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BEFORE THE ARIZONA CORPORATION COMMISSION

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IN THE MATTER OF THE JOINT NOTICE OF INTENT OF VERIZON COMMUNICATIONS INC. AND MCI, INC.	Docket No: T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

NOTICE OF FILING DIRECT TESTIMONY OF MICHAEL A. BEACH, TIMOTHY J. McCALLION AND PAUL B. VASINGTON

On July 13, 2005, MCI, Inc. and Verizon Communications, Inc. filed the attached direct testimony of Michael A. Beach, Timothy J. McCallion and Paul B. Vasington in the above referenced matter.

RESPECTFULLY SUBMITTED this 13th day of July, 2005.

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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

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WILLIAM A. MUNDELL
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE JOINT NOTICE OF INTENT OF VERIZON COMMUNICATIONS, INC., AND MCI, INC.	**DOCKET NOs: T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279**

**DIRECT TESTIMONY OF MICHAEL A. BEACH
ON BEHALF OF MCI, INC.**

JULY 13, 2005

PUBLIC VERSION

Q. What is your name, business address and current position with MCI?

A. Michael A. Beach. My business address is 6415 Business Center Drive, Highlands Ranch, Colorado 80130. I am Vice President – Carrier Management for MCI.[1]

Q. What are your qualifications?

A. As Vice President – Carrier Management for MCI, I am responsible for managing MCI's business relations with telephone companies and other vendors who provide facilities and services within the United States used by MCI to provide its telecommunications products; contract negotiation for interconnection, facilities and services provided to MCI by these vendors; and the audit and payment of line costs billed by these vendors to MCI with respect to these capabilities.

I joined MCI in 1974 and have managed a wide range of technical, regulatory and carrier relations activities. My previous position with MCI was Vice President – West Region Carrier Management, with responsibilities for similar activities as my present position, but limited to the territory comprised of the western 28 states in the United States. Prior to that, I was Vice President for Local markets with responsibility for negotiating and implementing Local Interconnect Agreements pursuant to the Telecommunications Act of 1996 with local exchange carriers throughout the United States.

Other assignments I have had at MCI include Director of Operations for MCI's West Division (from 1984 to 1987) with network and service installation

[1] MCI, Inc. identifies the holding company. I use "MCI" for ease of reference throughout this testimony to refer to the collective MCI operating companies.

and maintenance responsibility across the 14-state territory served by US West at that time, and Director – State Policy (from 1981 to 1984) with responsibility for MCI's State Regulatory and Legislative activity within the United States.

Before joining MCI, I was an industrial engineer for Bourns Electronics in Ames, Iowa. From 1969 to 1973 I was a Telecommunications Technical Control Specialist with the United States Air Force.

I have a bachelors of science degree in Business Administration from the University of Phoenix. I live and work in the Denver, Colorado area.

Q. What is the purpose of this testimony?

A. This testimony will describe, from MCI's perspective, how the merger between MCI and Verizon will promote a competitive telecommunications marketplace with public interest benefits to customers and to Arizona, while at the same time protecting and maintaining the wide availability of high-quality telecommunications services at just and reasonable rates.

I will first discuss MCI's presence in Arizona, MCI's various subsidiaries and their operations in Arizona, MCI's facilities in Arizona, MCI's business serving residential and small business customers, and MCI's business serving enterprise customers. Next, I will discuss the effects of the merger on MCI's business, its customers, and the state of competition in the marketplace. In particular, I will explain that the merger will be in the public interest and will not result in harm to competition in the market for residential and small business customers. This is so because nationally MCI's mass market business is in a state of continuing and irreversible decline and because the market is a highly competitive one characterized by a number of significant intermodal alternatives. By intermodal alternatives, I mean alternative services provided by wireless, cable or VoIP providers, as opposed to traditional competitive local exchange carriers ("CLECs") and incumbent local exchange carriers ("ILECs").

In addition, I will explain that the merger will not harm the public interest. In fact, the merger will benefit enterprise customers (i.e., large and medium-sized businesses and government institutions) because MCI and Verizon offer complementary services and, by combining forces, will be better able to serve this extremely sophisticated market. At the same time, the merger will not harm competition for enterprise customers, because MCI and Verizon are only two of many competitors in the few segments of this market in which they do currently compete with one another. In sum, as I will explain, in Arizona the merger will be pro-competitive, will promote customer choice, and will result in producer and consumer welfare gains without impairing any services to customers.

Finally, I will explain that the merger will not result in: (i) significant increased capital costs for MCI's Arizona operations; (ii) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (iii) a significant reduction in the net income of its Arizona operations and, therefore, from MCI's perspective, the merger is subject to the Commission's waiver of the Affiliated Interest Rule granted to MCI in Decision No. 62702. .

I. MCI'S SUBSIDIARIES IN ARIZONA

Q. Which MCI businesses have operations in Arizona?

A. MCImetro Access Transmission Services LLC provides local services in the state. MCI WorldCom Communications, Inc., and MCI WorldCom Network Services, Inc., provide long-distance services. MCI also operates two additional subsidiaries in the state: Teleconnect Long Distance Services and Systems Co. ("Telecom*USA"), and TTI National, Inc. Both of these entities offer resold interexchange services. Each of these firms is certificated by the Arizona Corporation Commission ("ACC").[2]

Q: What services do these subsidiaries provide?

A. MCImetro Access Transmission Services LLC ("MCIMetro") is the primary competitive local exchange carrier ("CLEC") subsidiary of MCI, Inc. As a CLEC, MCImetro offers a variety of local exchange services for residential and commercial customers, as well as access services for interexchange carrier ("IXC") customers. Its most familiar product is "The Neighborhood" suite of local and integrated local/long-distance services. MCImetro also offers similar offerings to its small business customers. For larger commercial customers, MCImetro offers basic line services, local trunks, ISDN, PBX services, and

[2] Intermedia Communications, Inc., another subsidiary of MCI Inc., also holds certificates of convenience and necessity issued by this Commission but has requested that they be cancelled and currently provides no regulated services in Arizona even though it is authorized to do so. The cancellation request was filed January 19, 2005, has been assigned Docket Nos. T- 03547A-05-0038 and T-03291-05-0038, and is still pending before the Commission.

private line services. MCImetro also provides switched and special access services for end users and IXC customers.

MCI WorldCom Communications, Inc. ("MWC") is the primary interexchange carrier subsidiary of MCI, Inc. MWC is a full service interLATA and intraLATA provider and offers retail service to residential customers as well as a complete array of products to our business customers. For those residential customers who select MWC as their Primary Interexchange Carrier (or "PICed" carrier), they can select from pricing plans that offer traditional per-minute rates or block-of-time options. MWC's commercial customers can choose from both dedicated and switched access offerings, as well as private line services. Some of those products include VNET, Vision, On-Net, On-Net Plus, MBS-1, and toll free (e.g., 800) Service.

MCI WorldCom Network Services, Inc. ("MWNS") is an IXC subsidiary of MCI, Inc. that provides wholesale long-distance service. MWNS offers switched and dedicated interLATA and intraLATA service for commercial customers. Those services include 800, calling card, and operator services, as well as traditional outbound services (rated on a per-minute basis). Volume and/or term discounts are available on many of MWNS's offerings. Switched 56/64 kbp and ISDN Service are available to those customers who need these specific applications.

Telecom*USA is an IXC subsidiary of MCI, Inc. and is the primary provider of dial-around services for MCI. Telecom*USA offers switched outbound long-distance interLATA and intraLATA services to both residential and business customers. Telecom*USA customers can access these services through a variety of access methods, including calling cards, selecting Telecom*USA as their PICed carrier through an operator service, casual calling, and a variety of 10XXX dialing patterns such as 1010220, 1010321, and 1010987 (referred to as "dial-around"). Business customers also have the option of accessing Telecom*USA services through dedicated access lines. Some of the calling plans are offered on a "block-of-time" basis, such as "Talk Smarter." These block-of-time plans are similar to many cellular companies' offerings that provide a certain amount of minutes for a set price.

TTI National Inc. ("TTI") is an IXC subsidiary of MCI, Inc. TTI offers inbound (e.g., 800) and outbound long-distance services for both residential and business customers. Services for residential customers are offered via switched access, while business customers can choose between switched or dedicated access, depending on their particular application. Service plans and/or term plans are available to obtain either volume or term discounts, or both.

II. MCI'S FACILITIES IN ARIZONA

Q. Can you describe MCI's local transport facilities in Arizona?

A. MCI has local fiber networks in the Phoenix and Tucson metropolitan areas. These fiber networks span only a relatively small portion of the metropolitan areas in which they are located. This is because construction of local fiber facilities is relatively expensive and time-consuming. MCI has therefore focused its construction on areas in which there is a high demand for services and large numbers of existing and potential customers. In each city, MCI has extended its local fiber network to particular buildings that have the highest level of demand, such as large office buildings, corporate headquarters campuses, and carrier hotels. In Arizona, MCI uses its own facilities to directly connect to **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** buildings, none of which are in Verizon's service territory.

Q **Can you describe MCI's local switching facilities in Arizona?**

A. MCI has two local Class 5 switches in Arizona.

Q. **How does MCI use these local facilities?**

A. MCI uses its local fiber networks to connect enterprise and wholesale customers in Arizona to MCI's long-haul voice, data, and Internet Protocol ("IP") networks. It also uses its networks to offer services to business and wholesale customers, including local private line services, special access services, metropolitan area frame relay services, and switched business local exchange services. Switched local voice services are provided to business customers using MCI's Class 5 circuit switches associated with its local network.

Q. **Can you describe MCI's other facilities in Arizona?**

A. MCI owns and operates fiber and related facilities to provide interstate and intrastate transport. It also owns and operates an Internet backbone, part of which traverses Arizona, and which includes Internet hubs located in the Phoenix metropolitan area.

Q: Does MCI use other carriers' facilities?

A. MCI leases facilities and services from Qwest Corporation ("Qwest") and other carriers to reach customers that are not on MCI's network. This role as both a competitor and a large customer of Qwest will not change in Arizona as a result of the merger.

III. MCI'S CONSUMER BUSINESS

Q. What is the purpose of this section of your testimony?

A. I will now discuss the state of MCI's consumer (or "mass market") business, which includes both residential and small business customers.

Q. What services does MCI provide to mass market customers?

A. MCI provides customers primarily with local and long-distance telephone voice services, which are often bundled together into a single, combined product. MCI also provides DSL to a limited number of customers. MCI provides the local component of these services using loops, transport, and switching leased from other carriers, through the use of UNE-P or commercial agreements. MCI has entered into such a commercial agreement with Qwest that I will discuss further. MCI provides no local services to residential and small business consumers in the Verizon territory of the state and has requested no interconnection agreement with Verizon. MCI offers no facilities-based local mass market services in Arizona.

Q. Does MCI provide these services on a local or a national basis?

A. MCI's mass market operations are national in scope. While rates and other terms and conditions of service may vary from state to state, in virtually every respect, MCI treats its mass market operations as one national operation. In particular, its cost structure is based on the scale and scope economies it achieves as a national carrier, virtually the same products are offered across the country, the marketing operation is national in scope, and other aspects of the business, such as ordering and provisioning activities, operate nationally and not at a state-specific level

Q. What is MCI's sense of its diminishing role in the mass market?

A. MCI's consumer base has declined, and will continue to shrink, because a series of market, technological, and regulatory changes have converged to reshape the telecommunications landscape. These factors include:

- restrictions on marketing resulting from "Do Not Call" legislation;
- erosion of long distance minutes resulting from competition from wireless providers, who offer long distance calling "for free";
- entry by Bell Operating Companies into the long distance business;
- customer preference for all-distance service and the convenience of one bill from one company for all their telecommunications needs;
- provision of voice services, whether circuit switched or IP based, by cable companies;
- availability of broadband-based telecommunications services, including VoIP; and

- regulatory changes that eliminated the availability of UNE-P at total element long run incremental cost ("TELRIC") rates and adversely affected the economics of MCI's provision of integrated services.

Q. What are the technological factors that are driving these changes and causing MCI's consumer business to decline?

A. Consumers are increasingly relying on technologies other than traditional wireline telephone service to communicate. Most of all, the much-discussed digital/broadband revolution finally is becoming a reality. Cable companies and the RBOCs are rolling out broadband-based cable modem service and DSL, respectively, on a widespread basis. The move to broadband has been accompanied by the emergence of VoIP technology, which allows people to make telephone calls at a fraction of the price traditional telephone companies charge. Broadband and VoIP technologies also have allowed many companies that have not traditionally offered telephone service to compete with traditional service providers. Thus, new companies such as Vonage and Skype have come into the marketplace and attracted customers to their telephony products. They have been joined by large companies such as AOL and Microsoft that are able to offer telephony-like services both to new customers and to their large, existing customer base. As these new services gain increasing consumer acceptance, voice service increasingly begins to look like a software application that rides over broadband facilities. The increasing availability of these services will further curtail MCI's opportunities in the residential arena. Furthermore, newer

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technologies such as "WiFi" mesh networks are beginning to be deployed by local governments and other entrepreneurial service providers. Newer and better broadband technologies such as "WiMax" offer even greater potential down the road. E-mail and instant messaging now allow consumers to communicate across the country and around the world without using a traditional wireline telephone. All of these technological developments are eroding and will further erode MCI's residential business.[3]

Q. What other factors are contributing to the decline in MCI's consumer business?

A. In addition to these broadband alternatives, wireless telephony has seriously eroded MCI's market position. Recent data show that the average household with a wireless phone now places 60 percent of its long-distance calls on wireless phones, instead of a traditional wireline home phone. [Yankee Group, *The Success of Wireline/Wireless Strategies Hinges on Delivering Consumer Value* at 7 (Oct. 2004).] Wireless carriers offer customers not only popular flat-fee pricing arrangements, but also the added convenience of mobility. Moreover, a small but growing percentage of consumers have "cut the cord" entirely, opting to use wireless service in place of both local and long-distance wireline service.

Moreover, MCI's stand-alone long-distance business has been hurt by the increasing desire of consumers to purchase integrated local and long-distance products. Recent data demonstrate that more than half of U.S. households

[3] Also see, Direct Testimony of Don Price filed on behalf of MCI, Inc. on November 18, 2004, in Docket Nos. T-01051B-03-0454 and T-00000D-00-0672, pages 6-25 that addresses the unavoidable forces changing the industry.

purchase an "all-distance" service, which includes local and long-distance service and a number of vertical features such as call waiting and caller ID. ["Bundle Up," *Wall Street Journal* at B4 (July 15, 2004).] Indeed, the number of customers purchasing all-distance service from the same provider has roughly doubled in the past two years, and will likely continue to grow in the future. ["Bundle Up" at B4.]

The success of the all-distance offerings (including, up until recently, MCI's own all-distance offering), along with the other factors I have discussed, has led to the severe erosion of MCI's stand-alone long-distance business. As the data summarized below describe, whether measured by revenue, minutes, or customer lines, MCI's stand-alone long-distance business is collapsing, as customers are showing a decided preference for all-distance service. This is true for MCI nationwide as well as in the Qwest service territory in Arizona.

Q. Did MCI attempt to benefit from consumers' desire for integrated products?

A. Yes. Initially, many of the customers who wanted integrated products purchased these products from MCI, so while MCI's stand alone long-distance business suffered, its integrated business grew. When MCI began offering an integrated product in several states including Arizona, in April 2002, it was able to do so without competition from the RBOCs, which were at that time precluded from offering in-region long-distance services. To meet the burgeoning demand for an "all-distance" product, MCI initially offered a bundle by purchasing UNE-P from ILECss at TELRIC rates.

Q. Why is MCI unable to remain an active and growing participant in the part of the market serving consumers who desire integrated products?

A. With intense initial marketing efforts, MCI was able to increase the number of UNE-P lines it served in Arizona following its initial entry into the market. While MCI believed that it was continuing to add customer value, its growth rates flattened and began to decline over time, as CLECs like MCI were no longer alone in their ability to offer these bundled services. Once the RBOCs entered the long-distance market, they quickly began offering integrated products and gained substantial market share. Moreover, consumers now and increasingly are also able to turn to cable companies for integrated products. In particular, cable operators have aggressive plans to deploy and market cable telephony services almost ubiquitously across the country.

Q. Did the regulatory environment that permitted MCI to offer bundled services change?

A. Yes, it changed in several respects. First, Do-Not-Call legislation has had and continues to have a profound effect on MCI. Federal legislation enacted in 2003 led to the establishment of a national Do-Not-Call registry, and within a year after the registry began to operate, 62 million telephone numbers had been registered on the national list. The effect of Do-Not-Call legislation and rules has been the removal of more than half of the potential customers from the reach of what had for many years been MCI's most effective and efficient consumer sales channel.

Additionally, the FCC's 2003 Triennial Review Order ("TRO") and related actions taken at the federal level changed the economics of MCI's approach to the consumer market. MCI had previously been able to purchase UNE-P at cost based TELRIC prices. That is no longer true.

Q. Has MCI negotiated commercial agreements with ILECs for the replacement of UNE-P?

A. Yes. MCI has negotiated commercial contracts with Qwest, SBC and Bellsouth. MCI also has an interim agreement in place with Verizon and is in negotiations with Verizon for a permanent agreement.

The commercial agreement with Qwest was MCI's first. The negotiations with Qwest were conducted in late 2003 and early 2004 in an atmosphere of pervasive uncertainty and business risk. In order to obtain some level of certainty, MCI agreed to pay higher per line prices for a UNE-P replacement product than it was paying under the regulated UNE-P regime at the beginning of the contract term. Under the Qwest – MCI agreement, the prices increase each year. In order to be compensated for these higher costs, MCI has already increased the rates for UNE-P customers by adding an interstate carrier access charge, as I will discuss below. Given the escalations built into the agreement, it may well have to increase rates further. These agreements thus do not provide a long-term mechanism for MCI to succeed in the mass market in competition with facilities based providers. The resulting change in the economics of its consumer business has limited MCI's ability to continue that business indefinitely, and means that in any event MCI will no longer be a price leader for residential services.

Q. Has MCI reduced its marketing for consumer and long-distance services?

A. Yes. Nationally, at the peak of MCI's activity as a competitor for consumer local and long-distance services, MCI placed over **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** hours worth of telemarketing calls per month. As of May 2005, MCI places only **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** hours per month, nationally, a reduction of **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]**. Because the decline in calling results in a diminished need for telemarketing representatives, MCI has been forced to close **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** call centers, leaving **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** open, and to close **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** customer service centers, leaving **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** open. MCI has reduced its overall mass market employee base from **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** in January 2002 to **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** in February 2005. On March 1, 2005, after the FCC's decision in the Triennial Review Remand Order, MCI announced that it would close an additional **[BEGIN**

HIGHLY CONFIDENTIAL] **** **[END HIGHLY CONFIDENTIAL]** customer service centers in May 2005.

In addition, because MCI no longer competes on a significant scale for new residential consumers, MCI no longer spends any money on any broadcast advertisements. Nationally, our spending on direct mail and print advertising has been reduced from a high of nearly **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** per month in early 2003 to **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** in January 2005, a reduction of 90 percent. Spending on media has decreased from a high of over **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** per month in the first part of 2003 to **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** for the month of January 2005. Total mass market overhead (sales, general, and administrative expenses) has been cut in half, from approximately **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** per month in 2002 to less than **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** per month in 2005.

The Arizona-specific local service data shows a similar decline in marketing. For example, in July 2003 MCI made **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** hours of telemarketing calls into Arizona. In May of 2005, by contrast, MCI made only about **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** hours of calls.

Q. Has MCI had to take any other steps that are likely to hasten the decline in its market share?

A. Yes, MCI has increased charges, and is likely to continue to do so in the future. For example, in September 2004, MCI increased the Carrier Cost Recovery Charge for stand-alone long-distance service to $0.85. In January 2005, MCI added an interstate carrier access charge for local customers in Qwest territory by $1.90, and followed this in March 2005, after the FCC's *TRRO* Order, with a $1.90 increase in the remainder of the country.

Q. What has been the effect on MCI's mass market business of these regulatory and technical changes?

A. MCI's share of the mass market business is small and shrinking. For example, although MCI was once a major player with respect to wireline stand-alone long-distance services, as the figures that follow demonstrate, MCI's participation in the wireline stand-alone long-distance component of the market has collapsed both nationally and in Arizona. Moreover, the number of customers who want stand-alone long-distance service is shrinking, as I discuss later.

MCI's market share for its other products is even lower. MCI was never able to achieve more than limited penetration of the local market segment or the segment for bundled products, even through use of UNE-P. As the figures that follow demonstrate, MCI's participation in the stand-alone local portion of the market also has declined nationally, as has its share of customers seeking a bundled local and long-distance product.

Q. Is it possible to measure the decline in MCI's mass market business?

A. Yes. MCI's consumer business is in a continuing and irreversible decline on a national level, as well as in Arizona. This is true whether evaluated in terms of revenues, minutes of use, or customers, and it is true across all of MCI's product lines. The following charts graphically define the scope of MCI's declining business, in terms of revenues, minutes of traffic carried by MCI, and lines.

[BEGIN HIGHLY CONFIDENTIAL]

*****

[END HIGHLY CONFIDENTIAL]

Q. Is MCI's mass market business declining in Arizona?

A. Yes, the decline in MCI's consumer business that is occurring nationally is also occurring in Arizona. For example, in Arizona standalone long-distance customer usage (measured in minutes) dropped from over **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** million minutes in January 2003, to approximately **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** million minutes in January 2004, to approximately **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** million minutes in April 2005. Stand-alone long-distance accounts during this same period fell from **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** in April 2005, and revenues from these accounts fell from approximately **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]**

Q. Is that also true for MCI's residential local service business in Arizona?

A. Yes. In December 2003, our residential local access line count was **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** in Qwest territory. Since then our access line count has steadily declined. At the end of April 2005, MCI provided residential local service to **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]** **** **[END HIGHLY CONFIDENTIAL INFORMATION]** access lines in Arizona in Qwest territory.

Q. Can you draw conclusions from these data?

A. MCI is no longer a significant player in the residential voice services portion of the market. MCI is not now, nor could it become, a price leader for residential services. Further, MCI's significance in this market will likely decline further as the effects of the technological, market and regulatory changes I have discussed become more pronounced, and new, nontraditional players increasingly begin providing voice applications.

Q. How does MCI address small business customers? Are the trends similar?

A. In addition to its residential customers, MCI sells local, long-distance, integrated, and DSL service to small business customers, through its mass market marketing channels. These customers purchase off-the-shelf, non-specialized products.

Like its consumer DSL offering, MCI's small business local service offering has just a minor presence. At the end of April 2005, MCI had only **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** small business local customers lines served via UNE-P nationwide, and only **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL].** MCI is not advertising its local small business offering, and its line count has remained relatively constant in recent months. And while MCI had approximately **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** small business stand-alone long-distance customers nationwide at the end of January 2005, that customer count has declined from **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** one year ago, **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** six months ago, and it continues to decline today.

Q. Can you summarize your understanding of MCI's role in the residential market in Arizona?

A. MCI will become an increasingly less significant part of the marketplace, and other intermodal competitors will increasingly provide the competition in the mass market.

IV. MCI'S ENTERPRISE BUSINESS

Q. What is the enterprise segment of the telecom market?

A. Generally speaking, the enterprise segment is the market for large and medium business and institutional customers. For the purposes of this testimony, I will use the term "enterprise" to refer to large business customers, federal and large state government customers, and medium-sized business and government customers. Within this category, so-called "large enterprise customers," which generally have more than 1,000 employees and spend more than $2 million a year on communications services (although not necessarily all with MCI), account for more than 85 percent of MCI revenue for all commercial and international customers.

Q. What are the characteristics of the enterprise segment?

A. There are several key characteristics that enterprise customers have in common. First, typically they have multiple business locations around the United States, and often in other countries as well. For instance, companies with significant presence in Arizona, like Intel, have worldwide communications needs. Many of MCI's largest global customers, like Daimler/Chrysler, have their headquarters outside the United States. Second, these customers' networking needs are complex and often individualized. Unlike mass market customers, enterprise customers do not select from among a number of bundled "off the shelf" packages, but rather look for customized solutions that fit their particular business objectives. Third, enterprise customers are highly sophisticated. They often have large, in-house information technology ("IT") departments with substantial technical expertise of their own. As described in what follows, these customers are willing to adopt new technologies that improve efficiency and create new business opportunities.

Q. What services does MCI provide to its enterprise customers?

A. Enterprise customers in Arizona and across the country demand extensive, sophisticated packages of services, connecting multiple locations with reliable and secure connections. They generally require a broad range of services, including voice, various data services such as ATM and frame relay, wireless, IP, call center services, and web hosting. It is important to note, though, that enterprise customers often do not distinguish between different types of networks and services. They increasingly do not want separate voice and data networks, but instead want integrated networks that can provide both. In fact, traditional voice services now provide less than half of MCI's revenue from large enterprise customers, and that proportion is steadily declining. In addition to network services, enterprise customers also require advanced features, such as intelligent call routing and integrated voice response systems, and value-added capabilities such as security services. Examples of these security services are e-mail filters, firewalls, intrusion detection and protection, denial-of-service mitigation, and security scans. Although enterprise customers may purchase similar types of services, one of the key characteristics of the enterprise segment is that each customer has unique requirements. Each may purchase a particular combination of services tailored to meet its business objectives, customized individual services, or a customized integration of services and applications. Many enterprise customers also require providers to guarantee specific service levels.

Q. How do enterprise customers procure these services?

A. The procurement process used by enterprise customers reflects both their sophistication and their diverse needs. Enterprise customers will be advised by their in-house IT departments, and will often employ consultants to help them determine which communications services will best fit their particular business objectives. Once this determination has been made, the enterprise customer usually procures services for multiyear periods through a formal request for proposals ("RFP"). The RFP is a long and detailed document that describes the package of services and specific requirements that the customer wishes a communications provider to supply. In a process that can take months, proposals are reviewed by the customer's IT department and, typically, by top executives such as the Chief Information Officer or Chief Financial Officer.

Because no single provider has network facilities everywhere, enterprise customers often need to procure services (either directly or indirectly) from multiple providers. Generally, a primary carrier who submits the winning bid under the RFP will in turn secure bids from secondary carriers. Enterprise customers also directly seek out more than one service provider in order to ensure redundancy in the case of a network outage or other problem, or for other business reasons. The nature of the procurement process, by which large organizations leverage their sophistication and financial strength to secure low prices and high quality, combined with the large revenues at stake, help make the enterprise segment a highly competitive segment of the telecom industry.

Q. What level of competition currently exists in the enterprise segment?

A. The enterprise segment is widely recognized as a highly competitive segment of the telecom industry, and it is expected to remain so. Enterprise customers generate large revenues for service providers, so there is a great incentive for many carriers to compete for this business. Moreover, because primary bidders generally need to secure network access from other carriers, one of their responsibilities is to aggregate and integrate the network facilities of the various secondary carriers. This means that the primary provider does not necessarily need to be a facilities-based provider and that new entrants can successfully bid for large RFP contracts. The competition for enterprise business in Arizona and across the country now includes international carriers, network consolidators, IP/Virtual Private Network providers, wireless carriers, and major software providers, in addition to the traditional competitors in this area such as MCI, AT&T, and Sprint.

Q. How many enterprise accounts does MCI currently serve in Arizona?

A. As of February 2005, MCI provided services to **[BEGIN HIGHLY CONFIDENTIAL INFORMATION]** **** **[END HIGHLY CONFIDENTIAL INFORMATION]** enterprise customers in Arizona.

Q. Does Verizon compete with MCI for these enterprise customers' business in Arizona?

A. Almost never. Verizon rarely provides services to enterprise customers outside of its region. Indeed, even within its region, most of these customers have a national (or even a global) reach, and (with the notable exception of its wireless services) Verizon does not have the footprint outside of its region to offer services on this basis.

Q. What are the foreseeable trends in this area of the telecommunications market?

A. The most significant trend is that enterprise customers are relying less on traditional voice services and increasingly demanding a much wider range of services, platforms, and applications from an increasing number of suppliers. As indicated, enterprise customers now spend more on data and wireless services than they do on traditional, wireline voice services, and that disparity is increasing. Reflecting this trend, the percentage of MCI's revenues associated with IP and other advanced services is steadily increasing while the percentage of revenue associated with voice and older data services is decreasing. A second notable trend is a downward trend in pricing. The major categories of services purchased by enterprise customers, including voice, ATM, frame relay, private line, and IP services, all continue to drop in price at a rapid pace. Some of the steepest declines are seen in the most advanced services, including high-speed private line services and Internet access services.

Q. How does the market for medium-sized businesses differ, if at all, from the market for large enterprise customers?

A. The market for medium-sized businesses is not very different from the market for large enterprise customers. While smaller than the very large enterprise businesses responsible for most of MCI's business revenues, these medium-sized businesses still have sufficient demand for services that they are targeted by specialized firms that do not seek to compete for the mass market. Many of these businesses purchase the same types of integrated packages as larger enterprise customers, and they utilize similar procurement methods. Others might purchase more commoditized packages, but they do so in volumes sufficient to warrant specialized attention from providers, and they buy them in combination with other services. Competition to provide services to medium-sized businesses is similar to what I described earlier. The same players are involved, as well as cable companies, value-added resellers, and especially CLECs, who focus more intently on medium-sized businesses.

Q. Can you summarize your understanding of MCI's role in the enterprise market in Arizona?

A. MCI's business is concentrated in the large enterprise segment of the market, and MCI is just one of a number of entities generating intense competition for enterprise customers. Particularly because MCI's business activity is focused primarily in Qwest's service territory in Arizona, Verizon is not a significant competitor of MCI for these customers in Arizona.

V. BENEFITS OF THE MERGER

Q. What effects will the merger have on competition in Arizona?

A. The Notice of Intent filed with this Commission on April 13, 2005, particularly paragraphs 17 through 31, discusses at length the benefits of the merger. I incorporate that explanation and those statements here. The merger will have a pro-competitive effect and will not cause competitive harm in Arizona.[4] In the enterprise market, MCI's and Verizon's networks, services, and areas of expertise are highly complementary and not overlapping. MCI is strong in the enterprise sector; Verizon is not. MCI operates a large Internet backbone network; Verizon does not. MCI has no wireless assets and offers no wireless services to enterprise customers; Verizon operates a large and successful wireless business. Thus, their combination will benefit customers by enabling the merged entity to operate at lower costs, to develop high-quality innovative services, and to deploy those services rapidly. It will bring Verizon, with all of its expertise and financial resources, into the Arizona enterprise market, and the combined company will be able to offer a broader and more complete array of services than either Verizon or MCI is positioned to offer on its own. And, because MCI's and Verizon's facilities and businesses in the state generally do not overlap, the merger will not result in a lessening of competition in the enterprise market. Moreover, the merged entity will not occupy a dominant position or otherwise be in any position

[4] See, Supplemental Response of Verizon to Data Request JBF 1-91 served upon Staff on or about May 31, 2005.

to stifle growth in competition. Changes in technology and other developments have led to increased competition in all market areas for all types of customers, and MCI and Verizon typically do not now compete head-to-head for enterprise business in Arizona. In the mass market, the continuing decline of MCI's national mass market business results from factors unrelated to the merger and means that MCI will be an increasingly less important competitor for mass market customers in Arizona. This continuing decline, whether in the near future or following the merger with Verizon, will not substantially change the competitive balance in Arizona.

Q. What do MCI and Verizon bring to the combined company?

A. The contributions of Verizon and MCI to the merged company reflect their respective focuses to date and are highly complementary. MCI has a global fiber optic network and global data capabilities. One of MCI's most valuable assets is its considerable Internet Protocol backbone and IP-related expertise. In recent years, MCI has made a multi-billion dollar investment in developing IP-based technologies and applications to help businesses shift from voice-based to IP-based services. Verizon does not have a substantial Internet backbone or interLATA transmission facilities. On the other hand, Verizon Wireless has a similarly extensive wireless business and network, while MCI has no wireless presence.

The two companies' services are as complementary as their assets. Verizon largely focuses on local and regional services, while MCI focuses on services for large enterprise customers with a global reach. As a result of this focus, MCI brings strong relationships with enterprise customers and account teams with in-depth understandings of their customers' businesses and unique communications needs.

Q. How will the combined company benefit enterprise customers?

A. The combined company will be in a strong financial position to invest in the existing IP network at a lower cost of capital than MCI could obtain on its own. This increased investment will enable the new company to increase network capacity, extend network reach, and add new capabilities to the network. Such investment will become more attractive to the combined company because it will be able to recover the costs associated with product development and network expansion across a larger base of customers. Simply put, the merger will bring to Arizona all of the capabilities and resources of Verizon.

These strengths will benefit enterprise customers. The new company will be able to develop and deploy brand new services more rapidly than either company could on its own. Especially promising in this regard is the development and deployment of mobile IP services. These services represent a combination of two prominent trends in telecommunications today: the shift to IP-based services and the shift to wireless communication. With mobile IP services, customers would have corporate mobility, allowing existing applications and data to be accessed by workers, no matter where they are. New applications could be developed that would exploit this newfound mobility. MCI has attempted to explore this promising field, but has made little progress to date because it lacks a wireless network. A combined company with MCI's IP backbone and Verizon's wireless network would have the essential infrastructure to deploy mobile IP devices. The company would also have the significant in-house expertise needed to overcome the technical challenges to mobile IP services.

Q. How will the combined company benefit government customers and impact state and national security?

A. The transaction will greatly benefit government customers. The merged company will be able to provide an integrated suite of services that can better serve government customers. In addition, the transaction will promote domestic security by enhancing investment in the communications infrastructure that is used by the Departments of Defense and Homeland Security, as well as other federal and state agencies, and ensuring that the crucial networks remain robust and technologically advanced.

Q. Will the combined company be in a dominant competitive position or otherwise stifle competition in Arizona?

A. Not at all. Because MCI's business in Arizona is entirely complementary to Verizon's, the transaction will not damage competition in any part of the marketplace in Arizona.

More specifically, with respect to the mass market, with few exceptions, MCI's business is already in decline due to a variety of factors unrelated to this transaction, and MCI would not, absent the merger, be a significant competitor going forward in this market. Indeed, as the facts discussed above plainly demonstrate, in the absence of this transaction MCI's participation in the market would consist largely of serving its dwindling legacy customer base and managing its decline as a provider of mass market services. In addition, this transaction will not affect the rapid growth of intermodal alternatives (which MCI does not offer) such as cable and wireless, which are major factors in Arizona today and will provide the most significant competition for mass market customers in the future. For instance, in Arizona, cable companies have deployed two-way broadband networks that were initially used to provide high-speed data services, but are now increasingly being used to provide voice services. Wireless carriers have secured an increasing percentage of voice traffic, spurring some customers to give up their landline phones altogether. In addition, new VoIP providers have deployed services over broadband networks and IP backbones, offering services such as personal conferencing and locate-me services. Accordingly, the mass market will retain its lively competitive character after the merger is complete; the transaction simply reflects a transition in the market caused by unrelated technological and regulatory factors that will continue to reshape the market whether or not there is a merger between MCI and Verizon.

With respect to the enterprise market, and in particular with respect to the large enterprise segment that is at the center of MCI's business in Arizona, the combined company will be just one of many competitors. As discussed above, enterprise customers are sophisticated in their approach to both identifying potential vendors and negotiating extremely competitive pricing through the RFP process.

VI. EFFECTS OF THE MERGER

Q. Please summarize the effects and benefits of the merger.

The proposed merger will not impair the financial status of any MCI subsidiaries in Arizona, prevent any MCI subsidiaries from attracting capital at fair and reasonable terms, or impair the ability of any surviving MCI subsidiaries and the parent company, MCI, L.L.C., to provide safe, reasonable and adequate service because, as stated in paragraphs 42, 45, 46 and 47 of the Notice of Intent filed April 13, 2005. As stated by both MCI and Verizon in response to Staff Data Request JFB 1-65, the financial strength of Arizona subsidiaries and access to capital for MCI subsidiaries should increase from the resulting merged entity. In addition, as stated by Verizon in its response to Data Request JBF 1-65, this transaction will enhance the abilities that both Verizon and MCI now possess as stand-alone companies to provide a comprehensive suite of services to consumers, businesses and government customers. It will bring together two companies with complementary strengths in a way that will benefit the existing customers of each company. It will enhance Verizon's ability to compete for and serve large businesses and government customers by improving the delivery of competitively priced wireline services, broadband services, wireless services and IP-based

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services to that vital sector of the U.S. economy. Finally, as stated in paragraph 47 of the Notice of Intent, the transaction will have no adverse effect on the rates or the quality of service of the regulated subsidiaries of MCI and Verizon. To the contrary, as a result of the transaction, the operating subsidiaries of both companies will be able to provide better services to their customers than either company could provide alone.

Q. **Will MCI's capital costs increase as a result of the merger?**

A. No. Verizon's much higher credit rating will help MCI overcome its reduced rating resulting from the WorldCom bankruptcy. As a result, MCI expects its capital costs to decrease.

Q. **Will the merger add costs to MCI's Arizona operations?**

A. No. While there is very little overlap between MCI and Verizon operations in Arizona, the merger will result in some general corporate overhead efficiencies that MCI anticipates will reduce the costs of MCI's Arizona operations.

Q. **Will the merger result in a reduction in MCI's Arizona net income?**

A. No. In fact, the lower cost of capital and increased operating efficiencies should have a positive effect on net income.

Q. Has MCI been granted waivers of the Affiliated Interest Rules?

A. Yes. In Decision No. 62702, the Commission granted limited waivers of those rules to MCImetro Access Transmission Services, LLC, MCI WorldCom Communications, Inc., MCI Network Services, Inc. and Teleconnect Long Distance Services and Systems Company.

Q. What about TTI National, Inc. and Intermedia Communications, Inc.?

A. Their annual intrastate revenues in Arizona do not exceed $1,000,000. It is my understanding that, for this reason, they are not subject to the Affiliated Interest Rules.

Q. Does this conclude your testimony?

A. Yes.

VERIFICATION

STATE OF _South Carolina __________)
) ss
County of __Beaufort _______________)

I, Michael A. Beach, do state under penalty of perjury that the factual information contained in my Direst testimony dated July 13, 2005, is true and correct to the best of my belief and knowledge.

Dated: ____July 12, 2005______________

Michael A. Beach
Vice President – Carrier Management

STATE OF ARIZONA
CORPORATION COMMISSION

Joint Petition of Verizon Communications Inc., and MCI, Inc. for Approval of Agreement and Plan of Merger.	) Docket No.	T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-04-0279 T-03291A-05-0279

VERIZON COMMUNICATIONS INC.

DIRECT TESTIMONY OF

TIMOTHY J. MCCALLION

Dated: July 13, 2005

OPENING TESTIMONY OF TIMOTHY J. MCCALLION

Q. Please state your title, business address and responsibilities.

A. I am employed by Verizon Corporate Services Group Inc. as President — Pacific Region. My business address is 112 South Lakeview Canyon Road, Thousand Oaks, California, 91362. My responsibilities include all corporate matters, regulatory affairs, governmental affairs, and community relations for Verizon California Inc.

Q. Please describe your background.

A. I hold an undergraduate degree in Business Management and a Master of Business Administration degree from Gannon University. I began my career with Verizon over 29 years ago in the accounting department of General Telephone Company of Pennsylvania. In the ensuing years, I continued working for the Company in various locations, including Ohio, Indiana, Hawaii, and GTE's former corporate headquarters in Stamford, Connecticut. In 1987, I became External Affairs Director for GTE California, Inc. and have assumed several positions of increasing responsibility since that time.

Q. Please state the purpose of your testimony.

A. The purpose of my testimony is to describe Verizon's operations in Arizona. In addition, I describe how the transaction meets the criteria that the Commission established when it granted Verizon a waiver from the Affiliated Interest Rules set forth in Arizona Administrative Code ("A.C.C.") R14-2-803.

Q. Who else is submitting testimony on behalf of joint applicants?

A. Paul B. Vasington, Director of State Public Policy for Verizon, demonstrates that the transaction is in the public interest and satisfies the requirements of A.A.C. R14-2-803(C). He explains that the transaction will not impair the financial status of the companies, prevent them from attracting capital at fair and reasonable terms, or impair their ability to provide safe, reasonable and adequate service. Michael A. Beach, Vice President – Carrier Management for MCI describes, from MCI's perspective, how the merger between MCI and Verizon will promote a competitive telecommunications marketplace with public interest benefits to Arizona customers, while at the same time protecting and maintaining the wide availability of high-quality telecommunications services at just and reasonable rates.

Q. Please describe Verizon's corporate structure.

A. Verizon Communications Inc. ("Verizon") is a corporation created and existing under the laws of the State of Delaware. Its principal office is located at 1095 Avenue of the Americas, New York, New York 10036. Verizon directly or indirectly owns telephone operating companies that provide telecommunications services on a regulated and unregulated basis in 29 states, Puerto Rico and the District of Columbia, serving 53 million access lines. Although Verizon provides no services and is not a regulated telephone company within Arizona or elsewhere, its local telephone subsidiaries are subject to public utility regulation in the jurisdictions in which they operate. They are also subject to regulation by the Federal Communications Commission ("FCC") for the services they provide pursuant to federal tariffs and federal law. Verizon's domestic telecommunications services include the provision of exchange telecommunications services, including switched local residential and business services, local private line, voice and data services and Centrex services. Verizon subsidiaries also provide intraLATA and interLATA toll and interexchange services, as well as exchange access services, including switched access and special access services. These subsidiaries provide wireline services to consumers, small and enterprise businesses and to other communications carriers. Verizon's other domestic subsidiaries provide voice and data wireless services, information services including directory publishing, and electronic commerce. Verizon's international subsidiaries provide wireline and wireless communications operations and investments.

In 2004, Verizon had annual operating revenues of approximately $71 billion nationwide. Stressing diversity and a commitment to the communities in which it operates, Verizon has a highly diverse national workforce of 210,000 employees, including approximately 1,450 employees in Arizona. Verizon has a strong balance sheet and investment-grade credit rating and is a stable, viable enterprise.

Q. Please describe Verizon's operating entities in Arizona.

A. Verizon has five regulated entities in Arizona: Verizon California Inc. (providing local exchange and related services); Verizon Select Services Inc. (licensed as a competitive local exchange carrier, but not currently serving any customers); One Point Communications-Colorado, LLC d/b/a Verizon Avenue (providing local and long distance service as a competitive local exchange carrier to a small number of multi-dwelling unit customers); Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance; and NYNEX Long Distance Company d/b/a Verizon Enterprise Solutions (both providing long distance service to a variety of customers). Based on 2004 financial data, only Verizon California has annual intrastate operating revenues in excess of $1 million. Each of the other entities has annual intrastate operating revenues substantially less than $1 million.

Q. Please describe Verizon California's operations.

A. Verizon California has approximately 8500 local exchange access lines in the southwestern part of Arizona, in and around Parker, in La Paz County. Approximately seventy percent of the lines are used to provide residential service. Verizon California Inc. is the second largest local exchange company in California, serving over 4.3 million switched access lines primarily in southern California, as well as over 40,000 access lines in northwestern Nevada.

Q. Has the Commission previously granted any waiver of the Affiliated Interest Rules to Verizon California?

A. Yes. On July 1, 2005, Applicants filed their Second Amendment to Notice of Intent in order to identify for the record several waivers of the Affiliated Interest Rules this Commission has issued over the years for Verizon and its predecessors. As explained in more detail in that Amendment, Contel of California, Inc. (the predecessor of Verizon California) was granted a limited waiver of the Affiliated Interest Rules in March 1993. That waiver required Contel of California to file a Notice of Intent with this Commission regarding any transaction subject to the Affiliated Interest Rules only for those transactions which were likely to result in: (1) significant increased capital costs to the Arizona operations, (2) significant additional costs allocated or charged directly to the Arizona jurisdiction, or (3) significant reduction of net operating income of the Arizona jurisdiction.

Subsequently, when GTE merged with Bell Atlantic, the Commission's Chief Counsel opined that Commission approval was not required in part because the limited waiver described above, and a similar one previously granted to Bell Atlantic Corporation, relieved the companies of any obligation to seek Commission approval for that merger. That opinion also noted that, by not seeking Commission approval for the GTE-Bell Atlantic merger, the companies were representing that the three waiver conditions outlined above were satisfied.

Q. Were those three conditions satisfied in the GTE-Bell Atlantic merger?

A. Yes. In the five years since that merger was consummated, Verizon California Inc. has provided high quality services to its small number of Arizona customers and has done so efficiently. Its operations are financially sound. Verizon's small rural local exchange operations in Arizona are part of a strong subsidiary of a financially sound and successful national company.

Q. Is the pending transaction with MCI likely to significantly increase capital costs to the Arizona operations?

A. No. Verizon obtains capital as a national company, and the 8,500 lines in Arizona represent only a tiny fraction of a percentage of Verizon's lines nationwide. The transaction with MCI at the parent company level is being entered into in order to take advantage of the complementary strengths of both companies. The combination will respond forcefully to the convergence of technologies, products, and services in the communications industry by creating a company with the financial strength, infrastructure, geographic reach, technological depth, and managerial and operational expertise to be a strong competitor in the rapidly changing communications marketplace. This transaction is not likely to significantly increase the cost of capital to the Arizona operation, but rather is intended to strengthen the company as a whole.

Q. Is the pending transaction with MCI likely to significantly increase costs allocated or charged directly to the Arizona jurisdiction?

A. No. The primary expected benefit is the enhanced ability of the combined company to generate additional revenues from increased sales to new and existing enterprise customers. Allowing MCI and Verizon to use one another's strengths to become a stronger competitor in the evolving, increasingly intermodal, communications industry will bring long-term benefits to customers nationwide. Developments such as this will are not likely to significantly increase costs charged to the Arizona jurisdiction.

Q. Is the pending transaction with MCI likely to lead to a significant reduction of net operating income of the Arizona jurisdiction?

A. No. For the same reasons discussed above, this transaction is not likely to significantly reduce net operating income in Arizona.

Q. Is Verizon asking this Commission to grant it a waiver for purposes of this transaction?

A. Verizon believes that the Commission should consider its prior waivers and their impact when it issues a decision regarding this transaction. However, Verizon and MCI have provided evidence that demonstrates that the merger is in the public interest and should be approved regardless of whether the existing waivers are honored.

Q. Does this conclude your opening testimony?

A. At this time, yes.

STATE OF ARIZONA
CORPORATION COMMISSION

Joint Petition of Verizon Communications Inc., and MCI, Inc. for Approval of Agreement and Plan of Merger.	Docket No.	T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-04-0279 T-03291A-05-0279

VERIZON COMMUNICATIONS INC.

DIRECT TESTIMONY OF

PAUL B. VASINGTON

Dated: July 13, 2005

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I. INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME, TITLE AND BUSINESS ADDRESS.

A. My name is Paul B. Vasington. I am a Director of State Public Policy with Verizon and my office is at 185 Franklin Street, Boston, MA 02110.

Q. PLEASE SUMMARIZE YOUR BACKGROUND AND QUALIFICATIONS.

A. Prior to joining Verizon, I was a Vice President with Analysis Group, Inc., where I was an expert consultant in the telecommunications and energy industries. I provided reports for private telephone and electric companies, government agencies, and international clients. I worked on various projects, including alternative regulation, business valuation, regulatory principles, business strategy assessments, policy research on taxation, and development of policy for new technologies. I have also been a witness before state commissions in Vermont, Maine, Delaware, New Hampshire, Pennsylvania, and New Jersey.

Before joining Analysis Group, I was a member of the Massachusetts Department of Telecommunications and Energy ("DTE"), serving as Chairman from May 2002 through August 2003, and as a Commissioner from 1998 through May 2002. While serving on the DTE, I gained extensive experience in the regulation of rates and conditions of service of the telecommunications, cable television, electric power, natural gas, pipelines, water, and transportation industries in the Commonwealth of Massachusetts.

During my tenure on the DTE, I was a member of several organizations focused on regulatory policy. I served as the Chairman of the Massachusetts Energy Facilities Siting Board. I was a member of the National Association of Regulatory Utility Commissioners (NARUC), where I served on the Telecommunications Committee, and taught courses as a faculty member of the Annual Regulatory Studies Program. I was Vice President of the New England Conference of Public Utilities Commissioners (NECPUC), where I served as Chairman of the Telecommunications Committee. And, I was a member of the Board of Directors of the National Regulatory Research Institute at Ohio State University.

From 1990 through 1996, I was in the DTE's Telecommunications Division, first as a staff Economist and then as the division's Director. I left the DTE in 1996 and joined National Economic Research Associates, Inc., where, from 1996 to 1998, I was a Senior Analyst consulting with telecommunications and other utility companies.

I have a master's degree in Public Policy from Harvard University's John F. Kennedy School of Government and graduated *magna cum laude* from Boston College, where I obtained my bachelor's degree in Political Science. My complete resume is attached as Exh. PBV-1.

Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to explain why as a matter of sound public policy the proposed merger of MCI, Inc. ("MCI") and Verizon Communications Inc. ("Verizon") should be approved by the Arizona Corporation Commission (the "ACC" or the "Commission"). Verizon and MCI are holding companies with subsidiaries that provide services in Arizona.[1] MCI and Verizon have entered into an Agreement and Plan of Merger, under which MCI will become a wholly-owned subsidiary of Verizon. In considering a transaction pursuant to A.A.C. R14-2-803(C), the Commission evaluates whether the transaction "would impair the financial status of the public utility, otherwise prevent it from attracting capital at fair and reasonable terms, or impair the ability of the public utility to provide safe, reasonable and adequate service." The ACC has referred to this as the "minimum standard."[2] The ACC also may evaluate the transaction pursuant to its constitutional duty to determine whether the transaction is in the public interest, the "scope and breadth" of which is influenced by the "individual circumstances of each case."[3] Whether the ACC decides to evaluate the proposed merger of Verizon and MCI under the minimum standard, or whether it broadens its evaluation, it should find that the proposed merger of MCI with Verizon: will not impair the financial status of the companies; will not prevent them from attracting capital at fair and reasonable terms; will not impair their ability to provide safe, reasonable and adequate service; will enhance the companies' abilities in these areas; and likely will provide benefits to Arizona customers.

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[1] As holding companies, neither Verizon nor MCI provide services to customers in Arizona or elsewhere; such services are provided by their various regulated and unregulated subsidiaries. For ease of reference, however, in this testimony, when speaking about services provided in Arizona, references to the parent companies are intended to include references to their subsidiaries operating in the state.

[2] Decision No. 67454, p. 28.

[3] The circumstances that caused the ACC to broaden its recent inquiry into other proposed reorganizations are not present in this case. *See* Decision No. 67454, p. 29. Of particular note here is the fact that Verizon's incumbent local exchange carrier ("ILEC") subsidiary has very limited operations in Arizona. Both MCI and Verizon have limited operations in the state overall, particularly when compared to other companies providing communications services, such as Qwest. In addition, the Verizon-MCI merger is subject to significant review by both the Federal Communications Commission ("FCC") and the United States Department of Justice ("DOJ"), both of which are undertaking thorough reviews. All of these facts suggest that the ACC need not go beyond the minimum standard in evaluating this proposed transaction.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

A. The ACC should analyze the transaction in light of the dramatic changes in communications technology and competition that have already transformed the communications industry and that will likely continue to bring even greater changes in the future. This transaction is a positive response to industry convergence and the substantial intermodal competition such convergence has created. The merger of Verizon and MCI is part of a much broader restructuring of the industry around new technologies, new services and new providers. The creation of a strong new competitor for enterprise customers nationwide and here in Arizona will spur new investment in communications infrastructure and promote the public interest. Given that the transaction will not impair the financial status of the companies, prevent them from attracting capital at fair and reasonable terms, or impair their ability to provide safe, reasonable and adequate service, it satisfies the requirements of A.A.C. R14-2-803(C), is in the public interest, and should be approved by the ACC.

Q. PLEASE EXPLAIN IN MORE DETAIL HOW THE MERGER WILL RESULT IN BENEFITS.

A. The Verizon and MCI subsidiaries operating in Arizona today will continue to operate after the transaction as before. The Verizon-MCI Agreement and Plan of Merger (the "Agreement") does not call for the merger of any assets, operations, lines, plants, franchises or permits of MCI's regulated subsidiaries with the assets, operations, lines, plants, franchises or permits of any Verizon entity. Nor does the Agreement call for any change in the rates, terms or conditions for the provision of any communications services provided in Arizona. Any such changes that might be made at a later date will be made in accordance with all applicable regulatory rules and requirements. Under the circumstances, the transaction will not harm ratepayers or impair either company's ability to provide safe and adequate service at just and reasonable rates.[4]

Nor will the transaction harm competition in the state. This is so for several reasons. It should first be noted that Verizon and MCI bring complementary assets to the transaction. For example, in Arizona, there is no overlap in the facilities deployed by MCI with those deployed by Verizon, and Verizon and MCI have very different relative strengths and their service mixes complement each other.. Verizon offers wireless services and MCI does not. While MCI's relative strengths are in the provision of services to large enterprise customers and the operation of an IP-backbone, Verizon has a relatively small share of the large enterprise segment, both nationwide and particularly in Arizona. Similarly, while Verizon's strengths are in the provision of services to residential and small business customers, MCI's mass market business is in a continuing and irreversible decline. Indeed, as discussed in the accompanying testimony of Michael Beach, MCI's current business plan is to manage the decline of that business, so that MCI would not be a significant competitor in the Arizona mass market in the absence of this transaction. In short, the transaction will not harm competition for mass market or enterprise customers.

The proposed merger of Verizon and MCI will benefit both companies and their current and prospective customers. The transaction enhances Verizon's current strengths in the

[4] Nor should the ACC be concerned that an increase in rates will result from completion of the transaction. Rates in a competitive environment, such as exists in Arizona, are a function of market forces which will continue unabated after the merger is completed for the reasons stated above.

local service and wireless markets with the capability to better address the large enterprise segment of the market. In addition, MCI's nationwide transmission backbone will supplement Verizon's local, wireless and broadband networks. The merger will allow MCI to capitalize on its core strengths – its large enterprise business, its extensive network in the large enterprise sector, and its Internet backbone – by teaming with a company that needs those assets and will invest in them.

Customers will also benefit from this transaction as it will enable Verizon and its subsidiaries to better meet the needs of large enterprise customers, including federal and state government agencies. As I discuss later in this testimony, because of the complex needs of such customers, neither MCI nor Verizon, standing alone, can be as effective at serving the enterprise segment as the merged company will be.

In addition, the merger should deliver benefits to customers of all types in the form of competitive prices, network improvements, and the enhanced ability for customers to purchase all of their communications needs from a single supplier. Further, Verizon has already committed to investing $2 billion in enhancing MCI's network and systems, including MCI's Internet Protocol ("IP")-based backbone, which will also benefit customers that rely on the services that such networks and systems enable.

Q. CAN THE COMMISSION BE CONFIDENT THAT THE COMPANIES WILL DELIVER THESE BENEFITS?

A. Yes. Verizon was created through a series of mergers of substantial scale (such as between Bell Atlantic and NYNEX, and subsequently Bell Atlantic and GTE), which were executed effectively and efficiently. Verizon also is a majority partner with Vodafone in Verizon Wireless — itself a product of various mergers and one of the most successful wireless businesses in the country. This experience should give the ACC confidence in the ability of Verizon management to implement the transaction without disruption to ongoing operations and financial status, to manage MCI as a successful subsidiary, and to deliver the anticipated efficiencies and customer benefits of this transaction.

Q. WILL THE PROPOSED MERGER HARM COMPETITION?

A. No. Although adverse effects on competition are a potential concern in any proposed merger, this transaction will not adversely impact competition in communications, either nationally or in Arizona, as I will discuss later in more detail. I reach this conclusion for several reasons, including the extensive inter-modal competition already present both nationally and in Arizona; the growth of such competition going forward; the lack of a strong Verizon presence in the large enterprise market segment; the irreversible decline in MCI's mass-market businesses; and the generally complementary, rather than competitive, nature of the core services that the Verizon and MCI subsidiaries currently provide.

As a threshold matter, it is important to note that the services provided by Verizon California in Arizona encompass approximately 8000 lines – less than 3/10 of one percent of the conventional (ILEC + CLEC) wireline access lines in Arizona. When wireless and high speed lines are included, Verizon's ILEC lines are only about 1/10 of one percent of the total lines in service.[5]

Q. WILL THERE BE ANY ADVERSE IMPACT FROM THE MERGER?

A. No. As noted above, the Verizon-MCI Agreement requires no change in the operations of the Arizona regulated subsidiaries; in particular, there is no change contemplated with respect to the terms and conditions of service; service quality; customer service; the quality of facilities; the rate of investment; the companies' corporate affiliate transaction guidelines and policies; and their respective commitments to their customers and to their communities. To the contrary, the transaction will greatly enhance the abilities that both Verizon and MCI now possess as stand-alone companies to provide a comprehensive suite of services to consumers, businesses and government customers. Moreover, the transaction will not affect the ACC's regulatory authority over the companies, because the state-regulated MCI and Verizon business units will retain whatever regulatory certificates and obligations they currently have.

For all of these reasons, I conclude that the transaction will affirmatively provide benefits and will not adversely affect competition, rates, financial status, or ability to attract capital in Arizona and should be approved as proposed.

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[5] These calculations are based on internal Verizon data and data from the FCC, Local Telephone Competition: Status as of December 31, 2004, Tables 8, 9 and 13 and FCC, High-Speed Services for Internet Access: Status as of December 31, 2004, Table 8.

II. THIS TRANSACTION IS PART OF A MUCH BROADER RESTRUCTURING OF THE INDUSTRY AROUND NEW TECHNOLOGIES, NEW SERVICES AND NEW PROVIDERS

Q. YOU SAID THAT THIS MERGER IS A RESPONSE TO NEW TECHNOLOGIES, NEW SERVICES, AND NEW PROVIDERS. WHAT DO YOU MEAN WHEN YOU USE THOSE TERMS?

A. The transformation of the communications industry is the result of sweeping changes in technology. The deployment of digital, two-way, broadband capabilities, along with the growth of IP-based technologies, has finally brought about the long-anticipated "convergence" among once-separate networks and providers. Wireline voice, data, cable, wireless, and satellite networks are all now capable of delivering more and better voice, data, and video services. Telephone networks originally were built to transmit a voice signal from one place to another, but networks now are being optimized to deliver data, rather than voice, such that voice is just an adjunct to some data services. Enterprise and mass-market customers alike have adopted these new technologies and services and increasingly use them both along with, and in place of, traditional wireline offerings.

Q. HOW HAVE THESE CHANGES AFFECTED CUSTOMERS?

A. These new technologies have produced new services that have changed the way people communicate and the way that they purchase their communications services. Customers at home and at work often communicate using e-mails and instant messages from their computers or personal digital assistants (PDAs) instead of making traditional phone calls. And when customers do need to make a voice call, they are increasingly turning to their wireless phones.

The growth of broadband networks and services also has had an impact on communications. For example, some customers are replacing wireline phones with broadband connections, which can be used to provide a range of voice over Internet protocol (VoIP) services. Customers are using their various wireline and wireless devices not only to make voice calls and send messages, but also to share multimedia files, such as photos, video clips, music and documents. E-mail and instant messages are more numerous than voice calls, and many of the former now substitute for the latter.

Q. HOW HAVE COMMUNICATIONS COMPANIES ADAPTED TO THESE NEW CUSTOMER EXPECTATIONS?

A. Communications companies of all varieties — wireline, cable, wireless, and VoIP alike — have adapted to and accelerated these changes by offering "any time, any distance" calling plans and bundles of services that reflect this new reality and at prices that would have seemed implausible just a few years ago. Companies that were never in the *tele*communications business are now thriving competitors in the communications business.

Q. THIS BROAD RESTRUCTURING MUST INCLUDE CHANGES TO NETWORKS. PLEASE DESCRIBE SUCH CHANGES.

A. The most important change to networks is the ability to seamlessly carry both voice and data traffic as digital bits. At a technological level, there is no distinction between voice and data traffic because digital networks convert both voice and data into indistinguishable digitized bits. To remain competitive, companies must replace, upgrade, expand and develop their networks to meet customer demands for efficient, competitively-priced voice and data delivery services.

Q. HAS THE LINE BETWEEN LOCAL AND LONG DISTANCE ALSO BECOME BLURRED?

A. Yes. In addition to blurring the line between voice and data traffic, the technological innovations described above have blurred – indeed, rendered irrelevant – the line between local and long-distance traffic. New technologies and new modes of communication are erasing the distinction between local and long distance that once segregated the industry and drove some of the more significant policy decisions of the past. From the customer's standpoint, it is no different to send an e-mail across the globe than across the street. A customer can plug in a VoIP phone in Tucson using a local telephone number from Boston. A business can provide its employees with a Blackberry® to communicate between Phoenix and Philadelphia as easily as they communicate across town. A customer can use her wireless phone in Scottsdale, Tampa or San Francisco, and pay the same amount whether she calls a neighbor around the corner, a colleague in another town or a relative across the continent. The obliteration of distinctions between local and long-distance calling has been caused primarily by intermodal competition from wireless and other technologies.

Stated simply, local and long distance wireline carriers have been forced to adapt to the marketing strategies and technological capabilities of their *non*-wireline competitors. At this point, even though they may still offer a stand-alone long distance or local product, many traditional wireline carriers actively market packages of services to customers. This is because the new entrants to the market often ignore geographic and jurisdictional boundaries. The perfect example of such a service is VoIP, in which a customer may have a number from one city, a broadband connection in another city, and use the phone almost anywhere in the world. Such offerings make geography irrelevant to communications. As a result of such new services and the flexibility that they have made possible, customers now demand – and carriers must supply – communications services that allow calling to local, regional, national, and even international locations with ease and at competitive rates.

Q. HOW CAN THE COMMISSION BEST EVALUATE THIS TRANSACTION IN LIGHT OF THE INDUSTRY DYNAMICS THAT YOU DESCRIBE?

A. The ACC, like the companies providing communications services, should adapt its regulatory analysis to match an environment of new technologies and new customer expectations. The ACC should evaluate the competitive effects of this transaction based on the entirety of the communications market and not based on the wireline market segment standing alone, much less any subset of that market, such as local or long distance.

Q. WHAT DO YOU MEAN BY "THE ENTIRETY OF THE COMMUNICATIONS MARKET?"

A. The ACC should view the market from the perspective of customers, who take little notice of jurisdictional boundaries or outdated market distinctions except when they stand in the way of efficient, reasonably priced services. It is particularly important to recognize the breadth of the new market in which Verizon and MCI will compete following the transaction. For example, large enterprise and medium-sized business customers purchase services that include not just wireline voice, but data services as well as network integration, network management capabilities and wireless services. The competition to provide such services includes not only MCI, Verizon, AT&T and other ILECs and competitive local exchange carriers ("CLECs"), but also, numerous companies that are not regulated by the ACC and with which the ACC may be unfamiliar.

Q. HOW DOES THIS INDUSTRY ANALYSIS RELATE TO CONSUMERS AND SMALL BUSINESS CUSTOMERS?

A. Consumer and small business expectations have similarly changed and this market segment too is now served by a broad array of providers and services, including wireline and wireless voice and data, broadband from cable, VoIP, e-mail and Instant Messaging. These customers generally can choose from a full range of "any time, any distance" services from various providers such as wireline, wireless, broadband, cable, and VoIP. If the ACC reviews this transaction with an understanding of current market realities and expected market advances, it should conclude that this transaction will promote the public good by creating an entity that is better able to compete against the new players in the mass market sector (for example, VoIP and wireless companies) than MCI or Verizon would have been alone.

Q. PLEASE PROVIDE AN OVERVIEW OF MCI'S BUSINESS.

A. MCI's subsidiaries[6] offer communications services through three business segments defined by their customer bases: "Enterprise Markets;" "U.S. Sales and Service;" and "International and Wholesale Markets."[7] The Enterprise segment includes the largest and most complex business customers, including the Fortune 1000, as well as similarly complex government and institutional accounts. MCI's enterprise segment primarily serves large enterprise customers, including 75 federal government agencies. MCI's enterprise services include a comprehensive portfolio of local-to-global data, Internet and voice services, including IP network technology, VPN services, SONET private line, frame relay, ATM and a full range of dedicated, dial-up, and value-added Internet services.

The U.S. Sales and Service segment encompasses both commercial and mass market segments. The commercial market segment includes other large and medium businesses, while the mass market segment sells to residential customers and small businesses. The international and wholesale market segment provides services to foreign entities and wholesale customers.

MCI has a strong and successful interstate and international enterprise segment sales organization and network assets. MCI's extensive long-haul fiber network is particularly

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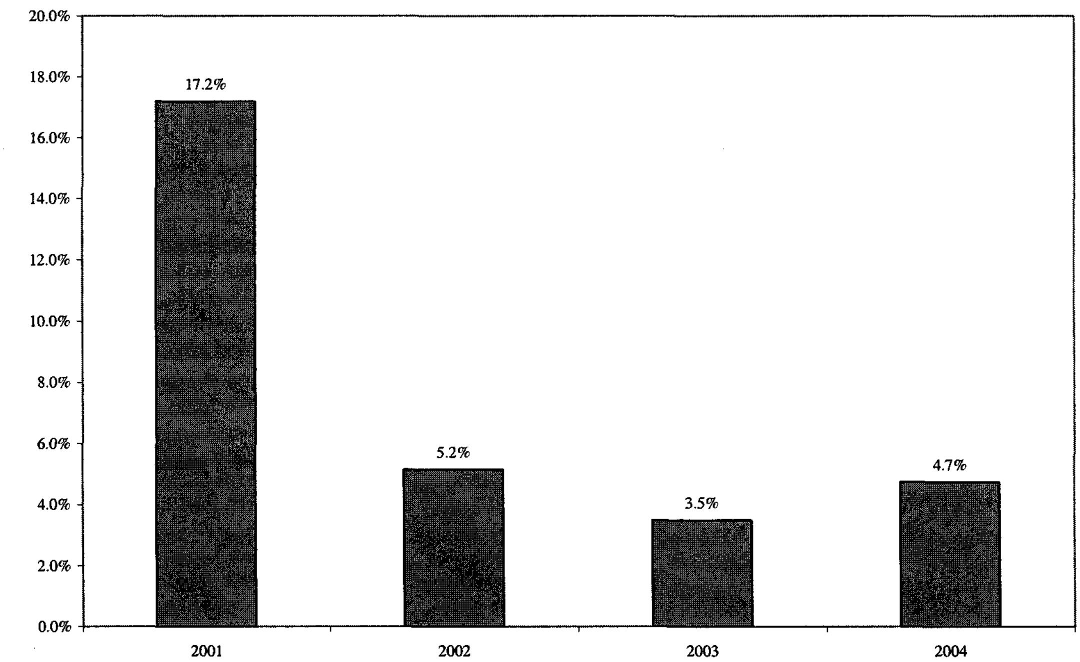
[6] The MCI subsidiaries operating in Arizona are listed in Verizon-MCI Joint Notice of Intent.

[7] MCI Announces Fourth Quarter and Full-Year 2004 Results, MCI Press Release, Feb. 25, 2005.

well equipped to handle Internet protocol and data traffic, and its extensive international network is capable of providing transport both across countries and in cities outside the United States. However, between 2001 and 2004, MCI's capital expenditures decreased from approximately $6.5 billion to $1 billion per year. Expressed as a percentage of its revenues, MCI's capital expenditures for this period are set forth in Figure 1 below.

Figure 1
MCI Wireline Capital Expenditures as a Percentage of Wireline Revenue[8]



Source: MCI 10Ks

Q. HAVE EVOLVING TECHNOLOGICAL AND MARKET TRENDS AFFECTED MCI'S WIRELINE REVENUES?

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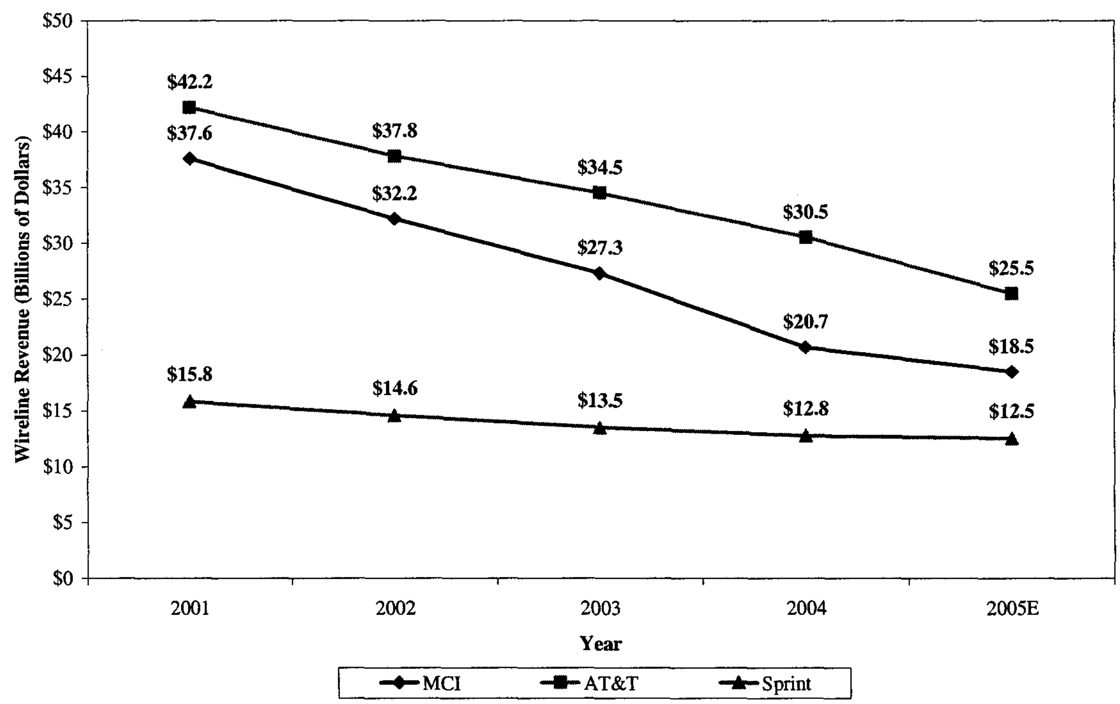
[8] Note that the 4.7 percent shown for 2004 is from MCI's 2004 SEC Form 10 K. It differs slightly from the corresponding estimate of 4.9 percent from the January 14, 2005 UBS *Wireline Telecom Play Book* reported in the declaration of Bamberger, Carlton, and Shampine, Figure 2, filed on behalf of Verizon with the FCC on March 11, 2005. But regardless of which figure is used, the evidence of declining investment is clear.

A. Yes. Like other wireline toll carriers, MCI has recently experienced a substantial and continuing decline in wireline revenues. MCI's witness, Michael Beach, explains the reasons for this decline in his testimony. Figure 2 below depicts the trends in the major IXCs' wireline revenues, including MCI's wireline revenues:

Figure 2
Wireline Revenue of MCI, AT&T and Sprint
2001 through 2005



Sources: Company Form 10-Ks and Hodulik, John C., et. al, "Wireline Telecom Play Book," UBS Investment Research, January 14, 2005.

Q. HOW HAS MCI DECIDED TO MANAGE ITS DECLINING REVENUES?

A. As Mr. Beach explains, MCI's declining wireline revenues and sales volumes informed that company's decision to reduce dramatically its marketing efforts to mass market customers, including very significant reductions in mass market advertising, reductions in force among its mass markets sales force, as well as the closing of several call centers.

Q. PLEASE PROVIDE AN OVERVIEW OF VERIZON'S BUSINESS.

A. Verizon subsidiaries[9] provide wireless communications throughout the United States and provide wireline services in 28 states (including Arizona) and the District of Columbia. Verizon's operations include four business segments: domestic, wireless, information services, and international.[10] Verizon's domestic communications services include voice and data services, Centrex services, as well as exchange access services, including switched access and special access services.

Verizon owns 55 percent of Verizon Wireless through a joint venture agreement with Vodafone Group Plc ("Vodafone"). Verizon Wireless offers wireless voice and data services as well as wireless equipment. In addition to providing communications services, Verizon's domestic subsidiaries provide information services including directory publishing and electronic commerce. Verizon's international subsidiaries provide wireline and wireless communications operations and investments.

Q. HOW HAVE TECHNOLOGICAL AND MARKET PLACE TRENDS AFFECTED VERIZON'S TRADITIONAL WIRELINE BUSINESS?

A. Verizon's wireline business has declined substantially, with dramatic reductions in the number of retail lines served and minutes of use of its switched access services. Total Verizon retail lines in service fell by 18 percent between December 2001 and December

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[9] The Verizon companies that operate in Arizona are listed in the Verizon-MCI Joint Notice of Intent.

[10] *Verizon Fourth Quarter 2004*, Investor Quarterly, Jan. 27, 2005.

2004.[11] Verizon's retail lines declined in each customer category, including residential and all business customers.[12]

Q. HOW DOES THE MERGER OF MCI AND VERIZON RESPOND TO THE INDUSTRY TRENDS AND COMPETITIVE CHALLENGES THAT YOU DESCRIBE?

A. Verizon's merger with MCI represents a natural, evolutionary step in the industry transformation discussed above. The evidence of a dramatic transformation of the communications industry – driven by technological advances – is overwhelming, whether viewed on a national scale or in Arizona. For example, some large enterprise customers are moving to wireless services in lieu of wireline services (as illustrated by an agreement between Sprint and Ford Motor Company to replace 8,000 SBC lines with Sprint's wireless PSC service). Many enterprise customers are migrating their traffic from separate voice and data networks to integrated IP networks capable of providing all of the services they need more efficiently. In addition, mass-market customers are increasingly taking advantage of wireless, digital, cable and other solutions for their evolving communications needs. The companies that can provide such services are numerous and varied. Verizon and MCI have determined that a combination of their complementary strengths is the best way to compete with such providers.

Q. ARE THE TECHNOLOGY AND MARKET TRENDS DESCRIBED ABOVE CONFINED TO THE ENTERPRISE MARKET SEGMENT?

[11] Derived from data provided by Verizon, *see* "Verizon-Total (excl. HI), Retail Quarterly Data for December 2001-December 2004, Located-Channels Basis."

[12] *Id.*

A. Hardly. As previously noted, a similar transformation is reshaping the consumer market, with wireline, cable and other broadband, wireless, and VoIP competition present in the state. I discuss these various modes of competition below.

Q. PLEASE DESCRIBE WIRELINE COMPETITION IN ARIZONA.

A. Competition among traditional wireline providers in Arizona – that is, among ILECs and CLECs – is extensive, as evidenced by a decline in Verizon's access lines in Arizona since 1999. This is evident even when competition is measured by reports that include only a limited portion of the total market, such as larger wireline CLECs. According to the FCC's Local Competition Report, CLEC market share in Arizona is 25%, higher than the national average, and increased substantially in the past four years. CLEC market share has increased almost 400 percent since 2000 and grew 15 percent during 2004 alone. Over 55 percent of the CLEC lines in Arizona are "CLEC Owned," i.e., CLECs reported that 439,522 of their 792,272 lines in Arizona were served over their own facilities, rather that using UNEs or resale. Much of this competition comes from cable companies, such as Cox Communications.

As noted, FCC reports are conservative in terms of measuring competitive line losses for ILECs. First, the FCC report does not include VoIP providers, wireless carriers, or broadband lines – all of which can and are used as alternatives for traditional wirelines. Even the measure of wireline CLEC penetration does not capture the total CLEC market since CLECs serving less than 10,000 access lines are not required to report to the FCC.

Q. PLEASE DESCRIBE COMPETITION FROM CABLE AND BROADBAND SERVICES IN ARIZONA.

A. Cable companies, which provide both broadband and voice services, are among the most competitive communications providers in the state. For example, cable companies supply far more of the state's broadband connections than the local exchange companies provide. They can and do provide circuit-switched telephony, but their broadband connections are also being used for VoIP services that are supplied by the cable provider, or VoIP applications provided by other VoIP competitors, such as Vonage. All of the major cable operators have begun offering VoIP services over their networks and by the end of this year will be offering service to more than 40 million homes in the United States. Major cable operators already make voice service available across their entire footprint, while others expect to reach that milestone by the end of next year. Nearly five million American households already subscribe to cable telephony and VoIP services, and cable companies and other VoIP providers are predicted to displace wireline in as many as one-fifth of American households within five years.

Data from the FCC's Local Competition Report and Report on High-Speed Services for Internet Access show that Arizona, like the rest of the nation, is experiencing widespread and growing intermodal competition, none of which will be affected by the transaction. Said differently, once the transaction is completed, numerous cable, wireless, Internet and broadband and VoIP competitors will continue to provide communications services to mass market customers in the state.

According to data reported by the cable companies to the *Television & Cable Factbook*, 97 percent of the two million homes passed by cable systems in Arizona have broadband service available and 73 percent of the homes passed already have cable company provided telephony available. Table 1 provides a more detailed look at these data:

Table 1
Advanced Cable Services Are Widely Available in Arizona

	Homes Passed			Percent of Homes Passed	
Company	Total	Broadband Ready	Telephony Ready	Broadband Ready	Telephony Ready
Cox Communications	1,477,068	1,473,291	1,446,823	100%	98%
Other	517,474	460,664	0	89%	0%
Total	1,994,542	1,933,955	1,446,823	97%	73%

Notes: Missing homes passed data is estimated based on the average penetration of other Arizona systems; Qwest's cable operation in Phoenix is excluded.
Sources: Television & Cable Factbook, Cable Volume, 2005.

Cox Communications, which accounts for almost 75 percent of cable homes in Arizona, has been quite successful in selling its advanced services. In its first quarter 2005 earnings release, Cox states that it added 177,413 high speed Internet customers nationally, to end the quarter with over 2.7 million, representing year-over-year customer growth of 28%. Cox added 111,522 digital phone customers, the most ever added in a quarter to reach over 1.4 million, representing year-over-year growth of 33%.[13]

The technological convergence and intermodal competition between the cable companies and wireline carriers is further illustrated by Qwest's decision to compete

[13] Cox Press Release available at http://phx.corporate-ir.net/phoenix.zhtml?c=76341&p=irol-newsArticle&t=Regular&id=707716&.

directly with Cox in parts of Phoenix by offering a competing television service.[14]

According to Qwest's web site:

- Qwest Choice™ TV & OnLine offers an innovative alternative to existing cable or satellite service, with the latest in video entertainment, high-speed Internet access, and integrated telephony features -- all delivered through an existing telephone line. Qwest Choice TV & OnLine customers can view programming, access the Internet, and talk on the phone—all at the same time, through one single phone line.[15]

- Qwest Choice™ TV provides more value and choice for a customer's dollar, with multiple premium movie options, Pay-Per-View and audio music channels. Powered by VDSL technology, Qwest Choice TV integrates telephony features such as Qwest Caller ID and Voice Messaging,* and is connected by a single Digital Gateway box.[16]

Q. PLEASE DESCRIBE THE GROWTH OF BROADBAND SERVICES IN ARIZONA.

A. According to the FCC's High-Speed Services for Internet Access Report, broadband access lines in Arizona grew from about 153,500 in December 2000 to about 751,000 in December 2004. The number of residence and small business broadband lines increased by almost 558,000 lines, or almost 400 percent, over the same period. Broadband networks also facilitate the use of other means of communications as an alternative to voice calls, such as e-mail and instant messaging. More consumers now use broadband connections instead of dial-up connections to access the Internet, and an increasing

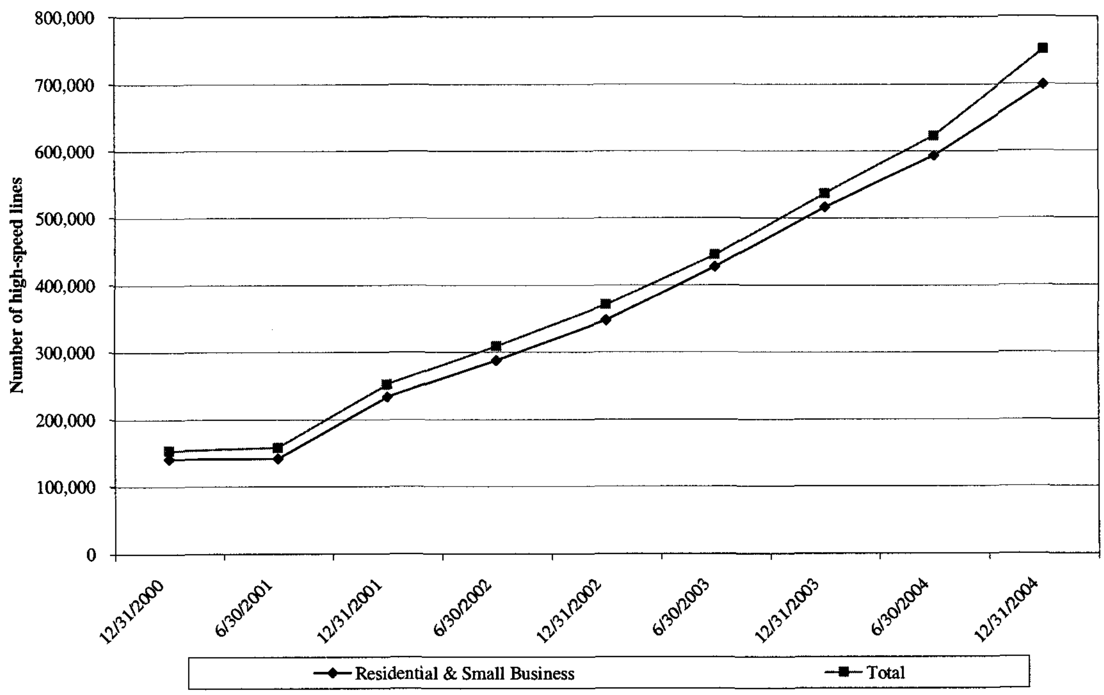
[14] See Television & Cable Factbook, Cable Volume, 2005.

[15] http://www.qwest.com/vdsl/phoenix/

[16] http://www.qwest.com/residential/products/tvservices/phoenix/tv.html

number have begun using these broadband connections for voice as well.[17] Data on the growth of high-speed lines in Arizona are shown in Figure 3 below.

Figure 3
High Speed Lines in Arizona
2000 Through 2004



Source: Federal Communications Commission Reports, High Speed Services for Internet Access: Status as of June 30, 2000 through 2004 and December 31, 2000 through 2004.

With the increase in the number of broadband lines, the number of entities offering high-speed Internet services has grown. As of December 2004, there were nine ADSL providers, eight coaxial cable providers and a total of 26 unduplicated high-speed line providers in Arizona. This is an increase from four ADSL providers and between one

17 *See* Nielsen Net Ratings, "U.S. Broadband Connections Reach Critical Mass," August 18, 2004. http://www.netratings.com/pr/pr_040818.pdf

and three coaxial cable providers for a total of nine unduplicated providers in 2000. Moreover, the number of Zip Codes with two or more providers had grown to 95 percent, exceeding the national level of 83 percent. Cable modem service continues to be the major source of broadband in Arizona. As of December 2004, coaxial cable accounted for about 73 percent and ADSL accounted for about 18 percent of the 751,000 high speed lines serving Arizona.

Q. PLEASE DESCRIBE COMPETITION FROM WIRELESS CARRIERS IN ARIZONA.

A. There are numerous wireless providers serving customers in Arizona. These include Cingular, Sprint, T*Mobile, Nextel, MetroMobile, as well as Verizon Wireless. Wireless competition is robust and customers are increasingly using wireless services in direct competition with traditional telecommunications services. Nationally, the number of wireless subscribers has overtaken the number of traditional incumbent local exchange carrier lines, and this is also true in Arizona where there are approximately 3.3 million wireless subscribers versus approximately 2.4 million ILEC lines. In Arizona, the number of wireless subscribers grew 193 percent between December 1999 and December 2004.

Over this same period, the number of wireless subscribers in the United States grew from 79.7 million to over 181 million.[18] According to the FCC, 23 percent of voice minutes in the U.S. in 2003 were wireless, up from 7 percent in 2000,[19] and from 1999 to 2003 the

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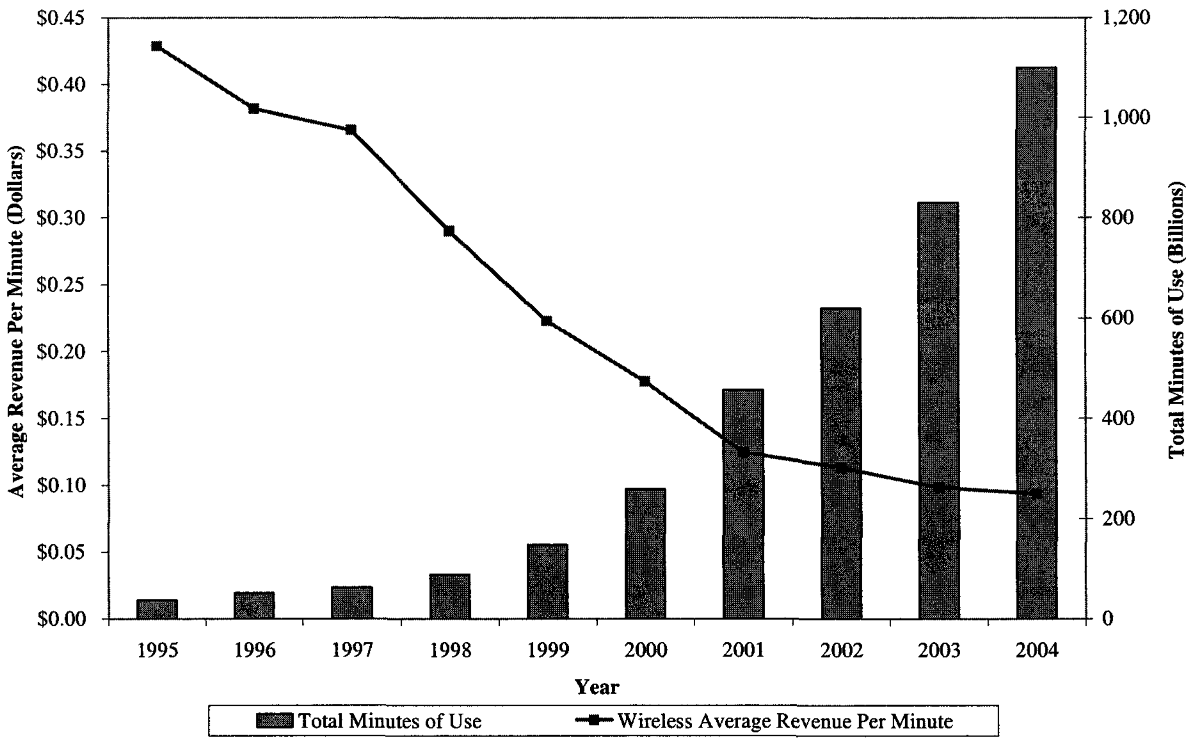
[18] FCC Report, Local Telephone Competition: Status as of December 31, 2004, Table 13.

[19] *See* In the Matter of Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services, Ninth Report ("Ninth CMRS Report"), FCC 04-216, released September 28, 2004, at ¶ 213.

monthly minutes of use per subscriber increased from 185 to 507.[20] As shown in Figure 4 below, total minutes of use of wireless services increased from 38 billion in 1995 to about 1.1 trillion in 2004, a 29-fold increase in nine years. This growth has come as a result of, and has contributed to, the declining average charges for wireless usage depicted below.[21]

Figure 4
Wireless Average Revenue Per Minute and Total MOUs



Notes and Source: Federal Communications Commission Ninth Annual CMRS Competition Report, Table 9 at A-11. CTIA survey.

The tremendous growth of wireless subscribership and usage proves that customers have become accustomed to the rapidly diminishing drawbacks of wireless and are becoming

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[20] Ninth CMRS Report, Table 9.

[21] Note that BLS wireless services price indices decreased significantly from the late 1990s through 2001; leveled off and then declined slightly more through the end of 2004. Price indices for wireline services stayed relatively constant over this period as declines in toll service prices offset the local price increases. Overall, wireless prices have clearly come down by a substantial amount relative to wireline services.

more willing to give up wireline. Indeed, it was reported more than a year ago that wireless service has gained a general level of acceptance among consumers despite its "limitations." One study concludes that "[c]onsumers appear to be more willing to accept a modest reduction in the level of reliability in return for other benefits (especially low price, and improved convenience)."[22]

Q. YOU HAVE MENTIONED COMPETITION FROM VOIP SERVICES AND PROVIDERS. HOW DOES VOIP COMPETE WITH WIRELINE SERVICES?

A. VoIP technology allows customers to make and receive local and long distance calls using adapters with ordinary telephone equipment and ordinary dialing patterns. VoIP technology can be used in at least three basic ways: (1) cable companies use VoIP technology over their own networks to provide "cable telephony" without requiring customers to subscribe to broadband service;[23] (2) VoIP service can be provided as a software application over customers' existing broadband (DSL or cable) connections and uses the public Internet to transport calls; and (3) businesses use VoIP equipment on their private networks and switching systems in place of traditional telephone services. VoIP services include many of the basic features that wireline circuit switched telephony offers, as well as advanced features often not available from ILEC services. VoIP

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[22] *See, e.g.*, R. Talbot, *Battle for the Broadband Home*, RBC Markets, Jan. 27, 2004, p. 7. *See also* Frank Louthan, Vice President, Equity Research, Raymond James, prepared witness testimony before the Subcommittee on Telecommunications and the Internet of the House Energy and Commerce Committee, Washington, DC (Feb. 4, 2004) ("A key change in consumer preference would include acceptance of less than '5-9's' reliability for phone coverage, which I believe is already emerging, as evidenced by the significant numbers of consumers that already view wireless as an acceptable alternative to a landline phone.").

[23] *See, e.g.*, Cox Communications FAQs "*Will My House Need to be Rewired*?" and "*Will My Current Telephones Work*?" at http://www.cox.com/Telephone/FAQs.asp#P25_5970 accessed March 29, 2005. Typically, the customer is not required to buy specific equipment to use the VoIP service and can use her existing telephones with adapters provided by the cable company.

offerings are typically priced lower than ILEC wireline unlimited local and long distance calling packages. They also offer features not available from traditional wireline services, such as the ability to choose any area code in the nation, the ability to access voice mails on the Internet that were sent via sound attachments by e-mail, telemarketer blocking that rejects calls from automated dialing computers, and call filtering that offers control over who can call at what hours.[24]

VoIP providers' services have grown extremely fast in the last year or so. For example, Vonage offers Premium Unlimited services for $24.99 per month and Small Business Unlimited services for $49.99 per month.[25] Vonage had exceeded 400,000 subscribers as of January 2005, after adding over 300,000 new subscribers in 2004 alone.[26] And, according to a recent article in BUSINESS WEEK: "*Vonage subscriptions have jumped 63% this year, to 700,000. Some 15,000 more jump on board every week.*"[27]

Q. PLEASE DESCRIBE VOIP COMPETITION IN ARIZONA.

A. Given the widespread availability of broadband service in Arizona and given the state's favorable high-technology environment, growth in the VoIP market likely has occurred in Arizona, although state-specific data are not reported. Because VoIP service is offered as an application over the Internet, and because the providers are not regulated and can

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[24] Pogue, David, "*Cut-Rate Calling, By Way of the Net*," The New York Times, April 8, 2004.

[25] Vonage, *Products and Services,* accessed March 29, 2005, http://www.vonage.com/products.php, accessed April 8, 2005.

[26] Vonage Press Release, "Vonage Crosses 400,000 Line Mark," January 5, 2005, accessed March 29, 2005, http://www.vonage.com/media/pdf/pr_01_05_05.pdf, accessed April 8, 2005.

[27] *See* BUSINESSWEEK ONLINE June 20, 2005, ***The Future Of Tech–Telecommunications****, Vonage: Spending As Fast As It Can*," emphasis added. http://www.businessweek.com/magazine/content/05_25/b3938626.htm, accessed June 15, 2005.

provide service from anywhere, it is not feasible to determine all of the providers that are serving customers in Arizona. However, even a cursory review of some VoIP providers demonstrates that the service is available to Arizona customers from a variety of VoIP companies. For example, Packet8 offers an unlimited calling plan for $19.95 per month and provides for unlimited calls to anyone in the U.S. or Canada. Broadvox Direct offers similar plans starting at $12.95 a month for 500 minutes anywhere in the U.S. or Canada. It also offers an unlimited plan for $19.95 a month. Vonage offers several plans starting at $14.99.

Table 2 below lists some VoIP providers with Arizona area codes; the table shows the Arizona area codes in which they have number assigments, and their package offerings for residential and small businesses.[28] All provide some sort of unlimited local and long distance calling plan with monthly prices ranging from $19.95 to $29.99.

[28] VoIP providers can serve customers in any area of the state, even it they don't have an area code assignment. They can also use number portability.

Table 2
Arizona VoIP Plans

Provider	Plan	Area Codes Offered	Monthly Price	Anytime Minutes	Additional Minutes	Long Distance
(a)	(b)	(c)	(d)	(e)	(f)	(g)
Vonage	Premium Unlimited	480, 520, 602, 623	$24.99	Unlimited	N/A	Included
Vonage	Basic 500		$14.99	500	$0.039	Included
Vonage	Small Business Unlimited		$49.99	Unlimited	N/A	Included
Vonage	Small Business Basic		$39.99	1,500	$0.039	Included
AT&T	CallVantage Service	480, 520, 602, 623, 928	$29.99	Unlimited	N/A	Included
AT&T	CallVantage Local		$19.99	Unlimited Local	N/A	$0.04
AT&T	CallVantage Small Office[1]		$49.99	Unlimited	N/A	Included
Lingo	Link	520, 602, 623, 928	$7.95	Unlimited In-Network	$0.03	Unlimited In-Network
Lingo	Basic		$14.95	500	$0.03	Included
Lingo	Unlimited		$19.95	Unlimited	N/A	Included
Lingo	Business Unlimited[2]		$49.95	Unlimited	N/A	Included
Lingo	Business Unlimited Int'l[2]		$99.95	Unlimited	N/A	Included
Net2Phone	US/Canada Unlimited	520, 602, 928	$29.99	Unlimited	N/A	Included
Net2Phone	US/Canada 500		$14.99	500	$0.039	Included
Net2Phone	VoiceLine Basic[3]		$8.99	Unlimited Inbound	N/A	$0.05

Notes & Sources:

Provider websites, accessed May 18, 2005.

[1] CallVantage Small Office also includes unlimited faxing, additionally the service includes a second line with 500 long distance faxing and calling minutes per month. Additional minutes over 500 for the second line costs $0.04 per minute.

[2] Lingo Business plans includes 500 outgoing fax minutes. The Unlimited Business International plan includes calls to many international countries.

[3] Net2Phone VoiceLine Basic: Unlimited inbound calls & pay-as-you-go outbound calls.

Q. HOW HAS THE COMPETITION THAT YOU HAVE DESCRIBED AFFECTED VERIZON AND MCI?

A. Providers of wireline services – whether ILEC or CLEC – face intense competition both from other wireline companies and from intermodal competition of the type I described above. The widespread availability and rapid growth of non-wireline alternatives has changed the communications business to the point that the traditional wireline (*i.e.*, telephone exchange) businesses of both MCI and Verizon (like those of other wireline carriers) have been in decline for some time.

As shown in Figure 5 below, residence and small business conventional wireline (*i.e.*, ILEC + CLEC) access lines in Arizona have declined by seven percent since year-end 2000 (*i.e.*, an average of about two percent per year). During that same time period: (i) the number of wireless subscribers increased by over 75 percent or almost 1.5 million new subscribers; (ii) the number of residential and small business broadband lines increased by about 558,000 lines or about 400 percent; and (iii) by December 31, 2004 the number of wireless subscribers and residential and small business broadband lines was over 1.7 million (or about 75 percent) higher than the number of residential and small business ILEC and CLEC lines.

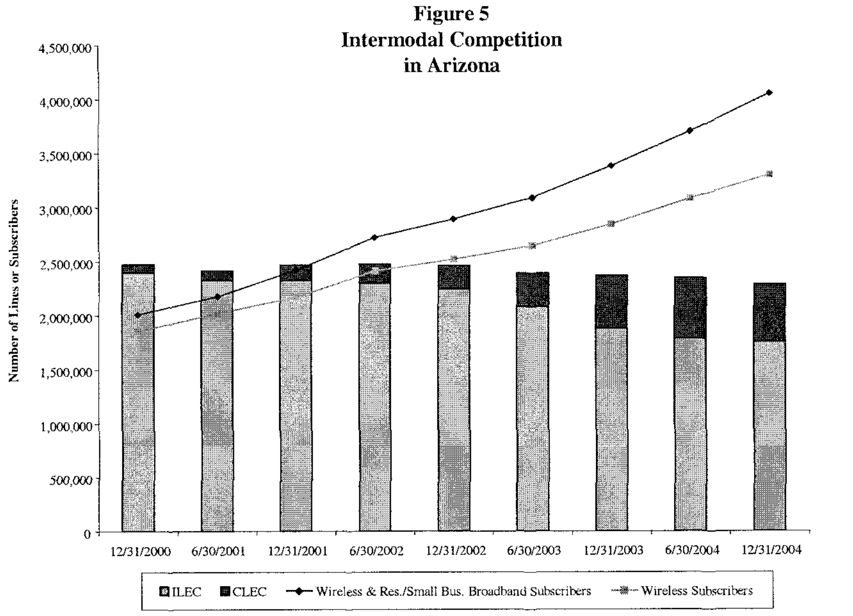

Figure 5
Intermodal Competition in Arizona

Sources: Federal Communications Commission Reports, Local Telephone Competition: Status as of June 30, 2001 through June 30, 2004 and December 31, 2001 through December 31, 2003. FCC Reports, High Speed Services for Internet Access: Status as of June 30, 2000 through June 30, 2004 and *December 31, 2000 December 31, through 2004.*

This transaction is intended to enhance the ability of Verizon and MCI to compete effectively by offering a full suite of competitively priced services, both nationally and in Arizona. It is a rational response to the intermodal competition described above.

III. JOINING VERIZON'S AND MCI'S COMPLEMENTARY BUSINESSES WILL BENEFIT ALL CUSTOMERS

Q. HOW WILL THIS TRANSACTION HELP VERIZON MEET THE NEEDS OF LARGE ENTERPRISE CUSTOMERS?

A. Customers in the large enterprise segment of the market (*i.e.*, Fortune 1000 companies, federal government agencies, large state agencies and similar sized institutions) are among the most sophisticated consumers of communications services. These customers purchase complex, integrated packages of voice and data services through competitive procurement or individually negotiated contracts. These customers also typically require services at multiple locations, and often require customization of network functions and systems. Under such contracts, voice is just one of many applications that ride over these networks. Although Verizon has been working to increase its large enterprise business for several years, it still has a relatively small share of this business in its operating territories and even less of a presence outside its operating territories. By joining Verizon's and MCI's complementary assets and sales forces, the transaction will make the combined company more competitive across the enterprise market segment than either company would have been alone. Verizon's local and wireless presence, coupled with MCI's core strength in enterprise and government sales, will allow the companies to provide enterprise and government customers with a better mix of products and services to meet these customers' needs.

Q. YOU SAID THAT VERIZON AND MCI TOGETHER WILL BE BETTER ABLE TO COMPETE IN THE ENTERPRISE SEGMENT, BUT HOW WILL THIS TRANSACTION BENEFIT LARGE ENTERPRISE CUSTOMERS?

A. Large enterprise customers will benefit from the creation of a strong new company with the network reach and financial resources that enable it to compete in this technologically intense and highly competitive market segment. Government customers will benefit and national security will be enhanced by the planned investment in the national and international communications infrastructure that is relied upon by the Departments of Defense and Homeland Security, as well as other federal and state agencies. Far from impairing the financial fitness of either company, Verizon will bring its financial strength to this transaction in a way that will ensure that these customers will continue to be served by a strong provider that can meet the customers' needs nationally and internationally. Indeed, Verizon will bring to the enterprise and governmental business sector the same commitment to innovation and investment that it previously (and successfully) brought to its mass-market wireline and wireless businesses. In addition, many large enterprise and government customers use multiple, coordinated providers to meet their needs. To the extent that such customers choose to have multiple suppliers involved in their provisioning, competing suppliers, and ultimately customers, will benefit from the availability of an efficient wholesale provider with a broad reach. Large enterprise and government customers are sophisticated purchasers in a market that has been highly competitive for years, but enhancing this important market is a significant benefit of this transaction that should be of prime importance to the ACC.

Q. ARE THERE ADDITIONAL BENEFITS FOR LARGE ENTERPRISE CUSTOMERS?

A. Yes. Within its region, Verizon has an extensive local network and Verizon Wireless has one of the most advanced and extensive wireless networks in the country. MCI, by contrast, has a global fiber optic long-distance network and global data capabilities that include private line and packet-switched data services such as ATM and Frame Relay. In addition, MCI has an extensive IP-based backbone network and related expertise. The combination of these assets will benefit customers by enabling them to obtain a broad array of services in a single transaction with a single, integrated supplier, and at the competitive pricing permitted and encouraged by the more efficient operation of these networks. The transaction also will allow Verizon to use MCI's ISP connectivity services (such as email, web hosting, DNS services and others), in a way that will enhance its capabilities in a segment in which Verizon is currently a small provider.

Q. CAN OTHER EXISTING PROVIDERS ALSO DELIVER A RANGE OF CAPABILITIES TO LARGE ENTERPRISE CUSTOMERS?

A. Yes, the transformation in communications that I described earlier applies to *all* communications providers. The Verizon-MCI acquisition is just one example of the changes the industry is undergoing. Verizon and MCI believe that their combination is the best way for the two companies to offer customers services provided over a centrally managed network, leading to an increased transparency in network management that some customers desire. Ownership of the various pieces of a network enhances a carrier's ability to standardize service quality and other requirements across the entire network. But other providers bring their own, sometimes unique, assets to the table and probably consider their own mix of products, services, and expertise to be most responsive to customer needs. Even where competitors do not have significant network assets, they are able to and can assemble transmission capacity from diverse sources, and there is generally a surplus of long-haul capacity in the market today.[29] The point is that Verizon and MCI believe that this transaction is the best way for them to compete, given their current situations, but there are many other companies who are similarly able to compete by offering their own services over their own facilities, by leasing facilities from others, or by partnering with various companies. Enterprise customers clearly will

[29] *See* Jeff Halpern, Bernstein Research Weekly Notes, *U.S. Telecom: Wholesale Segment Is Declining, But Still Significant* at 2 (Jan. 21, 2005) ("*Bernstein Wholesale Report*") ("The long-distance market is burdened with a capacity glut from the overinvestment of the late 1990s, leading to persistent pricing pressure.").

benefit from this type of dynamism as Verizon, MCI, and every other market participant try to determine the best way to meet customer demand.

Q. HOW WILL THIS TRANSACTION HELP VERIZON MEET THE NEEDS OF CONSUMERS AND SMALL BUSINESS CUSTOMERS?

A. Mass-market telecommunications services consist of services sold to residence and small business customers. As discussed in detail above, providers to this segment of the market include cable companies, traditional IXCs, CLECs, VoIP and wireless providers, and resellers. Although, many medium-sized businesses buy sophisticated communications solutions for voice and data that are similar to those purchased by large enterprise customers and are properly regarded as part of the enterprise segment, whereas some medium-sized businesses may buy "off the shelf" solutions to their communications needs and are more like small business customers. Either way, these customers will benefit from the transaction. As products and services are developed for the large enterprise sector, they can be delivered to smaller business customers with similar needs. These customers also want services and/or packages that take care of their any-distance voice and data (Internet) needs at reasonable prices, and the transaction will allow Verizon and MCI to meet this need more effectively than either company could alone.

IV. THE COMBINATION OF VERIZON'S AND MCI'S COMPLEMENTARY ASSETS AND EXPERTISE WILL NOT IMPAIR THE COMPANIES' ABILITY TO ATTRACT CAPITAL AT FAIR AND REASONABLE TERMS, WILL NOT IMPAIR THE FINANCIAL STATUS OF EITHER COMPANY AND WILL NOT HARM THEIR RATES, OR SERVICE QUALITY IN ARIZONA

Q. WILL THIS TRANSACTION HAVE AN ADVERSE EFFECT ON THE RATES AND QUALITY OF SERVICE OF THE REGULATED SUBSIDIARIES OF EITHER VERIZON OR MCI?

A. No. As previously discussed, the transaction requires no change to the operations of the regulated subsidiaries of either MCI or Verizon; therefore, there should be no impact on rates, service quality or operations at the regulated company level, and the post-transaction company will maintain or improve the quality of service to customers in Arizona. Verizon and MCI have both long recognized that providing high-quality service is essential in a competitive marketplace. Both companies are providing high-quality service and their commitment to service quality will remain unaffected by the transaction. In addition, the transaction will allow Verizon and MCI to share their areas of expertise and position the new company to improve its overall quality of service and customer satisfaction. Moreover, the increased financial strength of the post-transaction company will support additional investments in advanced technologies and upgrades in network infrastructure, which will in turn contribute to improved service quality.

The transaction will not impair the management of the affected Arizona utility subsidiaries. Verizon and MCI are committed to ensuring that there will be no diminution in the quality of the management of MCI's subsidiaries. To the contrary, access to the skills and expertise of MCI's personnel (and those of its telephone operating subsidiaries), particularly in the enterprise line of business, is one of the reasons that Verizon chose to enter into the Agreement. And Verizon – whose wireline and wireless operations are themselves each the product of successive mergers – will draw on management personnel experienced in the effective implementation of the transaction without disruption to on-going operations.

Moreover, the management of the combined company will be drawn from the current management of both Verizon and MCI. These companies offer personnel with decades of diverse and complementary experience and expertise, which will undoubtedly benefit the combined company and its Arizona subsidiaries.

Q. HOW WILL THE BENEFITS OF THE TRANSACTION BE DELIVERED TO CONSUMERS AND SMALL OR MEDIUM BUSINESSES IF THE OPERATIONS OF THE REGULATED COMPANIES DO NOT CHANGE?

A. As discussed above, the more immediate impact of this transaction is most likely to be seen in the delivery of services to large enterprise and government customers. However, the benefits of the transaction will ultimately be provided to all customers because the transaction will create a more competitive entity able to provide a broader range of services than either MCI or Verizon could have provided alone. It will also benefit all customers by enabling investment in, and improvements to, MCI's networks and operating systems.

Q. DOES THE TRANSACTION AFFECT THE REGULATION OF THE OPERATIONS OF THE COMBINED COMPANY IN ARIZONA?

A. No. This transaction does not alter the ACC's regulatory authority over the state-regulated Verizon and MCI business units. Under the Agreement, MCI will become a subsidiary of Verizon and the MCI subsidiaries will become secondary or tertiary subsidiaries of Verizon. All of the state-regulated MCI and Verizon business units will retain whatever regulatory certificates and obligations they currently have.

Q. PLEASE EXPLAIN WHY THE TRANSACTION WILL NOT IMPAIR THE FINANCIAL STATUS OF THE COMPANIES' ARIZONA OPERATIONS?

A. The transaction will maintain or improve the financial condition of the affected Arizona regulated subsidiaries. This transaction will occur at the parent holding company level and will have no structural impact on any of the subsidiaries. Thus, after the transaction, the regulated entities that will exist will be exactly the same entities that existed prior to the transaction. However, since Verizon is an established communications provider with a strong balance sheet, the transaction will improve the financial conditions of the MCI subsidiaries. Further, the combined company will have greater financial strength and flexibility than either company could achieve alone because of its greater size and complementary strengths and assets.

Q. PLEASE EXPLAIN WHY THE TRANSACTION WILL NOT PREVENT THE COMPANIES FROM ATTRACTING CAPITAL AT FAIR AND REASONABLE TERMS FOR THEIR OPERATIONS IN ARIZONA.

A. For reasons similar to those discussed above in terms of financial status, the merger will not prevent the companies from attracting capital at fair and reasonable terms. The analysis that has been done to date by Verizon shows that the overall impact on the combined company's ability to raise capital should be negligible. First, Verizon now funds its various ILEC subsidiaries through corporate funding mechanisms, rather than individual bond issues. Second, Verizon has made substantial progress in achieving significant reductions in debt overall and in cost controls throughout its business units. Finally, as a diversified communications company with wireline, wireless and broadband assets, Verizon successfully raises both debt and equity capital and does not foresee any diminishment in its ability to continue to raise capital at reasonable rates following the merger.

Q. WHAT SHOULD THE ACC CONCLUDE ABOUT THE TRANSACTION'S POTENTIAL IMPACT ON COMPETITION?

A. The ACC should conclude that this transaction creates a more effective competitor and does not cause any countervailing anti-competitive harm. This transaction will not impair competition and will not have a material adverse effect on competition among providers of communications services. Further, because of the substantial benefits that the merger will bring, the combination of Verizon and MCI will be in the public interest.

The evidence that supports this conclusion can be summarized as follows:

1. At the level of network assets, the two companies are an almost perfect fit, with MCI providing a global long-distance voice and data network and Internet backbone, and Verizon providing a dense, in-region local wireline network and best-in-class wireless network.

2. The transaction will enable greater investment in the companies' networks and assets than either company could provide alone. Verizon will make substantial investments to realize the efficiency and service-related benefits of the transaction, and has already committed to a $2 billion investment (enhancing MCI's network and systems) as a part of this transaction.

3. The state-regulated subsidiaries of both Verizon and MCI will remain regulated by the ACC. More important, the incentives of Verizon and MCI to provide quality services at reasonable rates to all customers will not be harmed, and their ability to do so should be enhanced.

4. The companies' core market strengths are complementary, with MCI's strength as a provider of large enterprise services and IP-based services paired with Verizon's strengths as a provider of local bandwidth, wireless services, CPE and related services, and network integration. The combination of the two companies promises more immediate efficiencies and long-term innovations than either company could achieve on its own.

5. Finally, because the companies' assets and capabilities are complementary, and because the combined entity will face competition from a number of diverse competitors in the enterprise segment, the transaction will not obstruct or impair competition in that segment of the communications market. Small business and residential customers also have growing competition from inter-modal and other competitors. And MCI's consumer segment of the mass market is already declining and would continue to do so absent this transaction. Therefore, the transaction also will not have anti-competitive effects in the mass-market segment.

Q. WILL THE MERGER IMPROVE VERIZON'S ABILITY TO COMPETE IN AREAS OF ARIZONA WHERE IT IS NOT THE ILEC?

A. Yes. By acquiring MCI, Verizon greatly increases its ability to compete with Qwest in both Phoenix and Tucson.[30] Moreover, one of the main reasons why Verizon is acquiring MCI is to compete nationwide for enterprise customers that want national and indeed global service. Many of those customers are located outside of Verizon's traditional ILEC service territory, and Verizon will have a strong incentive post-merger to maintain MCI's nationwide and worldwide enterprise business.

VI. CONCLUSION

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS.

A. For all of the reasons outlined above and the showing that the Verizon-MCI merger will not impair the financial status of the companies, prevent them from attracting capital at fair and reasonable terms, or impair their ability to provide safe, reasonable and adequate service, it satisfies the requirements of A.A.C. R14-2-803(C), is in the public interest, and should be approved by the ACC.

[30] Verizon already competes with Qwest in Phoenix and several adjoining areas, and Tucson, through its Verizon Avenue affiliate.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.