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Decision 98-05-022 May 7, 1998

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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Joint Application of AT&T Corp. ("AT&T"), Teleport Communications Group Inc. ("TCG") and TA Merger Corp. for Approval Required For the Change in Control of TCG's California Subsidiaries That Will Occur Indirectly as a Result of the Merger of AT&T and TCG.	ORIGINAL Application 98-02-001 (Filed February 2, 1998)

OPINION GRANTING MERGER APPLICATION

We approve the joint application filed by AT&T Corp. (AT&T), Teleport Communications Group Inc. (TCG), and TA Merger Corp. (collectively, applicants) for authority to transfer ownership and control of TCG's three California utility subsidiaries to AT&T. The three California subsidiaries at issue are TCG San Francisco (U-5454), TCG Los Angeles (U-5462), and TCG San Diego (U-5389). As explained below, we find the proposed plan of merger to be in the public interest and in accordance with the statutory requirement of § 854(a) of the Public Utilities (PU) Code. We also conclude that this is an appropriate case in which to exercise our authority under PU Code § 853(b) to exempt this transaction from scrutiny under subsections (b) and (c) of PU Code § 854.

The Parties and the Proposed Transaction

TCG San Francisco, TCG Los Angeles, and TCG San Diego are each wholly-owned subsidiaries of TCG, a Delaware holding company headquartered in New York. Pursuant to a series of decisions set forth in Appendix A to this decision, these three subsidiaries are authorized to operate as Competitive Local Carriers (CLCs), providing both resold and facilities-based local exchange service in the San Francisco Bay Area, the Los Angeles Basin and San Diego County, respectively. As shown in Appendix A, TCG San Francisco, TCG Los Angeles, and TCG San Diego are also authorized to provide both facilities-based and resold interLocal Access and Transport Area (LATA) and intraLATA telecommunications services. Pursuant to Decision (D.) 98-01-055, TCG San Francisco will soon begin providing both facilities-based and resold local exchange service in the Sacramento area, as well.[1]

According to TCG's Form 10-K (which is attached to the application as Exhibit B), TCG provides both switched and dedicated services to its customers over mainly fiber optic digital networks. Most of TCG's customers are heavy users of telecommunications services, such as businesses, educational institutions and long distance carriers.[2]

AT&T is a New York corporation that, on its own and through a number of subsidiaries, is authorized to provide domestic and international

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[1] In addition to its local exchange networks, TCG also holds, through a wholly-owned subsidiary, licenses issued by the Federal Communications Commission (FCC) authorizing it to provide telecommunications services using 38 Gigaherz (Ghz) digital milliwave transmission. This technology provides an alternative, facilities-based high capacity method of reaching customers. Application, page 2.

[2] On December 17, 1997, ACC National Long Distance Corp. (U-5459-C) (ACC) filed its Advice Letter No. 10 with the Commission. This advice letter stated that ACC's parent corporation, ACC Corp., was merging with TCG, pursuant to an Agreement and Plan of Merger attached to the advice letter. Under D.94-05-051, transfers of assets or changes of control between nondominant interexchange carriers (NDIECs) that have been certificated by this Commission become effective 40 days after the filing of an advice letter announcing the transaction, unless the advice letter is protested or suspended by the Commission. The advice letter filed by ACC was neither protested nor suspended, so Commission authorization for the ACC-TCG merger became effective on January 27, 1998. Thus, the authorization granted herein for the AT&T-TCG merger includes authority to complete the ACC-TCG merger described in the December 17, 1997 advice letter.

telecommunications services throughout the United States. AT&T has one direct subsidiary within California, AT&T Communications of California, Inc., which is authorized to provide inter and intraLATA toll services and facilities-based and resold local exchange service. AT&T also controls, through its subsidiary AT&T Wireless Services, Inc., a group of four wireless telecommunications companies that serve various areas of California.[3]

TA Merger Corp. is a newly-created Delaware subsidiary of AT&T that has been formed for the specific purpose of effectuating AT&T's acquisition of TCG. Under the Agreement and Plan of Merger (Merger Agreement) that is attached to the application as Exhibit H, TA Merger Corp. will merge with and into TCG, with TCG being the surviving entity and a wholly-owned subsidiary of AT&T. By structuring the transaction in this fashion, the applicants intend that it be treated as a tax-free reorganization within the meaning of section 368(a) of the Internal Revenue Code of 1986, as amended. (Merger Agreement, ¶ 7.10.) At the time of the merger, shareholders of TCG will receive 0.943 shares of AT&T common stock for each share of TCG common stock. (*Id.*, ¶ 4.1(a).) The total purchase amount is approximately $11.3 billion as of the announcement of the merger on January 8, 1998.[4]

The application offers the following summary of why AT&T and TCG have decided to enter into the proposed merger, and why they deem it to be in the public interest for California customers:

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[3] These four wireless companies are Airsignal (U-2028), AT&T Wireless Services of California, Inc. (U-3010), Redding Cellular Partnership (U-3020), and Santa Barbara Cellular Systems Limited (U-3015). These companies used to be part of McCaw Cellular Communications, Inc. (McCaw), which was acquired by AT&T in 1994. We approved AT&T's acquisition of McCaw in D.94-04-042, 54 CPUC2d 43 (1994).

[4] "AT&T to Buy Teleport for $11.3 Billion," *Wall Street Journal*, January 9, 1998, p. A3.

> "Fundamentally, AT&T has concluded that the best way to compete effectively in the provision of business local exchange service is to have a local telecommunications infrastructure where that is feasible. TCG will form the cornerstone of AT&T's facilities-based local exchange service offerings. Together the two companies will become a more effective competitor in local exchange markets than either is today.
>
> "TCG is today dwarfed in revenues and available capital by the formidable incumbent Local Exchange Carrier ('ILEC') competitors that it faces in local markets. Those carriers today continue to control the market for local exchange services . . . In addition to this disparity in size, TCG also lacks the familiar brand identity of its RBOC and other ILEC competitors. Without such brand awareness, TCG would face increasing difficulty in expanding its target markets to include customers smaller than the larger users it has primarily served in the past. The merger directly addresses these competitive disadvantages.
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> "While AT&T is an effective non-dominant competitor in the long distance marketplace, it has thus far been highly dependent on ILEC systems and facilities in its efforts to enter the market for local exchange services and bring the benefits of vigorous competition to that market. AT&T's ability to provide full and robust competitive local exchange services thus would be greatly enhanced were AT&T [to] have its own local exchange telecommunications infrastructure. However, construction of local infrastructure is unavoidably complex and time-consuming . . . This acquisition allows AT&T to achieve its goal of having its own local infrastructure without the lengthy delay that would occur if AT&T were to pursue that goal through construction rather than acquisition." (Application, pp. 7-8.)

The application emphasizes that the proposed merger will have no immediate effect on the way in which the California subsidiaries of AT&T and TCG will continue to serve their existing customers. The application represents that following the proposed transfer of control, the California subsidiaries of AT&T and TCG "will continue to provide services pursuant to tariffs on file with this Commission." Thus, applicants conclude, the proposed transaction "will have no adverse impact on the customers of the California affiliates [of AT&T and TCG] in terms of the services that they receive[,] and will provide a base for broader service." (Application, pp. 6-7.)

Under ¶ 9.2 of the Merger Agreement, the boards of directors of both AT&T and TCG have the right to abandon the merger, upon notice to the other company, if the merger has not been consummated by December 31, 1998. That date can be extended to March 31, 1999 upon the occurrence of certain specified events.

Responses to the Application

Notice of the application appeared in the Commission's Daily Calendar on February 4, 1998, so the protest period expired on March 6, 1998. On that date, the Office of Ratepayer Advocates (ORA) filed a timely response to the application. On March 11, 1998, the Greenlining Institute and the Latino Issues Forum (collectively, Greenlining) filed a motion seeking leave to have the Commission accept a late-filed response to the application. No protests to the application, and no other responses, were received.

ORA supports the application, which it concludes offers "some competitive benefits" to large business customers in the local exchange market.[5] While noting that the merger will not immediately benefit small business or residential customers, ORA states:

> "ORA believes the merger will provide specific benefits to local competition. The major and immediate beneficiaries of the proposed merger of AT&T and TCG will be large business customers, as TCG

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[5] It should be noted, however, that ORA's response takes no position "on any required review under [PU] Code section 854." ORA Response, p. 1, fn. 1.

> will have the ability to expand its facilities presence beyond its current ownership of less than 1% of the state's local exchange facilities. ORA accepts as credible the Applicant[s'] assertion that additional investment by AT&T in TCG's markets will expand TCG's ability to serve business customers and [multiple dwelling units] via high capacity service." (ORA Response, p. 4.)

In its late-filed Response of March 11, 1998, Greenlining – which alleges that it represents small inner-city and minority-owned businesses, as well as low-income residential customers – argued that the application did not adequately address the proposed merger's effect on small businesses, or upon AT&T's ability to "ensure universal service to low-income ratepayers." (March 11 Greenlining Response, p. 1.) Greenlining therefore requested that a hearing be held. (*Id.* at 2.) However, on March 17, 1998, Greenlining filed an Amendment to its March 11 Response, which states that "subsequent information has been gleaned" by it, that it no longer requests hearings on the issues raised in the March 11 Response, and that it now supports the application. (March 17 Greenlining Amendment, p. 1.)[4]

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[4] In the Joint Ruling and Scoping Memorandum of the Assigned Commissioner and the Administrative Law Judge (Joint Scoping Memorandum) issued in this docket on April 6, 1998, Greenlining's March 11 motion to have the Commission accept its late-filed response, as amended on March 17, 1998, was granted.

Categorization, Presiding Officer, and Scope of the Proceeding

The applicants requested that this matter should be categorized as a ratesetting proceeding, and that no hearings should be required. By Resolution ALJ 176-2986 (February 4, 1998), the Commission ratified the preliminary determination that this was a ratesetting proceeding. In the absence of protests, no prehearing conference was held. On April 6, 1998, the Joint Scoping Memorandum was issued, which affirmed the preliminary determination that this application should be treated as a ratesetting proceeding, affirmed the determination that no hearing was necessary and designated the ALJ as the presiding officer. The Joint Scoping Memorandum also determined that the scope of the proceeding would be to determine whether the change in control that would occur as a result of the proposed merger would be in the public interest, and under which subsection of PU Code § 854 it should be reviewed.

Do §§ 854(b) and (c) Apply to the Proposed Transaction?

1. *Position of the Applicants*

In view of the fact that this application is unopposed, our principal task in this decision is to determine how extensive a review of the proposed merger is required under PU Code § 854. In this connection, we must determine whether --as the applicants urge -- the proposed transaction need be reviewed only under the "public interest" standard inherent in § 854(a)[7], or whether the transaction is subject to the more detailed review required by §§ 854(b) and (c).[8]

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[7] PU Code § 854(a) provides in pertinent part:

> "No person or corporation, whether or not organized under the laws of this state, shall merge, acquire, or control either directly or indirectly any public utility organized and doing business in this state without first securing authorization to do so from the commission. The commission may establish by order or rule the definitions of what constitute merger,

Footnote continued on next page

The facts concerning the $500 million threshold under §§ 854 (b) and (c) are not in dispute. As shown by the financial statements attached to the

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acquisition, or control activities which are subject to this section. Any merger, acquisition or control without that prior authorization shall be void and of no effect."

In *M. Lee (Radio Paging)*, 65 CPUC 635 (1966), we held that under this section, "[t]he primary question to be determined . . . is whether the proposed transfer would be adverse to the public interest. Questions relating to public convenience and necessity usually are not relevant to the transfer proceeding because they were determined in the proceeding in which the certificate was granted." (65 CPUC at 637.)

[a] PU Code § 854(b) provides in full:

"Before authorizing the merger, acquisition, or control of any electric, gas, or telephone utility organized and doing business in this state, where any of the utilities that are parties to the proposed transaction has gross annual California revenues exceeding five hundred million dollars ($500,000,000), the commission shall find that the proposal does all of the following:

(1) Provides short-term and long-term economic benefits to ratepayers.

(2) Equitably allocates, where the commission has ratemaking authority, the short-term and long-term forecasted economic benefits, as determined by the commission, of the proposed merger, acquisition, or control, between shareholders and ratepayers. Ratepayers shall receive not less than 50 percent of those benefits.

(3) Not adversely affect competition. In making this finding, the commission shall request an advisory opinion from the Attorney General regarding whether competition will be adversely affected and what mitigation measures could be adopted to avoid this result."

PU Code § 854(c) sets forth eight factors that this Commission must consider in making its public interest determination in cases where the $500 million gross annual revenue test set forth in § 854(b) is triggered.

application as Exhibit G,[9] the gross annual revenues of the three California TCG subsidiaries being acquired are substantially less than $500 million. However, applicants acknowledge, the gross annual intrastate California revenues of AT&T Communications of California, Inc. and the four California wireless companies that are subsidiaries of AT&T Wireless Services, Inc. exceeded $500 million in 1996. (Application, p. 11.)

The applicants advance two reasons why, despite the revenues of AT&T's two California affiliates, review under §§ 854 (b) and (c) is not appropriate here. First, according to the applicants, § 854(f)[10] specifically *precludes* consideration of these revenues, because (a) they are revenues of the *acquiring* company's affiliates, and (b) neither of AT&T's California affiliates is being used to effectuate the merger in question. Applicants argue that application of the literal terms of § 854(f) in this case is consistent with the common-sense public policy determination reflected in this provision:

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[9] These financial statements were filed under seal, along with a motion urging that they be accorded confidential treatment under General Order (G.O.) 66-A. No opposition to the motion for confidential treatment has been received, so we will grant it.

It should also be noted that in a ruling dated March 2, 1998, the Law and Motion Judge granted a motion by the applicants that access to these confidential financial statements should be granted only to persons who execute a form of nondisclosure agreement attached to the ruling. *See* Administrative Law Judge's Ruling Granting Motion of Teleport Communications Group, Inc. and AT&T Corporation for Approval of Nondisclosure Agreement, issued March 2, 1998.

[10] PU Code § 854(f) provides in full:

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

> "The distinction drawn by the legislature in § 854(f) represents a policy judgment that acquisitions *of* holding companies with large California utilities warrant closer scrutiny than acquisitions *by* holding companies with large California utilities. That legislative judgment is what common sense suggests. The acquisition by any entity, regardless of size, of a company owning a large California utility may have significant implications for the state. In contrast, acquisitions of companies not meeting the $500 million threshold are likely to have fewer implications even if the acquiring company happens to have a large California utility subsidiary. This legislative judgment is fully consistent with the approach taken by the Commission in [D.97-03-067, the SBC-Pacific Telesis merger case.]" (Application, p. 12.)

Second, applicants argue that the public policy considerations that led the Commission to "pierce the corporate veil" in the SBC-Telesis merger are not present here. In Decision (D.) 97-03-067, the Commission found that Pacific Bell, a subsidiary of Pacific Telesis, was "key to the merger," so review under PU Code §§ 854 (b) and (c) was appropriate. (Mimeo. at 12.) Here, in contrast, "the facilities of AT&T of California and AT&T Wireless are not required for TCG['s] provision of local exchange service." (*Id.*) Thus, applicants continue,

> "[T]his is not an application where two monopolists propose to merge. Rather, it is a case in which a nondominant interexchange carrier [NDIEC] proposes to acquire a relatively small, nondominant facilities-based local exchange carrier to jump start its entry into that market. Such a transaction does not pose the policy concerns confronting the Commission in [D.97-03-067.]" (*Id.*)

2. *Discussion*

Although both of the justifications that applicants have suggested for the inapplicability of §§ 854 (b) and (c) are plausible, we decline to adopt them on the minimal record before us here.

With respect to applicants' suggestion that §§ 854(b) and (c) are directed principally at the situation in which "two monopolists propose to merge," and not where one NDIEC is acquiring another, we repeat what we said last Spring in D.97-05-092, our interim opinion concerning the proposed merger between MCI Communications Corporation (MCI) and British Telecommunications plc (BT). In that decision we stated:

> "While there may be much merit to consideration of a blanket exemption from §§ 854 (b) and (c) for [NDIECs], we do not consider such a blanket exemption today. Instead, any such blanket exemption should be subjected to a separate generic rulemaking with full opportunity to comment and, if we find the statute ambiguous regarding its application to NDIECs, with a full review of the legislative history of the statute." (Mimeo. at 17.)[11]

With respect to § 854(f), we are not yet prepared to agree with applicants that acquisitions by "holding companies with large California utilit[y]" affiliates can *never* raise public policy issues warranting review under PU Code §§ 854 (b) and (c). While our relaxed regulation of NDIECs makes that a reasonable position in this case,[12] it is conceivable that other acquisitions might

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[11] As noted above in footnote 2, we did rule in D.94-05-051 (54 CPUC2d 520) that transfers of assets or changes in control between NDIECs can be made by means of an advice letter, which becomes effective 40 days after filing unless it is protested or suspended by the Commission. However, our decision in D.94-05-051 expressly provided that such an advice letter process would not be available where the transaction was subject to PU Code §§ 854 (b) and (c). (54 CPUC2d at 523.) Moreover, D.94-05-051 does not cover the situation in which an NDIEC is also certificated as a CLC, because the Commission did not authorize CLC status until D. 95-12-057.

[12] TCG's three California subsidiaries are all classified as NDIECs as well as Competitive Local Carriers (CLCs). AT&T Communications of California, Inc. was classified as an NDIEC in D.97-08-060. Appendix A to D.97-08-060 sets forth a concise summary of our regulatory requirements for NDIECs.

warrant consideration of the revenues of the acquiring company's California utility affiliates. Moreover, if we were to endorse the applicants' argument here, our decision would in all likelihood be construed as a precedent, and the contention would soon be made that the same rule should be applied to acquisitions involving electric and gas utilities. Until we can give broader consideration to the issue of whether the revenues of California utility affiliates should ever trigger review under PU Code §§ 854(b) and (c), we are reluctant to say that the literal terms of § 854(f) should be applied without exception in every case.[13]

Even if PU Code §§ 854 (b) and (c) are Applicable Here, Should the Commission Exercise its Discretion Under § 853(b) to Exempt the Merger from Review Under Those Sections?

The applicants have requested that even if we conclude this transaction crosses the jurisdictional threshold set forth in §§ 854 (b) and (c), we should nonetheless exercise our discretion under PU Code § 853(b)[14] and rule that the

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[13] "It is a familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit, nor within the intention of its makers." *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892).

[14] PU Code § 853(b) provides in full:

> "The commission may from time to time by order or rule, and subject to those terms and conditions as may be prescribed therein, exempt any public utility or class of public utility from this article [i.e., PU Code §§ 851-856] if it finds that the application thereof with respect to the public utility or class of public utility is not necessary in the public interest. The commission may establish rules or impose requirements deemed necessary to protect the interest of the customers or subscribers of the public utility or class of public utility exempted under this subdivision. These rules or requirements may include, but are not limited to, notification of a proposed sale or transfer of assets or stock and provision for refunds or credits to customers or subscribers."

proposed merger will not be reviewed under those sections. (Application, pp. 13-14.)

As applicants point out, this is what we did in D.97-05-092, where the proposed merger of MCI and BT was under review. We concluded in that decision that "regardless of whether any [affiliate of MCI] has gross annual California revenues in excess of $500 million," it was appropriate, pursuant to the powers set forth in PU Code §§ 854(a) and 853(b), to exempt the transaction from review under §§ 854(b) and (c). (Mimeo. at 15-17.)

We reached this conclusion by reviewing the legislative history of SB 52, the 1989 statute that added §§ 854 (b) and (c) to the PU Code. In our review, we noted that the impetus for these provisions, which became known as the "Edison conditions," was the proposed merger of San Diego Gas & Electric Company (SDG&E) and Southern California Edison Company (Edison), a transaction that if approved would have resulted in the largest energy utility in the United States.[15] We quoted from the analysis of SB 52 prepared by the Assembly Committee on Utilities and Commerce to show that the Legislature intended to confer upon us broad discretion as to the circumstances in which the "Edison conditions" would apply to other mergers.[16] Based on this legislative intent, we concluded:

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[15] The Edison-SDG&E merger was disapproved by us in D.91-05-028, 40 CPUC2d 159 (1991).

[16] In discussing the proposal to amend § 854(a) to allow the Commission to define control activities (a provision now found in the second sentence of § 854(a)), the Assembly Committee's report said:

> "Whether the Edison conditions will apply to any transaction other than the pending Southern California Edison/San Diego Gas & Electric merger proposal may depend to a large extent on the definitions of control activities that the PUC adopts pursuant to the bill's directive."

"We think this [legislative history] evinces a legislative intent to permit us to use our powers under both § 853(b) and § 854(a) to exempt transactions from review under §§ 854 (b) and (c), regardless of the presence of gross annual California revenues in excess of $500 million. For this reason, we reject the contention that we must review this transaction under the criteria in (b) and (c) if any utility or entity which is a party to this transaction has gross annual California revenues exceeding $500 million. We believe our exemptive power under § 853(b) extends to the granting of an exemption from §§ 854 (b) and (c) if such an exemption is in the public interest. The import of the language added to § 854(a) by SB 52 makes the broad extent of our exemptive power clear." (*Id.* at 17.)

We also concluded that the determination of whether to exempt a proposed merger from review under §§ 854 (b) and (c) should be made on a case-by-case basis. (*Id.* at 14, 20.) We found that there were three reasons unique to the MCI-BT situation that made such an exemption appropriate.

First, we noted that "this application does not involve putting together two traditionally regulated telephone systems." We noted that acquisition of a heavily-regulated local exchange carrier was not the reason for the merger. Instead, we pointed out, "BT operates exclusively in the United Kingdom and does not propose to enter the California market," but was seeking only to become the "ultimate corporate parent" of MCI. (*Id.* at 18-19.)

Second, we concluded that because MCI was a nondominant carrier, we lacked the type of ratemaking authority over it that is contemplated by § 854(b). Without such broad authority -- the type we exercise over local exchange carriers -- it is not possible to allocate at least half the benefits of a merger to ratepayers, as required by § 854(b). (*Id.* at 19.)

Third, we concluded that because MCI had "grown under competitive forces at the sole risk of its shareholders without a captive ratepayer base and guaranteed franchise territory to buffer risk and reward," it was inappropriate to subject MCI's proposed merger to a detailed review for determination of merger benefits and allocation of those benefits, as required by §§ 854(b) (1) and (2). On the contrary, we concluded, to subject a company like MCI to review under § 854(b) would be likely to "stifle competition and discourage the operation of market forces." (*Id.* at 19.)

While the proposed merger between AT&T and TCG differs in many respects from the one between MCI and BT, we conclude that many of the same underlying factors that made it appropriate to exempt the MCI-BT merger from review under §§ 854(b) and (c) also make such an exemption appropriate here.

First, as in D.97-05-092, the AT&T-TCG merger "does not involve putting together two traditionally regulated telephone systems," because the California affiliates of both AT&T and TCG are nondominant carriers.

AT&T Communications of California, Inc. (AT&T-C) is a nondominant interexchange carrier, a status that accords it more pricing flexibility and less regulatory scrutiny. Our conclusion in D.97-08-060 that AT&T-C should be treated as a nondominant interexchange carrier was based on the effective competition that has come to exist within the interLATA market, both nationally and in California. More than five years ago, we pointed out in D.93-02-010 -- our decision to grant AT&T-C additional regulatory flexibility even though it remained the dominant interexchange carrier in California -- that AT&T-C's national parent was losing market share at a significant rate, and that the market shares of its chief rivals were on the rise. (48 CPUC2d at 46-47.) In analyzing the extent of AT&T's market power in our 1994 decision on the AT&T-McCaw merger, D.94-04-042, we noted that AT&T's share of the national interexchange market had declined from nearly 100% in 1984 to about 60% a decade later. (54 CPUC2d at 54.) By the time we designated AT&T-C as a nondominant interexchange carrier in D.97-08-060, its share of the California interexchange market (based on minutes of use) stood at 55%, having declined from 67% in 1990 and 70% in 1989. This decline had occurred even though AT&T-C had enjoyed since 1993 the same flexibility in filing tariffs as its competitors. (Mimeo. at 15.)[17]

With respect to facilities ownership, we noted in D.97-08-060 that AT&T's share of the telecommunications infrastructure has declined from nearly 100% in 1984 to approximately 20% in 1996. (*Id.* at 20.) AT&T's share of transmission capacity has also declined over the years, with its competitors controlling 80% of the active capacity in the state. (*Id.*)

Our decision to grant AT&T-C's request to be classified as a nondominant carrier is an acknowledgment of the impact of these events. In D.97-08-060, we concluded that AT&T does not wield "significant market power." Hence, we now permit it complete rate flexibility, including the elimination of rate of return regulation. With one exception, AT&T-C is treated today the same way as any other NDIEC.[18] Accordingly, our consideration of the merger application of AT&T and TCG under the purview of § 854 necessarily includes the nondominant status of, and the regulatory framework applicable to, AT&T-C. AT&T-C's status as an NDIEC is a significant factor warranting an exemption from review under §§ 854 (b) (1) and (2).

TCG's three California subsidiaries -- which provide local exchange service to business customers -- are also nondominant carriers, as well as CLCs. Thus, as was the case with MCI, this Commission does not exercise the type of ratemaking

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[17] Based on revenues, AT&T-C's share of the California interexchange market was 49% in 1995, and its share based on presubscribed lines was 66%.

[18] Under D.97-08-060, AT&T-C continues to be required to file an annual report on its rate of return on intrastate rate base until such time as Pacific Bell or its affiliate has been granted permission to enter the intrastate interLATA market and has operated for one full reportable period. (Mimeo. at 23.)

authority over them that would permit a determination of and allocation of merger benefits, as required by §§ 854(b) (1) and (2).

Further, it is as true of TCG as it was of MCI that TCG has "grown under competitive forces at the sole risk of its shareholders without a captive ratepayer base and guaranteed franchise territory to buffer risk and reward." Thus, review of TCG's proposed merger with AT&T under §§ 854 (b) and (c) would be contrary to the reliance upon competitive forces that is one of the basic principles of the Telecommunications Act of 1996 (as well as one of our own goals as a Commission).

Accordingly, in light of the mode of regulation we apply to the California subsidiaries of AT&T and TCG -- and the competitive conditions in which they operate -- we conclude that, as in D.97-05-092, it is appropriate to exercise our "exemptive powers" under §§ 854(a) and 853(b) and review the proposed merger only under the "public interest" standard inherent in § 854(a).

Review of the Proposed Merger Under the Public Interest Standard of § 854(a)

As indicated above, "the primary question to be determined in a transfer proceeding [under § 854(a)] is whether the proposed transfer would be adverse to the public interest." *M. Lee (Radio Paging Co.)*, 65 CPUC 635, 637 (1966).

As stated in D.97-07-060,[11] our decisions over the years have laid out a number of factors that are usually considered in making this determination.

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[11] D.97-07-060, our decision approving the MCI-BT merger, has been overtaken by events. In October 1997, WorldCom made a tender offer to MCI shareholders that they eventually found more attractive than the offer made by BT. The proposed acquisition of MCI by WorldCom, which has been approved by the shareholders of both companies, is now under review at both this Commission and the FCC. However, the analytical framework set forth in D.97-07-060 remains valid.

(Mimeo. at 15-17.) First, we inquire whether the proposed utility operation is economically and financially feasible. *R.L. Mohr (Advanced Electronics)*, 69 CPUC 275, 277 (1969); *Santa Barbara Cellular, Inc.*, 32 CPUC2d 478 (1989). There can be no reasonable doubt about that in this case. Although TCG has experienced losses as it has expanded its fiber-based digital network, it has experienced good revenue growth during the past several years, and AT&T's ready access to financing will facilitate further expansion of TCG's network.[20]

As part of our examination of the financial feasibility of the transaction, we may also inquire whether the price to be paid is fair to both buyer and seller. *Union Water Co. of California*, 19 CRRC 199, 202 (1920). However, given the prevailing competitive market conditions and the nature of the industry in telecommunications, the need for a traditional reasonableness review of the purchase price for this transaction is obviated by the decisions the shareholders of these companies make on their investment. Still, we note that the exchange ratio of 0.943 shares of AT&T common stock for each share of TCG common stock means that the price being paid by AT&T appears to be relatively high. However, we have no reason to second-guess the judgment of either the financial markets or shareholders that TCG's strategically-placed network will give AT&T much-needed infrastructure that it can use to "jump start" its entry into the local exchange market. Under these circumstances, we conclude that the price being paid is not unreasonable.

Second, we have traditionally inquired under § 854(a) whether the proposed merger is likely to result in a broader base for financing, with more

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[20] According to its 10-K report, TCG now serves 65 metropolitan markets, including 28 of the 30 largest metropolitan areas. (Exhibit B, p. 3.)

resultant flexibility. *Southern California Gas Co.*, 74 CPUC 30, 50; *modified on other grounds* 74 CPUC 259 (1972). According to the applicants, "AT&T's acquisition of TCG holds great promise for the development of facilities-based local competition by taking full advantage of the complementary aspects of AT&T's financial strength and marketing expertise and TCG's local facilities." (Application, p. 8.) Thus, increased ease of financing is one of the principal benefits that TCG foresees from the merger. AT&T's decision to buy TCG's network, rather than go through the "unavoidably complex and time-consuming" process of building its own, leads us to conclude that the proposed merger is also likely to result in efficiencies and savings in operating costs, another factor we have traditionally considered under PU Code § 854(a). *Southern California Gas Co.*, 70 CPUC 836, 837 (1970).

Third, the fact that AT&T is the acquiring party seems sufficient to satisfy another test we have traditionally applied; viz., whether the new owner of the business is experienced, financially responsible and adequately equipped to carry on the business sought to be acquired. *City Transfer and Storage Co.*, 46 CRRC 5, 7 (1945). AT&T's presence adds weight to applicants' assertion that "combining the experienced management of both companies will maintain or improve the high quality of TCG and AT&T management in California . . ." (Application, p. 9.)

Another aspect of the public interest determination we must make under § 854(a) is whether the proposed merger raises any antitrust concerns, because we must take into account the antitrust aspects of any application before us. *Northern California Power Agency v. Public Utilities Commission*, 5 Cal.3d 370, 379-80 (1971). We agree with ORA's conclusion that the proposed merger poses "no competitive detriment" to any of the affected markets and offers "some competitive benefits" to the local exchange market. (ORA Response, p. 5.)[21] In the short run, we believe the merger is desirable because it will bring more facilities-based competition to the local business market, and it may contribute to the introduction of facilities-based service to local residential markets in California. In the long run, vigorous competition in this industry probably depends upon carriers owning their own facilities whenever it is economically justifiable.

Finally, although it is not a factor that has been traditionally considered under § 854(a),[22] we note that the proposed merger appears to offer some tangible benefits to TCG's employees. Under ¶ 7.12 of the Merger Agreement, they will enjoy the superior benefits available to AT&T's employees.

Taking all of these factors into account, we have no difficulty in concluding that the proposed merger between AT&T and TCG is in the public interest, and we will therefore approve it.

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[21] As ORA notes, AT&T and TCG are at present in different lines of business:

> "AT&T is primarily a long distance carrier, with cellular operations and authority to provide local service in California. AT&T's local operation is limited, and AT&T no longer is holding itself out as a local service provider. TCG is primarily a facilities-based provider of local exchange and high-speed services to large business customers in California." (ORA Response, p. 2.)

[22] It should be noted that in a merger subject to review under PU Code § 854(c), one of the factors we must consider before deciding whether the proposed transaction is in the public interest is whether it is "fair and reasonable to affected public utility employees, including both union and nonunion employees." § 854(c)(4).

Findings of Fact

1. Applicants filed for approval of the proposed merger between AT&T and TCG by application under PU Code § 854(a).

2. Along with their application, applicants filed a motion seeking to have Exhibits G and J to the application afforded confidential treatment pursuant to G.O. 66-C.

3. Notice of the application appeared in the Commission's Daily Calendar on February 4, 1998. The protest period expired on March 6, 1998.

4. On March 2, 1998, the Law and Motion Judge issued a ruling granting AT&T's and TCG's motion to make Exhibits G and J of the application available to parties who sign a nondisclosure agreement substantially identical in form to the one attached to the March 2, 1998 ruling as Appendix A.

5. ORA filed a timely response to the application on March 6, 1998. ORA's response supports the proposed merger, but takes no position on the nature of the review that the Commission should conduct under PU Code § 854.

6. On March 11, 1998, Greenlining filed a motion seeking to have the Commission accept a late-filed response to the application, which response was attached to said motion. Greenlining's response urged that a hearing be held on the application.

7. On March 17, 1998, Greenlining submitted an amendment to its late-filed response. The amendment withdrew Greenlining's request that a hearing be held on the application.

8. On April 6, 1998, the assigned Commissioner and the assigned Administrative Law Judge (ALJ) issued a Joint Scoping Memorandum that, among other things, (1) granted Greenlining's motion to have its late-filed response, as amended on March 17, 1998, accepted by the Commission, and (2) confirmed the categorization of this proceeding as ratesetting.

9. No protests to the application have been filed.

10. AT&T is a New York corporation that provides domestic and international telecommunications services throughout the United States. It is primarily a long-distance carrier.

11. TCG is a Delaware holding company with three California subsidiaries: TCG-San Francisco, TCG-Los Angeles, and TCG-San Diego.

12. TCG's California subsidiaries offer dedicated and switched telecommunications services over a digital network. The customers of these TCG subsidiaries are primarily businesses and other institutions that are heavy users of telecommunications services.

13. TA Merger Corp. is a Delaware subsidiary of AT&T that has been formed for the specific purpose of effectuating AT&T's merger with TCG and ensuring that the transaction qualifies as a tax-free reorganization under § 368(a) of the Internal Revenue Code.

14. Under the Merger Agreement, shareholders of TCG will, at the time the merger is completed, receive 0.943 shares of AT&T common stock for each share of TCG common stock.

15. AT&T wishes to enter into the merger so that it can acquire TCG's existing digital network and use it as the cornerstone of facilities-based local exchange offerings. AT&T prefers such an acquisition of local telecommunications infrastructure to the time-consuming and complex alternative of constructing such infrastructure.

16. TCG wishes to enter into the merger so that it can enjoy the benefits of AT&T's superior financial strength, brand-name recognition and marketing expertise.

17. After the merger is consummated, AT&T's and TCG's respective California subsidiaries will continue to serve their customers pursuant to existing tariffs on file at the Commission.

18. In 1996, the sum of the gross intrastate California revenues generated by AT&T's California subsidiary, AT&T Communications of California, Inc., and the revenues generated by the four California cellular companies that AT&T controls indirectly through its subsidiary AT&T Wireless Services, Inc., exceeded $500 million.

19. In D.97-05-092, the Commission concluded that it has power under PU Code §§ 853(b) and 854(a), upon an appropriate showing, to exempt from review under §§ 854 (b) and (c), a merger to which a California utility with gross annual California revenues in excess of $500 million is a party.

20. AT&T Communications of California, Inc. is both an NDIEC and a CLC.

21. Each of TCG's California subsidiaries is an NDIEC as well as a CLC.

22. The proposed merger between AT&T and TCG does not involve putting together two traditionally regulated telephone systems.

23. Because TCG's California subsidiaries are NDIECs as well as CLCs, the Commission does not exercise the type of ratemaking authority over them that would allow an allocation of merger benefits, as required by § 854 (b).

24. TCG has grown under competitive forces at the risk of its shareholders, without a captive ratepayer base or guaranteed service territory.

25. Nationally, TCG serves 65 metropolitan markets, including 28 of the 30 largest metropolitan areas.

26. Access to AT&T's superior financial strength, brand name recognition, and marketing expertise will enable TCG to expand its network further.

27. A merger with TCG is likely to enable AT&T to jump start its entry into the facilities-based local exchange market in California.

28. The price to be paid by AT&T for TCG's shares is not unreasonable.

29. A merger with AT&T is likely to enhance TCG's ability to attract and retain high quality, experienced managers.

30. Under the Merger Agreement attached to the application as Exhibit H, TCG employees will, upon consummation of the proposed merger, be entitled to the superior benefits enjoyed by AT&T employees.

Conclusions of Law

1. Applicant's motion to place under seal, pursuant to G.O. 66-C, the financial statements set forth in Exhibits G and J to the application, should be granted to the extent set forth below.

2. It would not be appropriate to determine whether mergers involving NDIECs are exempt from review under PU Code §§ 854(b) and (c), even if one of the parties to the proposed transaction has gross annual California revenues in excess of $500 million, without considering the question in a generic rulemaking with full opportunity for comment.

3. It would not be appropriate to rule in this case, for the purpose of determining whether §§ 854(b) and (c) have been triggered, whether PU Code § 854(f) precludes consideration in every case of the affiliate revenues of acquiring utilities.

4. For the reasons set forth in Finding of Fact (FOF) Nos. 22, 23, and 24, this is an appropriate case in which to exercise the Commission's exemptive powers under §§ 853(b) and 854(a) and hold that, regardless of the fact that AT&T's California affiliates have gross annual intrastate revenues in excess of $500 million, the proposed merger should be exempt from review under §§ 854(b) and (c), and should instead be reviewed under § 854(a).

5. The proposed merger between AT&T and TCG poses no competitive detriment to any of the affected markets, and offers some competitive benefits to the local exchange market.

6. Because the proposed transaction involves only a change in the underlying ownership of facilities, it can be seen with certainty that the merger between AT&T and TCG will not have a significant effect upon the environment.

7. For the reasons set forth in FOF Nos. 26-30 and Conclusion of Law Nos. 5-6, the proposed merger between AT&T and TCG is in the public interest, and should be approved pursuant to PU Code § 854(a).

8. The approval set forth herein is not a finding of the value of the rights and property to be transferred.

ORDER

IT IS ORDERED that:

1. On or after the effective date of this order, AT&T Corp. (AT&T), Teleport Communications Group Inc. (TCG), and TA Merger Corp. are authorized to merge in accordance with the terms set forth in Application (A.) 98-02-001.

2. Exhibits G and J to A.98-02-001 shall remain under seal for a period of one year from the effective date of this order. Said exhibits shall not be made accessible or disclosed to anyone other than Commission staff or a party who has signed an Appropriate Nondisclosure Agreement, except upon further order or ruling of the Commission, the Assigned Commissioner, the assigned Administrative Law Judge (ALJ), or the ALJ then designated as the Law and Motion Judge. For purposes of the foregoing sentence, Appropriate Nondisclosure Agreement shall mean an agreement substantially identical in form to the attachment to the Administrative Law Judge's Ruling Granting Motion of Teleport Communications Group, Inc. and AT&T Corporation For

Approval of Nondisclosure Agreement, issued in this docket on March 2, 1998. Should the need for confidential treatment of Exhibits G and J to A.98-02-001 continue to exist after expiration of the one-year period specified herein, AT&T or TCG shall apply for an extension of this Ordering Paragraph (OP) 2 no later than 30 days before the one-year expiration date.

3. Within 30 days after the change of control authorized herein has taken place, AT&T shall file with the Commission's Docket Office, for inclusion in the formal file of A.98-02-001, written notice that said change of control has taken place.

4. The authority granted in OP 1 shall expire if not exercised within 12 months after the effective date of this order.

5. In the event that the books and records of the applicants or any affiliates thereof are required for inspection by the Commission or its staff, applicants shall either produce such records at the Commission's offices, or reimburse the Commission for the reasonable costs incurred in having Commission staff travel to any of applicants' offices.

This order is effective today.

Dated May 7, 1998, at San Francisco, California.

RICHARD A. BILAS
President
P. GREGORY CONLON
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

Commissioner Jessie J. Knight, Jr., being necessarily absent, did not participate.

APPENDIX A

	TCG San Francisco	TCG Los Angeles	TCG San Diego
InterLATA – Facilities-Based and Resale	D. 97-05-009 (Corrected by D. 97-06-003)	D. 97-05-010 (Corrected by D. 97-06-003)	D. 97-05-011 (Corrected by D. 97-06-003)
IntraLATA – Facilities-Based and Resale	D. 93-04-063	D. 93-04-063	D. 94-12-037
Local Exchange – Facilities-Based	D. 95-12-057	D. 95-12-057	D. 95-12-057
Local Exchange – Resale	D. 96-02-072	D. 96-02-072	D. 96-02-072
Local Exchange – Facilities Based and Resale (Roseville and Citizens Territory)	D. 98-01-055	Not applicable	Not applicable
InterLATA and IntraLATA High Speed Private Line	D. 89-02-016 (InterLATA) D. 90-07-022 (IntraLATA)	D. 89-04-044	D. 94-05-045
Transfer of CPCNs	D. 95-02-095	D. 95-02-056	Not applicable
Transfer of Ownership	D. 96-06-039	D. 96-06-039	D. 96-06-039

Prepared 2/2/1998