would be detrimental to the operation of market forces and is contrary to the main thrust of the 1996 Telecommunications Act, state telecommunications policy, and this Commission's stated policies under NRF.

MCIC has grown (and shrunk) under competitive market forces at the sole risk of its shareholders without a captive ratepayer base and guaranteed franchise territory to buffer risk and reward.

As a result, even if §854(b) applied to this transaction, granting an exemption would be consistent with past Commission practice and in the public interest. Thus, subjecting such a transaction to §854(b) "is not

necessary in the public interest" pursuant to the authority granted us in PU Code § 853(b), as well as § 854(a).

7. Commission precedent and §854(c) provide the appropriate guidelines for determining whether this transaction is in the public interest.

Over time, the Commission has used its discretion in different ways in reviewing mergers. In D.70829 the Commission approved a transfer of control after determining that the transaction "would not be adverse to the public interest."[24] Historically, the Commission has sought more broadly to determine whether a change in control is in the public interest:

> "The Commission is primarily concerned with the question of whether or not the transfer of this property from one ownership to another...will serve the best interests of the public. To determine this, consideration must be given to whether or not the proposed transfer will better service conditions, effect economies in expenditures and efficiencies in operation."[25]

D.97-07-060 notes that over the years, our decisions have identified a number of factors that should be considered in making the determination of whether a transaction will be adverse to the public interest.[26] More recently, D.00-06-079 provides an overview of these factors:

> "Antitrust considerations are also relevant to our consideration of the public interest.[27] In transfer applications we require an applicant to demonstrate that the proposed utility operation will be economically

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[24] *Ibid.*, Finding of Fact 3, 645.

[25] Union Water Co. of California, 19 CRRC 199, 202 (1920) at 200.

[26] 1997 Cal PUC LEXIS 557 *22-25.

[27] 65 CPUC at 637, n.1.

> and financially feasible.[28] Part of this analysis is a consideration of the price to be paid considering the value to both the seller and buyer.[29] We have also considered efficiencies and operating costs savings that should result from the proposed merger.[30] Another factor is whether a merger will produce a broader base for financing with more resultant flexibility.[31]
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> "We have also ascertained whether the new owner is experienced, financially responsible, and adequately equipped to continue the business sought to be acquired.[32] We also look to the technical and managerial competence of the acquiring entity to assure customers of the continuance of the kind and quality of service they have experienced in the past.[33]"[34] (footnotes in this text, with the exception of footnote 39, appeared in the original, but have been renumbered consistent with this sequence).

Subsequently, D.00-06-079 assessed the proposed transaction against the seven criteria identified in § 854(c),[35] and included a broad discussion

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[28] R. L. Mohr (Advanced Electronics), 69 CPUC 275, 277 (1969). See also, Santa Barbara Cellular, Inc. 32 CPUC2d 478 (1989).

[29] Union Water Co. of California, 19 CRRC 199, 202 (1920).

[30] Southern Counties Gas Co. of California, 70 CPUC 836, 837 (1970).

[31] Southern California Gas Co. of California, 74 CPUC 30, 50, modified on other grounds, 74 CPUC 259 (1972).

[32] City Transfer and Storage Co., 46 CRRC 5, 7 (1945).

[33] Communications Industries, Inc. 13 CPUC2d 595, 598 (1993).

[34] D.00-06-079 (2000 Cal PUC LEXIS 645, *17-*20), footnotes included but renumbered into the current sequence.

[35] Public interest factors enumerated under this code section are whether the merger will" (1) maintain or improve the financial condition of the resulting public utility doing business in California; (2) maintain or improve the quality of service to California ratepayers; (3) maintain or improve the quality of management of the resulting utility doing business in California; (4) be fair and

of antitrust and environmental considerations.[36] A consideration of these factors constitutes the appropriate scope of this proceeding.

E. Summary of Applicable Law

In summary, we rule that 854(b) and (c) do not apply to this transaction. To determine whether this transaction is in the public interest, the proposed transaction will be assessed against the seven criteria identified in § 854(c),[37] and will include a broad discussion of antitrust and environmental considerations, as has been done in previous cases.

The parties should use this ruling to guide them in the preparation of briefs.

The principal hearing officer will bring a proposed decision, including a discussion of applicable law, before the Commission consistent with the timetable adopted previously in this proceeding.

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reasonable to the affected utility employees; (5) be fair and reasonable to a majority of the utility shareholders; (6) be beneficial on an overall basis to state and local economies and communities in the area served by the resulting public utility; and (7) preserve the jurisdiction of the Commission and our capacity to effectively regulate and audit public utility operations in California."

[36] D.00-06-079 (2000 Cal. PUC LEXIS 645, *17-*38); see also D.01-06-007 (2001 Cal. PUC LEXIS 390 *25-*26) for a similar list of factors.

[37] Public interest factors enumerated under this code section are whether the merger will" (1) maintain or improve the financial condition of the resulting public utility doing business in California; (2) maintain or improve the quality of service to California ratepayers; (3) maintain or improve the quality of management of the resulting utility doing business in California; (4) be fair and reasonable to the affected utility employees; (5) be fair and reasonable to a majority of the utility shareholders; (6) be beneficial on an overall basis to state and local economies and communities in the area served by the resulting public utility; and (7) preserve the jurisdiction of the Commission and our capacity to effectively regulate and audit public utility operations in California."

III. Hearings Are Not Necessary

TURN, Level 3, Qwest, ORA, and DRA filed motions supporting the holding of hearings in this proceeding. The Applicants filed a motion for the submission of the proceeding without evidentiary hearings.

TURN, Qwest and ORA filed responses opposing the request of the Applicants for submission of the proceeding without evidentiary hearings. The Applicants and Greenlining filed responses opposing the motions calling for hearings.

A. Positions of Parties

TURN makes two major arguments supporting the need for hearings. First, TURN argues that this is a significant proceeding that requires hearings in order to ensure that the mandates of §854 are met and that this is a significant proceeding for the telecommunications industry. Second, TURN identifies specific issues that it argues require hearings. These include: a) issues concerning the magnitude of competitive line loses by Verizon; b) issues concerning the significance of intermodal competition; c) issues concerning the significance of the loss of MCI as a competitor in the provision of residential and small business services; d) issues relating the to significance of MCI's new commercial agreement with Verizon regarding UNE pricing; e) issues concerning the proper definition of markets; f) issues concerning the "extent of deference" to be accorded to applicants "business decision" concerning the calculation of merger synergies; g) issues relating to the definition of long-term and short-term; h) issues relating to the calculation of total national synergy benefits prior to allocation to California; i) issues relating to the calculation of net present value; j) issues relating to the calculation of the cost of capital savings for

MCI, if any; k) issues relating to the appropriate allocation of benefits identified in the Verizon national synergy model to California for the purposes of calculating shareable benefits subject to §854(b)(2); l) issues relating to the pass-through of merger benefits.

Qwest argues that hearings are necessary because material issues of fact remain in dispute. In particular, Qwest argues that there are; a) issues concerning the role of MCI in the special access market; b) issues concerning "the lack of alternatives to wireline special access; c) issues concerning the availability of stand-alone DSL on "reasonable terms." In addition to these specific issues, Qwest includes three broad arguments supporting the need for hearings: a) hearings are needed to develop a "complete record; b) dispensing with hearings would be "unusual and inappropriate" in light of the importance of this proceeding to California ratepayers; c) the benefits of hearings "are outweighed by any perceived drawbacks.

Level 3 argues that the Commission should hold evidentiary hearings because: a) this merger raises factual issues which the "public interest requires be addressed in public hearings with witnesses subject to cross-examination; b) there are factual matter in dispute and party and witness credibility is at issue; c) the experience of Level 3 and others in the "SBC-AT&T hearings demonstrates that there are factual and policy issues that cannot be addressed without the opportunity to cross-examine…"

DRA argues "that it is necessary and prudent for the Commission to set evidentiary hearings in this proceeding in order to develop a record concerning the constituency of people with disabilities." DRA states that it desires to present a case through cross-examination and that such cross-

examination will show the merger "fails to account for the needs of people with disabilities."

ORA also argues that hearings are necessary and it identifies broad areas in which it argues that there are significant factual disputes in issue. These include: a) intermodal competition; b) MCI's "irreversible" exit from the consumer market; c) the allocation of synergies to intrastate California; d) whether Verizon will compete with SBC; e) whether the internet is being monopolized; f) whether there are negative impacts on the California economy.

The Applicants, in their motion for submission of the proceeding without hearings, argue that the Commission already has sufficient information in the record to approve the transaction. More specifically, they argue that the existing record is sufficient for the Commission to render a decision. The Applicants argue further that the Commission has on many occasions resolved complex and contentious proceedings without holding evidentiary hearings. Finally, Applicants note that no provision of law or Commission rules provides a right to an evidentiary hearing in ratesetting cases.

Finally, Greenlining, filing a response, argues that evidentiary hearings are not necessary.[38]

B. Discussion

There is no need for evidentiary hearings to resolve the issues in dispute in this proceeding. This conclusion is reached in light of six major considerations: a) no statute or Commission rule requires evidentiary

[38] We will not summarize the responses of other parties in detail, but will address significant arguments in the course of the discussion.

hearings; b) there is sufficient evidence in the record to permit the Commission to decide this matter; c) the public has had ample opportunity to participate in this proceeding through six well-attended public participation hearings held in three different sites; d) since §854(b) does not apply to this transaction, many issues of material dispute raised by parties are moot; e) many of the remaining issues conflate issues of policy with issues of fact; f) the Commission can and has frequently resolved issues of fact without hearings;. We discuss each in turn.

1. No statue or Commission rule requires evidentiary hearings

No provision of law or Commission rule provides any party in this proceeding with a right to an evidentiary hearing. Section 1701.1(a) provides that the Commission "consistent with due process, public policy and statutory requirements, shall determine whether a proceeding requires a hearing" (emphasis added). Rule 44.4 of the Commission's Rules of Practice and Procedure provides that the "filing of a protest does not insure that an evidentiary hearing will be held." Moreover, even without the appearance of witnesses or cross examination, the parties are having an adequate opportunity to be hearings, consistent with due process.

As one might expect, the Commission has addressed this issue previously. The Commission previously has considered its due process obligations with respect to whether evidentiary hearings are required. In Re Competition for Local Exchange Service, D.95-09-121, 1995 Cal. PUC LEXIS 788, at *13-*14, the Commission stated:

> Due process is the federal and California constitutional guarantee that a person will have notice and an

> opportunity to be heard before being deprived of certain protected interests by the government. Courts have interpreted due process as requiring certain types of hearing procedures to be used before taking specific actions.
>
> The California Supreme Court has laid down a simple rule regarding the application of due process. According to the Court if a proceeding is quasilegislative, as opposed to quasi-judicial, there are no vested interests being adjudicated, and therefore, there is no due process right to a hearing. (Citing Consumers Lobby Against Monopolies v. Public Utilities Com. (1979) 25 Cal.3d 891, 901; Wood v. Public Utilities Commission (1971) 4 Cal. 3d 288, 292).

This proceeding is not a quasi-judicial proceeding in which a hearing is required; no vested interests of any party are being adjudicated. Rather, it is a ratesetting, proceeding and no party even argued in its protest that the proceeding should be classified as adjudicatory for purposes of Section 1701 of the Public Utilities Code or the Commission's rules. For purposes of determining whether evidentiary hearings are necessary, ratesetting cases are treated like quasi-legislative proceedings. The California Court of Appeal has confirmed that the Public Utilities Code does not require CPUC to conduct public hearings concerning rates, but leaves the matter to CPUC s discretion. *Pacific Gas & Electric Co. v. State Department of Water Resources*, 112 Cal. App. 4th 477, 500-502 (2003). The Court in *PG&E* also noted that the Code expressly permits the Commission to determine whether or not to hold hearings. *Id.* at 500-501. For example, Section 1701.3 states that *if* the Commission determines that a ratesetting case requires a hearing, certain procedures should apply, indicating that whether to hold a hearing in a ratesetting case is a matter within the

Commission's discretion. (Emphasis added). Similarly, Section 454(b) of the Code allows the Commission to adopt rules that apply in ratesetting cases including the form and manner of the presentation of the showing, *with or without a hearing*, and the procedure to be followed in the consideration thereof. . . . These statutes and precedents amply demonstrate that, in a ratesetting case such as this one, the Commission has discretion to determine whether to hold an evidentiary hearing.

The Commission has also affirmed that due process does not require a hearing that serves no useful purpose. In Touch Communications, Inc. and Inflexion California Comm. Corp., For the Sale and Purchase, Respectively of the Customer Base, Operating Authorities and other Assets, D. 04-09-027, 2004 Cal. PUC LEXIS 417 *6-7.

2. There is sufficient evidence in the record to permit the Commission to decide this matter

The record in this proceeding is extensive. This evidentiary record was developed through exhaustive discovery, which has proceeded efficiently and with few disputes requiring Commission resolution. Applicants have responded to approximately 800 data requests, or over1400 when subparts are counted separately, and produced well over a million pages of documents. Every intervenor has had ample opportunity to discover the facts on which the Applicants positions are based and to present facts which support their own positions with respect to the Application. The parties presented their positions in many hundreds of pages of opening, reply and rebuttal testimony. Briefs and Reply Briefs are still to be filed.

Because the Commission has ample information in this extensive record to determine whether the proposed transaction satisfies the

requirements of law, no evidentiary hearing is needed. *See* AT&T/MediaOne, D.00-05-023, 2000 Cal. PUC LEXIS 355 at *17.

3. The public has had ample opportunity to participate in this proceeding

The Commission conducted six Public Participation Hearings on August 15, 16 and 18, 2005, in Whittier, Long Beach and San Bernardino to take comments from consumers on the proposed merger. Verizon and MCI sent notices to all of their customers and posted newspaper announcements inviting the public to attend the public hearings. Nearly 400 persons turned out for the meetings, and the Commission heard from 245 speakers.

The overwhelming majority of speakers supported the proposed merger. Most of the speakers represented non-profit organizations, schools and other community organizations that had received financial and volunteer support from Verizon. They praised Verizon as a leading corporate citizen, and they endorsed the proposed merger for combining what they said were the complementary technological strengths of Verizon and MCI. For example, Vince Vazquez, a policy fellow in technology studies at the Pacific Research Institute in San Francisco, said that with new technologies like wireless, satellite and cable becoming more affordable, "traditional wireline companies like Verizon and MCI [must] seek additional ways to hone their competitive edge." Long Beach Mayor Beverly O'Neill praised Verizon as a leader in supporting community literacy efforts and added that in 2003 Verizon won the award of excellence for public/private partnership from the United States Conference of Mayors Business Council.

Twelve speakers opposed or had misgivings about the merger, expressing concern about the market power of the combined organization, the elimination of a strong competitor like MCI and the risk of reestablishing telephone monopolies. For example, Rick Werniche, speaking at one of the Whittier hearings, said, "The only thing I can see this merger doing is diluting shareholders' value and possibly adding a huge debt to the ratepayers, which the PUC will probably add on to our bill…This is a power play by a bunch of guys in New York that circles the wagons trying to put back together what Judge Green took apart [in the AT&T divestiture]."

In addition to those attending the Public Participation Hearings, the Commission also heard from more than 325 consumers who wrote letters or sent electronic mail in response to the announcement of the hearings. In contrast to the public speakers, the letters and e-mails were running about 80% in opposition to the transaction and about 12% in favor of it, with the rest undecided or urging conditions to keep rates low and improve service. Many cited individual service complaints, particularly against MCI. A typical message commented that, "As in the past with Pacific Bell and SBC, or AT&T Wireless and Cingular, mergers proved detrimental to the consumers as I could witness through decreased customer service, increased prices and overall lower quality."

In summary, this proceeding has already benefited from a review by the public of this proposed transaction.

4. Since §854(b) does not apply to this transaction, many issues raised by parties become moot.

The first part of this ruling demonstrated: 1) that as a matter of law, §854(b) does not apply to this transaction; 2) as a matter of Commission

precedent, §854(b) should not apply to this transaction; 3) as a matter of policy, §854(b) should not apply to this transaction.

Since neither law nor policy support an application of §854(b) to this transaction, the factual disputes concerning the exact enumeration and division of merger benefits become moot. In particular, of the twelve factual issues identified by TURN, a full six (issues g through l) become moot. Similarly, major portions of ORA's testimony address the enumeration and distribution of merger benefits become moot.

5. Many remaining issues identified conflate policy issues with issues of fact.

Many of the remaining issues identified by parties conflate policy disputes with disputes of facts. For example, ORA mentions two issues: (1) the definitions of "short-term" and "long-term" and (2) treatment of up-front merger implementation costs. Each of these issues is a matter that can and should be determined based on policy considerations and precedent, and cross-examination will shed no further light on them. Whether MCI's operations should be included in the calculation is plainly such an issue. The Commission has consistently exempted synergies associated with fully competitive services and declined to impose sharing obligations on nondominant interexchange and competitive local exchange carriers. The question in this case is simply whether the Commission should adhere to these precedents or, for policy reasons, depart from them. TURN admits that "the legal theory on which Applicants" exclude MCI-related synergies or revenue synergies "is an issue for briefs."[39] These legal issues account

[39] TURN, Motion, at 15.

for a majority of the differences among the synergy estimates, and the estimates of synergies that would result from applying one policy conclusion as opposed to another are not disputed as a factual matter. Likewise, the time period over which to calculate synergies, which TURN acknowledges is "one of the most significant determinants of the differences in estimates of shareable merger benefits,"[40] is a matter of policy and precedent. Neither ORA nor TURN disputes the estimates that would result depending on the various time periods chosen. While TURN argues that Applicants' management used a longer period than the one proposed here in calculating synergies, Applicants do not dispute that fact." Accordingly, the debate concerns whether this discrepancy is significant, as TURN claims, or irrelevant under Commission precedents that recognize that management calculations performed for purposes other than Section 854(b)(2) are not controlling, as Applicants claim. Either way, these are matters for the briefs.

6. The Commission can and has rrequently resolved issues of fact without hearings

Clearly, there are a series of factual issues identified above for which there remain factual differences between parties. For example, the assessment of the transaction's impact on the competitive situation in California specific issues concerning special access circuits, as well as the need for regulation to ensure non-discriminatory treatment of packets moving across networks remain to be made.

[40] TURN, at 11.

The Commission on many occasions including cases involving the merger or change in control of telecommunications utilities pursuant to Section 854 has decided complex and contentious proceedings without holding evidentiary hearings. The Commission is fully capable of deciding this case without holding evidentiary hearings.

The Commission has approved a number of contested applications involving mergers or changes in control of telecommunications utilities without holding evidentiary hearings. Mergers or changes in control involving AT&T and Comcast (D.02-11-025), Qwest Communications Corporation (D.00-06-079), AT&T and Media One (D. 00-05-023), MCI and WorldCom (D.98-08-068), and MCI and British Telecom (D. 97-07-060) all were protested by one or more parties and all (except for AT&T/Comcast) were subjected by the Commission to an analysis of the public interest factors set forth in Section 854(c). Despite extensive differences of opinion and disputes of facts presented and argued in the protests and the replies to protests in these cases regarding the public interest factors and other matters, the Commission elected not to hold evidentiary hearings, generally concluding instead that there is sufficient information in the record to determine whether the application complies with the requirements of §§ 851-854 and whether the application should be approved. In Re AT&T and Media One, supra, 2000 Cal.PUC LEXIS 355, at *17. While these decisions briefly discussed Section 854(c) public interest factors, the Commission determine that each transaction was exempt from review under Section 854(b) and (c).

The Commission's resolution of complex and contentious cases without holding evidentiary hearings is not restricted to telecommunications merger cases. In Rulemaking ReThird Triennial

Review of the New Regulatory Framework, D. 98-10-026, 1998 Cal. PUC LEXIS 669, the Commission made several significant modifications to the new regulatory framework applicable to Pacific Bell and GTE, including the suspension of sharing mechanisms by which cost savings related to streamlined regulation were shared with ratepayers and the elimination of Z factor adjustments related to the LECs recovery of certain costs. Although parties to the NRF proceeding differed greatly on whether such modifications should be made and the impact on ratepayers from making or not making such modifications, the Commission made its decision without holding evidentiary hearings.

In *Re PG&E Energy Recovery Bonds*, D. 04-11-015, 2004 Cal. PUC LEXIS 538, the Commission resolved a number of contested issues regarding PG&E s issuance of bonds related to its bankruptcy including the timing of the bond issuances, the permitted uses of bond proceeds, and the recovery of bond charges from departing load and new municipal load. Again, despite the fact that parties differed greatly on the resolution of these issues and their impact on ratepayers and others, the Commission resolved these matters without holding evidentiary hearings.

The mere existence of disputed facts does not require that evidentiary hearings be held. As in the telecommunications merger cases cited above, the question of whether to hold evidentiary hearings depends on whether there is sufficient information in the record to enable the Commission to determine whether the Application should be approved. Here, the record is clearly sufficient.

IT IS RULED that:

1. Section 854(a) of the Public Utilities Code applies to this transaction.

2. Section 854(b) of the Public Utilities Code does not apply to this transaction.

3. The proposed transaction will be assessed against the seven criteria identified in § 854(c),[41] and include a broad discussion of antitrust and environmental considerations.

4. No hearings are necessary in this proceeding.

5. The motions of TURN, ORA, DRA, Level 3 and Qwest are denied.

6. The motion of the Applicants is granted to the extent discussed herein. The proceeding will be deemed submitted upon the filing of reply briefs.

Dated September 19, 2005, at San Francisco, California.

/s/ SUSAN P. KENNEDY
Susan P. Kennedy
Assigned Commissioner

[41] Public interest factors enumerated under this code section are whether the merger will" (1) maintain or improve the financial condition of the resulting public utility doing business in California; (2) maintain or improve the quality of service to California ratepayers; (3) maintain or improve the quality of management of the resulting utility doing business in California; (4) be fair and reasonable to the affected utility employees; (5) be fair and reasonable to a majority of the utility shareholders; (6) be beneficial on an overall basis to state and local economies and communities in the area served by the resulting public utility; and (7) preserve the jurisdiction of the Commission and our capacity to effectively regulate and audit public utility operations in California."

CERTIFICATE OF SERVICE

I certify that I have, by electronic mail to the parties for which an electronic mail address has been provided, this day served a true copy of the original attached Assigned Commissioner's Ruling of Commissioner Susan Kennedy on all parties of record for proceeding A.05-04-020 or their attorneys of record.

I further certify that tomorrow, September 20, 2005, I shall place true copies of the attached original Assigned Commissioner's Ruling in the United States Mail to all parties of record.

Dated September 19, 2005, at San Francisco, California.

/s/ CHRISTOPHER V. MEI
Christopher V. Mei

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

* *

The Commission's policy is to schedule hearings (meetings, workshops, etc.) in locations that are accessible to people with disabilities. To verify that a particular location is accessible, call: Calendar Clerk (415) 703-1203.

If specialized accommodations for the disabled are needed, e.g., sign language interpreters, those making the arrangements must call the Public Advisor at (415) 703-2074, TTY 1-866-836-7825 or (415) 703-5282 at least three working days in advance of the event.