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BEFORE THE ARIZONA CORPORATION COMMISSION

Jeff Hatch-Miller
Chairman

Mark Spitzer
Commissioner

William A. Mundell
Commissioner

Mike Gleason
Commissioner

Kristin K. Mayes
Commissioner

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Joint Petition of	)	**Docket Nos. T-01846B-05-0279**
	)	**T-03258A-05-0279**
Verizon Communications Inc., and	)	**T-03475A-05-0279**
MCI, Inc.	)	**T-03289A-05-0279**
	)	**T-03198A-05-0279**
For Approval of Agreement and Plan	)	**T-03574A-05-0279**
of Merger.	)	**T-02431A-05-0279**
	)	**T-03197A-05-0279**
	)	**T-02533A-05-0279**
	)	**T-03394A-05-0279**
	)	**T-03291A-05-0279**

JOINT EXCEPTIONS OF
VERIZON COMMUNICATIONS INC.
AND MCI, INC. TO THE
RECOMMENDED OPINION AND ORDER

Pursuant to Arizona Administrative Code R14-3-110, Verizon Communications Inc. ("Verizon") and MCI, Inc. ("MCI") jointly submit their exceptions to the Administrative Law Judge's Recommended Opinion and Order ("RO&O"), issued on November 22, 2005.

The RO&O makes six serious errors:

1 *First*, the Arizona Corporation Commission ("Commission") does not have
2 jurisdiction under Article 15 of the Arizona Constitution to review a transaction that the
3 undisputed record evidence shows will have no effect on rates.[1] *See Corporation*
4 *Comm'n v. Arizona ex rel. Woods*, 171 Ariz. 286, 294, 30 P.2d 807, 815 (1992)
5 ("Commission has no regulatory authority under article 15, section 3 except that
6 connected to its ratemaking power"); *accord Corporation Comm'n v. Pacific Greyhound*
7 *Lines*, 54 Ariz. 159, 94 P.2d 443 (1939). The undisputed record evidence shows that the
8 transaction will not affect rates, and the RO&O did not find otherwise. Accordingly,
9 there is no basis for the Commission's jurisdiction.
10 *Second*, even assuming the Commission has jurisdiction, the undisputed record
11 evidence shows, and the Staff concluded, that the Verizon/MCI transaction meets the
12 three-part "no harm" test for Commission approval in the Affiliated Interest Rules. The
13 RO&O marshals no evidence to the contrary.[2] Instead, it detours into criticism of
14 Verizon's past public statements and litigation positions that are irrelevant to any
15 legitimate issue raised by the transaction. Based on these irrelevancies, and the legally
16 erroneous and economically unsupported notion that the transaction cannot be in the
17 public interest unless it directly benefits mass market consumers, the RO&O then
18 concludes that the transaction "barely clears the bar of being in the public interest."[3]
19 Given the thorough and favorable review this transaction has had across the country, this
20 conclusion simply is not tenable. The Federal Communications Commission ("FCC"),

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[1] The Commission also does not have jurisdiction to review the Verizon/MCI transaction because the transaction does not involve the "reorganiz[ation of] an existing public utility holding company" within the meaning of R14-2-803A.

[2] RO&O at 10.

[3] *Id.* at 21.

1 United States Department of Justice ("DOJ"), and numerous state public service
2 commissions, have conducted comprehensive and thorough public interest examinations
3 of the transaction and, looking at much the same evidence as that presented in Arizona,
4 have uniformly concluded that the transaction is in the public interest.

5 The RO&O's conclusion has no evidentiary support, cannot be squared with the
6 Affiliated Interest Rules or any constitutional authority, and serves only to justify the
7 proposed mandatory binding arbitration condition for residential consumers. The RO&O
8 expressly recognizes that the transaction will benefit Arizona business consumers. The
9 RO&O makes no finding that the transaction will harm residential customers. Nothing
10 more is required, and on that basis the transaction should be approved. The Affiliated
11 Interest Rules do not require that every transaction benefit residential consumers, nor
12 would it be good public policy to do so.

13 *Third,* no record evidence supports the RO&O's conclusion that approval of the
14 transaction should be conditioned on compelling Verizon to submit to binding arbitration
15 before the Commission of all residential consumer complaints concerning billings and
16 unauthorized charges for services provided by its Arizona-regulated affiliates.[4] Staff and
17 the RO&O correctly found that the transaction will not harm residential consumers.[5]

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[4] In these exceptions, Verizon and MCI do not represent the interests of Cellco Partnership d/b/a Verizon Wireless ("Verizon Wireless") and, therefore, do not discuss or rely upon arguments that both federal and Arizona law preclude the Commission from extending the proposed mandatory binding arbitration condition to wireless contracts and wireless rates. Because neither merger partner – nor their Arizona affiliates subject to the Commission's jurisdiction – provide wireless services in Arizona, and because Verizon Wireless, is not a party to this proceeding, nothing in these exceptions should be construed as a waiver of any legal argument regarding the absence of authority under Arizona or federal law, including federal preemption law as applied to wireless rates and wireless service contracts. *See, e.g.*, 47 U.S.C. § 332(c)(3); Second Report & Order, *In the Matter of the Truth-in-Billing and Billing Format,* 20 FCC Rcd 6448 (2005). Furthermore, pursuant to the explicit terms of the governing Partnership Agreement, Verizon has neither actual nor apparent authority to bind Verizon Wireless to any of the conditions proposed in the RO&O.

[5] RO&O at 20.

1 Thus, there is no legal or factual justification for conditioning approval of the transaction
2 on this new arbitration program for residential consumers.

3 *Fourth,* "establish[ing]" the proposed arbitration program as the by-product of a
4 series of unrelated proceedings – as the Commission seeks to do here and has already
5 done in proceedings involving SBC/AT&T and Cox – violates the Arizona
6 Administrative Procedures Act ("APA"). *See* A.R.S. §§ 41-1001(17), -1030; *see also*
7 A.R.S. § 40-243. If the Commission wants to establish a policy of mandatory arbitration
8 before the Commission of residential consumer billing disputes, it must proceed through
9 rule making, not serial, *ad hoc* adjudications, and it must apply those rules in a
10 competitively neutral manner. The Commission may not use *ad hoc* adjudication to
11 circumvent the APA's public notice and comment requirement, or its requirement that the
12 Arizona Attorney General review and certify the rule before it becomes effective.

13 *Fifth*, the proposed arbitration provision cannot lawfully include Voice over Internet
14 Protocol ("VoIP") services because the FCC has determined that it has exclusive
15 jurisdiction to regulate VoIP service. Preemptive federal law bars the Commission from
16 conditioning its approval of the transaction on Verizon's agreement to submit to binding
17 arbitration before the Commission of residential consumer disputes concerning VoIP
18 services. *See* Memorandum Opinion and Order, *Vonage Holdings Corp. Petition for*
19 *Declaratory Ruling Concerning an Order of The Minnesota Public Utilities Commission*,
20 19 FCC Rcd 22404 (2004).

21 *Sixth*, the proposed condition violates the United States and Arizona Constitutions,
22 including the Commerce and Due Process Clauses. The Commission cannot use its
23 purported authority to approve the transaction to coerce Verizon into accepting a
24 condition that violates state and federal constitutional rights.

ARGUMENT

I. THE COMMISSION DOES NOT HAVE JURISDICTION OVER THE TRANSACTION

The RO&O finds as a matter of law that the Commission has jurisdiction to review this transaction and impose its conditions under Article 15 of the Arizona Constitution.[6] This conclusion is erroneous.[7]

The Commission's authority under Article 15 is strictly limited to reviewing and approving transactions between "a public service corporation and its affiliates that may significantly affect economic stability and thus impact the rates charged by a public service corporation." *Woods*, 171 Ariz. at 294-95, 830 P.2d at 815-16 ("Commission has no regulatory authority under article 15, section 3 except that connected to its ratemaking power"); *accord Pacific Greyhound Lines*, 54 Ariz. 159, 94 P.2d 443.[8]

The record evidence in this proceeding is overwhelming and uncontradicted that the transaction will have no effect on Arizona rates or ratepayers. In their Notice of

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[6] RO&O at 21.

[7] The RO&O's conclusion that Verizon's Arizona subsidiary cannot rely on the waiver granted to its predecessor company because "no transfer of the limited waiver was sought or obtained from the predecessor companies to Verizon California," RO&O at 7, is contradicted by the publicly stated conclusion of the Chief Counsel to the Commission. In the context of the Bell Atlantic/GTE merger, which was also a parent company transaction just like this one here, Mr. Kempley told Verizon's predecessor companies that they could rely on the limited waivers granted to predecessor companies. *See* Letter from Christopher Kempley, Assistant Chief Counsel, Arizona Corporation Commission, to Jeffrey Crockett, Esq. (Nov. 16, 1998) (attached as Exhibit A). The Chief Counsel's opinion about the applicability of the waivers must be given substantial weight, *see, e.g.*, *Phelps Dodge Corp. v. Arizona Dept. of Water Resources*, 118 P.3d 1110, 1117 (Ariz. App. Div. 2005); *Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 883 (2000), and may estop the Commission from taking a contrary position in state or federal court, *see Valencia Energy Co. v. Ariz. Dep't. of Revenue*, 959 P.2d 1256, 1270-71 (Ariz. 1998).

[8] Even assuming the Commission has jurisdiction to review the transaction under Article 15, the public interest test and condition proposed in the RO&O plainly exceeds the scope of the Commission's powers because they do not relate to rates or ratemaking. Nor does any statute or regulation support the RO&O's public interest test or proposed condition.

1 Intent, Verizon and MCI repeatedly informed the Commission that, because the
2 transaction is at the parent company level and will have no effect on the Arizona
3 subsidiaries, it would "have no adverse effect on the rates or the quality of service of the
4 regulated Verizon and MCI subsidiaries."[9] Verizon witness Timothy J. McCallion
5 reiterated this point. In his rebuttal testimony,[10] and on cross examination, Mr.
6 McCallion testified that the transaction would not "result in an increase in rates,
7 withdrawal of any services, or changes to the terms and conditions of those services."[11]
8 Staff witness Elijah O. Abinah testified that Staff understood from Verizon and MCI that
9 "there will be no impact on the rates currently charged customers."[12] There is no
10 evidence to the contrary. The RO&O ignores this key, uncontested fact.
11 Because the RO&O has not found that the transaction will affect rates, the
12 Commission is without jurisdiction under Article 15, and it has no more authority to act.[13]
13 "It is fundamental that no court of law, board or administrative agency can act without

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[9] Notice of Intent at 3 (Apr. 13, 2005); *see also id.* at 7 ("The transaction will not affect the regulatory authority of the Commission over any of Verizon's or MCI's regulated subsidiaries, nor will it have any impact on the services that those subsidiaries provide in Arizona."); *id.* at 8 ("The proposed acquisition will have no adverse impact on rates or service quality of any regulated Arizona telephone utility or telephone corporation."); *id* at 17 ("The transaction will have no adverse effect on the rates or the quality of service of regulated Verizon or MCI subsidiaries.").

[10] McCallion Rebuttal Testimony at 5 (Sept. 9, 2005) ("No rate increases are contemplated as a result of the transaction); *id.* at 6-7 ("The operations of Verizon's and MCI's operating companies in Arizona will not be changed as a result of the merger. . . . The transaction will not adversely affect the rates or quality of service of the regulated Verizon and MCI subsidiaries.").

[11] Transcript (McCallion cross examination) at 193 (Sept. 14, 2005).

[12] Direct Testimony of Elijah O. Abinah at 12 (Sept. 2, 2005).

[13] The RO&O repeatedly mischaracterizes a statement in the pre-filed testimony of Mr. Vasington in an effort to suggest that Verizon "recognize[s]" that the Commission has the authority to review the transaction under its constitutional authority. RO&O at 12. Mr. Vasington's testimony was simply that the Commission "may" seek to review the transaction under its claimed constitutional authority. Mr. Vasington did not testify that the Commission actually has such constitutional authority, as the RO&O incorrectly implies. In any event, Mr. Vasington's opinion on the scope of the Commission's constitutional authority is irrelevant as neither Mr. Vasington nor the Commission can create constitutional authority where it does not exist. *See Williams v. Pipe Trades Industry Program of Arizona*, 100 Ariz. 14, 409 P.2d 720 (1966); *see also South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 97 (1984).

jurisdiction." *State ex rel. Pickrell v. Downey*, 430 P. 122, 126 (Ariz. 1967); *see also, e.g.*, *Steel Co. v. Citizens for Better Environment*, 523 U.S. 83 (1998) (quoting *Mansfield, Co. & L.M.R. Co. v. Swan*, 111 U.S. 379, 382 (1884) ("The requirement that jurisdiction be established as a threshold matter . . . is 'inflexible and without exception.'"). This is no different from a court or agency entertaining litigation, and then, finding no facts to support its exercise of jurisdiction, dismissing the action. *See, e.g.*, *Blackburn v. U.S.*, 100 F.3d 1426, 1436 (9th Cir. 1996) (affirming district court's dismissal for lack of subject matter jurisdiction after 120 days of jurisdictional discovery). Because there is no evidence of any possible adverse effect on rates, and the RO&O found no adverse effect, the Commission cannot claim that its review of the transaction somehow is "ancillary" to ratemaking authority under Article 15. The Commission should note the absence of jurisdiction and grant Verizon and MCI's request to dismiss their application.

II. THE TRANSACTION UNQUESTIONABLY MEETS THE THREE-PART TEST IN THE AFFILIATED INTEREST RULES

Staff conducted a careful, comprehensive review of the transaction and correctly determined that it meets the three-part test under the Affiliated Interest Rules.[14] Staff therefore recommended that the Commission approve the transaction as in the public interest, subject to Verizon and MCI's compliance with several merger-related conditions.[15] Verizon and MCI have agreed to comply with Staff's eight conditions (as stated in the RO&O at pages 10-12).[16]

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[14] *See* Direct Testimony Abinah at 14; RO&O at 10.

[15] *Id.* at 19; Direct Testimony of Armando Fimbres at 21 (Sept. 2, 2005); *see also* RO&O at 10-13, 20.

[16] *See also* RO&O at 13-15 (concerning performance bonds, compliance issues, and notice of merger-related layoffs and facility closings).

1 The RO&O does not challenge Staff's conclusion that the transaction meets the
2 test set forth in the Affiliated Interest Rules. Instead, to provide a façade for the
3 mandatory binding arbitration program that the Commission seeks to create for "all
4 Arizona residential consumers of telecommunications services," the RO&O points to a
5 few public statements by Verizon executives on unrelated issues and asserts that the
6 transaction "barely clears the bar of being in the public interest."[17] This assertion is
7 starkly inconsistent with the evidence in the record before the Commission, the Staff's
8 and RO&O's conclusions that the transaction will benefit enterprise customers, as well as
9 the findings of the FCC, the DOJ, and numerous state public service commissions.
10 The FCC's public interest review of the proposed transaction was searching and
11 comprehensive. The FCC, which reviews whether the transaction is in the national
12 interest, broadly considered whether the transaction "could result in public interest harms
13 by substantially frustrating or impairing the objectives or implementation of the
14 Communications Act or related statutes," with particular attention to "preserving and
15 enhancing competition," and the effect on services provided to consumers.[18] Not only
16 did the FCC conclude that the transaction "is not likely to result in anticompetitive effects
17 for mass market services,"[19] but it also concluded that the "proposed transaction is likely
18 to generate several significant merger-related public interest benefits."[20] Far from finding
19 Verizon and MCI's showing "minimally sufficient,"[21] the FCC found that the "potential

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17 RO&O at 21.

18 Memorandum Opinion and Order, Verizon Communications Inc. and MCI, Inc, *Applications for Approval of Transfer of Control*, WC Docket No. 05-75, FCC 05-184, ¶¶ 16, 17 ("Verizon/MCI Merger Order").

19 *Id.* ¶ 82.

20 *Id.* ¶ 193.

21 RO&O at 20.

public interest benefits from the proposed merger . . . outweigh *the relatively limited possible public interest harms*."[22] In reaching these conclusions, the FCC carefully considered the views, concerns, and evidence presented by more than fifty parties. Here, by contrast, no party intervened to offer evidence that the transaction is not in the public interest.

The DOJ conditioned its merger approval on the sale of indefeasible rights of use to fiber facilities in selected buildings in which the only Verizon competitor present was MCI. Notably, none of those buildings is in Arizona. When announcing its approval of the merger, the DOJ stated:

> The [Antitrust] Division thoroughly investigated not just the local private line issues covered by today's settlement but all areas in which the merging firms compete, including residential local and long distance service, Internet backbone services and a variety of telecommunications services provided to business customers. With the exception of the cities covered by today's action, in which the merging firms control the only wireline access to numerous buildings, the Division concluded that the transactions will not harm competition *and will likely benefit consumers, due to existing competition, emerging technologies, the changing regulatory environment, and exceptionally large merger-specific efficiencies.*[23]

The FCC's and DOJ's conclusions about the public benefits of the transaction are consistent with those of numerous state commissions, including those in the District of Columbia, Hawaii, New York, North Carolina, Vermont, and Ohio. For example, the District of Columbia Commission found that the proposed transaction satisfied its merger criteria – which include consideration of the effect of the proposed transaction on

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[22] Verizon/MCI Merger Order ¶ 220 (emphasis added).

[23] Department of Justice Press Release, Oct. 27, 2005, at 1 (emphasis added), hhttp://www.usdoj.gov/atr/public/press_releases/2005/212407.htm.

1 competition, universal service, public safety, quality of service, and *consumer rights.*[24]
2 The Hawaii Commission likewise found the transaction "reasonable and in the public
3 interest," noting that the proposed transaction "should not adversely affect
4 telecommunications services currently being provided to customers in Hawaii" and that
5 Verizon and MCI's "customers should benefit since they will be assured communications
6 services through providers with a strong parent company and should have access to new
7 product lines and services."[25] The New York Commission found that while the
8 transaction would "not likely result in anti-competitive effects for mass market
9 customers, . . . [t]he long term efficiency savings that the combined firm expects to
10 realize should help the new entity to continue to invest in its network and operations and
11 provide better service products over the long term. These are important benefits which
12 we expect, over time, will inure to the benefit of consumers."[26] Most recently, the
13 Vermont Commission found the transaction "will promote the public good,"[27] while the
14 Ohio Commission similarly concluded that it would "promote the state's
15 telecommunications policy on competition, diversity, and customer choice."[28]

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[24] Order, *In the Matter of Verizon Communications Inc.'s Proposed Acquisition of MCI*, Docket No. 1036-T-28, ¶¶ 42, 62 (D.C. PSC Oct. 20, 2005).

[25] Decision and Order, *In the Matter of the Application of Verizon Communications Inc. and MCI, Inc. For an Exemption and/or Waiver or, Alternatively, for Approval of Agreement and Plan of Merger*, Docket No. 05-0108, at 16-17 (Haw. PUC Sept. 12, 2005).

[26] Order, *Joint Petition of Verizon Communications Inc. and MCI, Inc. for a Declaratory Ruling Disclaiming Jurisdiction Over or in the Alternative for Approval of Agreement and Plan of Merger*, Case No. 05-C-0237, at 29, 61 (N.Y. PSC Nov. 22, 2005).

[27] Order, *Joint Petition of Verizon Communications, Inc. and MCI, Inc. for Approval of an Agreement and Plan of Merger Resulting in MCI Becoming a Wholly-Owned Subsidiary of Verizon*, Docket No. 7056, at 15 (Vt. PSB Nov. 29, 2005).

[28] Opinion and Order, *In the Matter of the Joint Application of Verizon Communications, Inc. and MCI, Inc. for Consent and Approval of a Change in Control*, Case No. 05-497-TO-ACO, at 74 (Ohio PUC Nov. 29, 2005).

None of the dozens of regulatory entities that have reviewed the transaction, including the FCC and DOJ, rejected it as contrary to the public interest. No reviewing governmental authority has found that the transaction would harm residential customers for any type of service, or found that its approval had to be conditioned on a program of mandatory arbitration of residential consumer billing disputes. The RO&O identifies no characteristic of the Arizona market that could support such a dramatically different conclusion regarding the public interest harms and benefits of the transaction. To the contrary, the transaction cannot harm Arizona residential consumers because MCI and Verizon do not provide residential services in the same geographic area in Arizona.[29] Furthermore, there will be no harm to any class of customers because the certificated entities will remain the same and there will be no adverse impact on rates or quality of service.[30]

III. NO RECORD EVIDENCE SUPPORTS CONDITIONING APPROVAL ON VERIZON'S AGREEMENT TO MANDATORY ARBITRATION BY THE COMISSION

There is no rational connection between the Verizon/MCI transaction and the RO&O's proposed condition that Verizon and MCI must submit to binding arbitration by the Commission of residential consumer billing disputes. Nothing in the record in this docket provides an evidentiary basis for finding that the transaction will harm residential consumers *at all*, for *any* class of service, let alone that the transaction could cause harm to residential consumers that must be remedied by mandatory arbitration of residential consumer disputes before the Commission. Verizon has only about 6,000 residential

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29 RO&O at 11 n.6; Transcript (McCallion cross examination) at 99.

30 RO&O at 20; Notice of Intent at 8,17.

1 access lines in Arizona, and only about 8,500 total access lines.[31] MCI also has only a
2 very small presence in the residential wireline services segment.[32] MCI and Verizon's
3 Arizona subsidiaries provide these services in different geographic areas. There also is
4 no evidence in the record of residential customer billing disputes – related or unrelated to
5 the transaction. No residential customers intervened in the proceeding. No residential
6 customers commented publicly or filed letters in the docket complaining about any
7 Verizon or MCI billing practices or unauthorized charges. Neither the Residential Utility
8 Consumers Office ("RUCO") nor the Arizona Consumer Council intervened or filed
9 comments expressing concerns about the need for additional consumer protections at all,
10 much less a binding arbitration program involving any Verizon or MCI entity, even
11 though both RUCO and the Arizona Consumer Council have intervened, filed comments,
12 and made public comment in other Commission proceedings when they thought
13 consumer interests were at issue.
14 The RO&O cites to no record evidence to justify the imposition of the mandatory
15 arbitration program of residential consumer billing disputes because there is none. There
16 is, in fact, no logical nexus between the transaction and the "framework" that the RO&O
17 proposes to require of Verizon as a condition for approval of its merger. The RO&O
18 instead relies on irrelevancies. For example, the RO&O cites a press report of an
19 interview with Verizon's CEO about Verizon Wireless's services, which is irrelevant to

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[31] Direct Testimony of Timothy J. McCallion at 4 (Jul. 13, 2005); Transcript (McCallion cross examination) at 182.

[32] Direct Testimony of Michael A. Beach at 18-19 (Jul. 13, 2005).

1 issues involving the transaction.[33] The RO&O also cites statements made several years
2 ago by Verizon executives denouncing the WorldCom fraud. Finally, the RO&O cites
3 Verizon's opposition to federal rules ultimately declared unlawful by the federal courts
4 and rejected by the FCC, which required incumbent local exchange carriers to provide
5 UNE-P at TELRIC prices.[34]

6 The RO&O does not explain how this material relates to the transaction (because
7 it does not), let alone how it justifies conditioning approval of the transaction on
8 Verizon's agreement to submit to mandatory arbitration before the Commission of
9 residential consumer billing disputes. Verizon and MCI agree with Commissioner
10 Spitzer's statement [35] that wireless services do "not relate" to the transaction at all,

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[33] *See* RO&O at 17. Moreover, the RO&O erroneously gives no weight to unrebutted testimony of Verizon witness McCallion (who was present during the interview) that the substance of the news article was wrong.

[34] RO&O at 17-18. The RO&O asserts without supporting evidence that "[i]t is undisputed that Verizon has historically been one of the most vocal opponents of CLEC competition[.]" *Id.* at 19. The RO&O is flat wrong on this point, and Verizon does dispute it. Verizon has been granted authority under Section 271 of the 1996 Telecommunications Act to provide interLATA services precisely because it has taken every required step (and more) to open its territories to CLEC competition. To be sure, Verizon along with many other carriers opposed certain of the FCC's unbundling and below-cost pricing rules, including its UNE-P requirement. The D.C. Circuit and the FCC ultimately agreed with Verizon and found those requirements to be anticompetitive because they decreased the incentive of carriers to invest in their own facilities. *See, e.g.*, FCC's Order on Remand, *Unbundled Access to Network Elements; Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, 20 FCC Rcd 2533 (2005) ("*Triennial Review Remand Order*), *petitions for review pending*, *Covad Communications Co., et al. v. FCC, et al.*, Nos. 05-1095, et al. (D.C. Cir.); *United States Telecom Ass'n v. FCC*, 359 F.3d 554 (D.C. Cir. 2004), *cert. denied*, 125 S. Ct. 313, 316 345 (2004).

[35] *See* Commissioner Spitzer's June 29, 2005 letter to Mr. Seidenberg. (Comm. Ex. 1) Even if the rates and services of Verizon Wireless were relevant here (and they are not), the record evidence would not support the proposed condition. Verizon Wireless's record in Arizona is virtually unblemished: Staff stated in Late Filed Exhibit 3 (Sept. 21, 2005), that the Commission had only logged *two* inquiries and complaints for Verizon Wireless since January 1, 2005. The RO&O expressly acknowledges this fact, *see* RO&O at 14 n.9, but then ignores its import by proceeding to impose a condition that is not designed to address any actual, demonstrable problem. Commissioner Spitzer's views on Verizon Wireless's service quality are consistent with Staff's data. Commissioner Spitzer noted at the hearing that on the issue of consumer service, Verizon Wireless is "doing great." Transcript at 137, lines 17. Specifically, Commissioner Spitzer agreed with Mr. McCallion's testimony that Verizon Wireless is "very devoted to customer service," *id.* at 135, lines 10-18, observing that "the anecdotal calls" received over his "five years on the Commission are consistent with what you say about the quality of Verizon's wireless service. I get the fewest complaints," *id.* at 137, lines 11-15.

confirming that the RO&O's discussion of wireless issues are utterly irrelevant to this proceeding. The widely noted and commented-upon WorldCom fraud is equally irrelevant – the new MCI has been through the cleansing fire of a long bankruptcy under extraordinary judicial supervision, and the malefactors have faced criminal prosecution. That federal courts have finally halted nearly a decade of pricing practices under the 1996 Act has nothing to do with this transaction: no entity purchased UNE-P from the Verizon geography in Arizona. Accordingly, there is no factual nexus between the transaction and the proposed condition, and no legal basis on which it can be justified. Under these circumstances, the imposition of the arbitration condition under the rubric of the Commission's review of the transaction would be arbitrary, unlawful, and unreasonable.

IV. THE COMMISSION CAN ONLY ESTABLISH A MANDATORY ARBITRATION PROGRAM THROUGH RULE MAKING, NOT A PROCESS OF SERIAL, *AD HOC* ADJUDICATIONS

Based on the Commission's expressly articulated intentions, the mandatory arbitration program that the RO&O proposes to require of Verizon is a rule. But having failed to comply with Arizona law requirements for rule making, the Commission cannot impose this rule on Verizon. Nor can the Commission condition its approval of the transaction on adherence to a rule that is not lawfully promulgated.

A. Adoption of a Mandatory Arbitration Program Requires Rule Making

The requirements under Arizona law for adopting policies of general applicability are well established. Under the APA," an agency statement of general applicability that implements, interprets or prescribes law or policy, or describes the procedure or practice

1 requirements of an agency" is a "rule."[36] If the Commission wants to adopt a rule it must
2 follow the rule making procedures prescribed by the Arizona legislature.

3 The Commission has announced its intention to establish "a framework to afford
4 Arizona residential consumers the opportunity to arbitrate claims and/or disputes with
5 respect to billing and unauthorized charges for all modes of telecommunications
6 services."[37] The Commission's policy was made public in the SBC/AT&T merger
7 proceeding, and then further explained in a Commission press release.[38] The
8 Commission's policy was next articulated in the Commission's decision requiring Cox
9 Arizona Telcom to agree to the mandatory arbitration program as a pre-condition to
10 receiving a limited waiver of A.A.C. R14-2-805.[39] In the Cox order, the Commission
11 declared that it "wishes to *establish a framework* to afford Arizona residential customers
12 the opportunity to arbitrate claims and/or disputes with respect to billing and
13 unauthorized charges for *all modes of telecommunications services*."[40]

14 Because the arbitration program is an announced Commission policy of broad
15 application and general effect, it is a "rule" within the meaning of the Arizona APA. If
16 the Commission wants to impose mandatory arbitration for all consumer disputes
17 concerning billing or unauthorized charges on telecommunications providers, however, it
18 must follow the prescribed APA requirements for rule making. The Commission cannot

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36 A.R.S. § 41-1001(17).

37 *See* Decision No. 68269, *In re Application of Cox Arizona Telcom, LLC for a Waiver of Rule 805 of the Public Utility Holding Companies and Affiliated Interests Rules*, at 12 (Nov. 14, 2005).

38 *See* Commission News Release, Commissioners Approve SBC-AT&T Merger (Nov. 4, 2005) (Attributing the following to Commissioner Spitzer: "Although this order applies only to Arizona customers of the merged SBC and AT&T, I will not rest until these benefits are accorded to all customers of wireless and VoIP services.").

39 Decision No. 68299, at 13.

40 *See* Decision No. 68299, at 12 (emphasis added).

establish a mandatory arbitration "program" for "all Arizona residential consumers of telecommunications services" through the serial, *ad hoc* adjudication of unrelated matters, as the Commission is attempting to do here and elsewhere.

B. Rules Adopted in a Manner Inconsistent with the Rule Making Requirements of the APA Are Unenforceable

The RO&O's proposed mandatory arbitration program comes squarely within the definition of a rule under the APA: it is generally applicable; it implements Commission policy; and it is a new procedure and practice prescribed by the Commission. Under the APA, however, rules must be proposed, published, made subject to public comment, and submitted to the Attorney General for review and certification – and all of these steps must be taken before adoption and attempted enforcement.[41]

The Commission has taken none of these mandatory steps here. Rather, the Commission is attempting to impose its new rule establishing mandatory arbitration without even the pretext of complying with the rule making requirements in the APA. Under these circumstances, the Commission's mandatory arbitration rule cannot be adopted or enforced. *See* A.R.S. § 41-1030 ("A rule is invalid unless it is made and approved in substantial compliance with sections 41-1021 through 41-1029 and articles 4, 4.1 and 5[.]"). Among the other requirements, for the rule to be valid, the Commission must have submitted it to the Attorney General for approval and certification pursuant to A.R.S. § 41-1044. *See U.S. West Communications, Inc. v. ACC*, 197 Ariz. 16, 23, 3 P.3d 936, 943 (Ct. App. 1999) ("Rules are invalid if not adopted and approved in accordance with the procedure outlined above.") (*citing* A.R.S. § 41-1030(A)).

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[41] *See generally* A.R.S. § 41-1021 to -1044.

The essential steps for valid rule making – publication, comment, and legal review – are intended to ensure that the rule is consistent with the Commission's legal authority and reflects the needs and concerns of relevant stakeholders. Rule making through serial, *ad hoc* adjudication not only thwarts full public comment but also evades the requisite review and certification by the Attorney General. As such, rules adopted in this manner are not enforceable under Arizona law. *See* A.R.S. § 41-1001.01.

C. The Commission Cannot Condition Approval of the Verizon/MCI Transaction on Adherence to a Policy Not Embodied in a Lawfully-Adopted Rule

Finally, Arizona law is clear that the Commission may not condition its approval of the transaction on Verizon's agreement to submit to the Commission's arbitration program because that program is not *specifically authorized* by statute or rule. *See* A.R.S. § 41-1030(B) ("An agency shall not base a licensing decision in whole or in part on a licensing requirement or condition that is not specifically authorized by statute [or] rule."). The Commission may not rely on a general grant of authority as a basis for imposing a condition "unless a rule is made pursuant to that general grant of authority that specifically authorizes the requirement or condition." *Id.* Nothing in the Affiliated Interest Rules or any other Commission rules, or the Arizona Constitution, contemplates the Commission's newly-devised mandatory arbitration program; therefore, the Commission is barred by the APA from imposing this condition on the Verizon/MCI transaction.

V. THE FCC HAS DETERMINED THAT STATE COMMISSIONS DO NOT HAVE JURISDICTION TO REGULATE VOIP SERVICES

The RO&O's proposed condition is also unlawful because the Commission does not have jurisdiction to impose regulations or obligations targeted at VoIP. *See Vonage Holdings Corp. Petition for Declaratory Ruling Concerning An Order Of The Minnesota*

1 *Public Utilities Commission*, Memorandum Opinion and Order, 19 FCC Rcd 22404
2 (2004) ("*Vonage Order*"). This is clear from the *Vonage Order*, in which the FCC
3 preempted the Minnesota commission from imposing "traditional 'telephone company'
4 regulations" on Vonage's VoIP service.[42] The FCC did so because it is impossible to
5 separate out an intrastate component of VoIP, and because state regulation of VoIP would
6 present an "outright conflict[] with federal rules and policies governing interstate
7 DigitalVoice communications."[43] The FCC noted that while state consumer protection
8 laws of general applicability (*i.e.*, applicable to all businesses, not just to VoIP, such as
9 the common law of fraud), may continue to apply,[44] state commissions are barred from
10 traditional telephone regulation.

11 Thus, the RO&O's proposed condition is contrary to federal law, and cannot
12 stand. Because of the "intrinsic ubiquity of the Internet"[45] and the inability of regulators
13 and providers to determine the geographic location of the users of VoIP service, the
14 proposed arbitration program would apply not only to calls initiated outside of Arizona,
15 but also to calls that occur wholly outside the borders of Arizona. If, for example, a user
16 in California with a billing address in Arizona uses VoIP to call someone in New York,
17 no part of the call would occur in Arizona -- yet under the proposed condition the call
18 could be subject to binding arbitration before the Commission. This is precisely why the
19 FCC preempted state commissions from regulating VoIP.

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42 *Id.* ¶ 1.

43 *Id.* ¶ 31. As the Commission found, "[d]ue to the intrinsic ubiquity of the Internet, *nothing short of Vonage ceasing to offer its [VoIP] service entirely* could guarantee that any subscriber would not engage in some communications where a state may deem that communication to be 'intrastate' thereby subjecting Vonage to its economic regulations absent preemption." *Id.* ¶ 30 (emphasis in original).

44 *See id.* ¶ 1.

45 *Id.* ¶ 30.

1 **VI. THE PROPOSED CONDITION IS UNCONSTITUTIONAL**

2 The proposed condition would also violate the United States and Arizona
3 Constitutions.

4 **A. The Condition Would Violate the Commerce Clause**

5 The condition would violate the Commerce Clause in the United States
6 Constitution for two separate reasons. *First*, it would directly burden an out-of-state
7 transaction to obtain a discriminatory benefit for Arizona interests. The transaction at
8 issue here – the merger of MCI, Inc. (a Delaware Corporation) into ELI Acquisition, LLC
9 (a Delaware limited liability company), a subsidiary of Verizon Communications Inc. (a
10 Delaware Corporation) – involves only out-of-state corporations. Although there are
11 Arizona residents who are shareholders of MCI, the mere existence of in-state
12 shareholders does not give a state authority to regulate a transaction that involves out-of-
13 state corporations. *See Healy v. Beer Inst*, 491 U.S. 324, 333 n.9 (1989) (quoting *Edgar*
14 *v. MITE Corp.*, 457 U.S. 624, 641 (1982). Thus, the condition proposed by the RO&O
15 would "directly regulate[]" an out-of-state transaction.

16 *Second*, the condition would impose a substantial burden on interstate commerce
17 unjustified by any legitimate state regulatory interest. *See Pike v. Bruce Church, Inc.*,
18 397 U.S. 137, 142 (1970). As demonstrated above, under Arizona law and Commission
19 precedent, *there is no valid state interest in reviewing or conditioning the terms of this*
20 *merger.* Verizon and MCI do not compete in Arizona,[46] and nothing in the merger

[46] As the Staff found in its testimony, and as the RO&O correctly concludes, there is virtually no competition between Verizon and MCI in the provision of intrastate communication services in Arizona, and, therefore, there is no basis for any conclusion that the mandatory arbitration provision is required to protect consumers from any competitive effect of the transaction. MCI is not even certificated or authorized to provide local services in Verizon's Arizona territory, and Verizon is not authorized to provide

affects the capital structure of a regulated public utility under the Commission's jurisdiction. Thus, the state interest is nil, while the burden on interstate (and foreign) commerce is enormous should these proceedings delay or obstruct a multi-billion dollar merger that both the FCC and Department of Justice have *found are in the national interest. See, e.g., Tyson Foods, Inc. v. McReynolds,* 700 F. Supp. 906, 912 (invoking the Commerce Clause to strike down state statute that "place[d] an enormous burden on interstate commerce in relation to its suspect local benefits"); *TLX Acquisition Corporation v. Telex Corp.*, 679 F. Supp. 1022, 1029 (W.D. Okla. 1987) ("The Commerce Clause prohibits . . . state regulation which indirectly burdens interstate commerce to a degree which is excessive in relation to local state interests to be served by the regulation.") (citing *Pike v. Bruce Church, Inc.,* 397 U.S. 137 (1970)).

B. <u>The Condition Is Unconstitutional Because it Deprives Verizon of Its Right to Judicial Forum</u>

The RO&O proposes that Commission approval of the transaction be conditioned on Verizon "agreeing" to participate "in a *binding* Arbitration Program administered by the Commission's Consumer Services Division."[47] Under the Due Process Clause of the United States Constitution, and Article 15, Section 17 of the Arizona Constitution, however, Verizon has a constitutional right to a judicial forum to resolve billing disputes. The Commission cannot compel Verizon to give up its constitutional right to judicial review in exchange for receiving approval of its transaction.[48] As the United States

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local service in MCI's certificated territory. The arbitration requirement cannot be justified as a measure taken to mitigate anticompetitive effects of the transaction.

[47] RO&O at 19 (emphasis added).

[48] Arizona law also provides a right to appeal. *See* A.R.S. § 40-254 (describing the appeals process from Commission actions and orders).

1 Supreme Court has repeatedly held, arbitration is "a matter of consent, not coercion."
2 *EEOC v. Waffle House, Inc.*, 534 U.S. 279, 294 (2002) (quoting *Volt Info. Scis., Inc. v.*
3 *Board of Trustees*, 489 U.S. 468, 479 (1989)).

4 **C. <u>The Commission Cannot Compel Verizon to Comply With An</u>**
5 **<u>Unconstitutional Condition</u>**

6 The Commission cannot use the transaction approval process to compel Verizon
7 to comply with a condition that the Commission could not constitutionally command
8 directly. *See Speiser v. Randall*, 357 U.S. 513, 526 (1958); *accord Perry v. Sindermann*,
9 408 U.S. 593, 597 (1972); *see also, e.g., Vance v. Barrett*, 345 F.3d 1083, 1093 (9th Cir.
10 2003) (explaining that the government cannot "exact a waiver as an end-round" to the
11 constitutional limitations of direct action). As explained above, the proposed condition
12 violates the Commerce Clause and Due Process Clause of the United States Constitution,
13 as well as Article 15, Section 7 of the Arizona Constitution. The Commission cannot
14 coerce Verizon into forfeiting its constitutional rights.

15 **<u>CONCLUSION</u>**

16 For these reasons, Verizon and MCI respectfully urge the Commission to find that
17 it lacks jurisdiction over the transaction. If the Commission concludes that it has
18 jurisdiction, however, it should approve the transaction without the unlawful mandatory,
19 binding arbitration condition proposed by the RO&O.

RESPECTFULLY SUBMITTED this 1st day of December, 2005.

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ORIGINAL and thirty-three (13) copies of the foregoing filed this 1st day of December, 2005, with:

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Docket Control – Utilities Division
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Phoenix, Arizona 85007

COPY of the foregoing hand-delivered this 1st day of December, 2005, to:

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EXHIBIT A

EXHIBIT C

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ARIZONA CORPORATION COMMISSION

JACK ROSE
EXECUTIVE SECRETARY

RECEIVED
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SNELL & WILMER

November 16, 1998

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Re: Merger of GTE Corporation and Bell Atlantic Corporation

Dear Jeff:

I am in receipt of your letter dated October 2, 1998, regarding the merger of GTE Corporation and Bell Atlantic Corporation. The letter stated your opinion that the merger does not require approval from the Arizona Corporation Commission.

I have reviewed your analysis and discussed the matter with the Utilities Division Staff. This letter is intended to advise you that we are in general agreement with your conclusion.

In particular, I agree that, because this merger occurs at the parent level and neither parent corporation is an Arizona public service corporation, A.R.S. § 40-285.A. does not act to require Commission approval. In addition, I agree that the limited waivers in effect for predecessors of GTE California and Cellular One limit the applicability of A.A.C. R14-2-803.A. to the merger in question. Those waivers relieve the obligation to seek approval of the merger. However, you should bear in mind that, by not seeking Commission approval, the entities are representing their opinions that the proposed merger is not likely to result in: (1) significant increased capital costs for the Arizona operations; (2) significant additional costs allocated or charged directly to the Arizona jurisdiction; or (3) a significant reduction of net operating income to the Arizona operations.

I also agree that, because GTE Communications, Tucson Cellular, Bell Atlantic Communications, Inc. and Bell Atlantic Long Distance have Arizona jurisdictional revenues of less than $1 million, A.A.C. R14-2-803.A. does not apply to them.

Finally, I agree that the Commission's authority over rates and charges of cellular carriers has been preempted by the Omnibus Budget Reconciliation Act of 1993. I do not agree that the preemption extends to the remaining affiliate reporting requirements as your letter would suggest. Since the limited waivers discussed above apply to all of the cellular entities, no approval is required.

In conclusion, I find no requirement that the merger of GTE Corporation and Bell Atlantic Corporation be submitted to the Arizona Corporation Commission for approval. I would be happy to discuss my conclusions with you at your convenience. Feel free to give me a call, if you are interested in having such a discussion.

Sincerely,

Christopher C. Kempley

Christopher C. Kempley
Assistant Chief Counsel

CCK/jes