

State of Florida



Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: June 12, 2006

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Competitive Markets & Enforcement (Buys, Kennedy)
Office of the General Counsel (Wiggins, Fudge)

RE: Docket No. 060308-TP – Joint application for approval of indirect transfer of control of telecommunications facilities resulting from agreement and plan of merger between AT&T Inc. (parent company of AT&T Communications of the Southern States, LLC, CLEC Cert. No. 4037, IXC Registration No. TJ615, and PATS Cert. No. 8019; TCG South Florida, IXC Registration No. TI327 and CLEC Cert. No. 3519; SBC Long Distance, LLC, CLEC Cert. No. 8452, and IXC Registration No. TI684; and SNET America, Inc., IXC Registration No. TI389) and BellSouth Corporation (parent company of BellSouth Telecommunications, Inc., ILEC Cert. No. 8 and CLEC Cert. No. 4455); and BellSouth Long Distance, Inc. (CLEC Cert. No. 5261 and IXC Registration No. TI554).

AGENDA: 06/20/06 – Regular Agenda – Proposed Agency Action – Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Deason

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\CMP\WP\060308.RCM.DOC

Case Background

On March 31, 2006, AT&T Inc., BellSouth Corporation, BellSouth Telecommunications, Inc., and BellSouth Long Distance, Inc. (collectively referred to as “Applicants”) submitted a joint application for approval by the Florida Public Service Commission (Commission) of

indirect transfer of control of telecommunications facilities from BellSouth Corporation to AT&T Inc. resulting from an Agreement and Plan of Merger jointly executed by the two companies.

The merger of AT&T Inc. and BellSouth Corporation is a holding company transaction. Upon completion of the merger, BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. will become wholly owned subsidiaries of AT&T Inc., and thus, AT&T Inc. will indirectly control BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc.

AT&T Inc. is a Delaware corporation with its headquarters at 175 East Houston Street, San Antonio, Texas. AT&T Inc. is a holding company and does not directly provide any services in Florida. However, AT&T Inc. owns several subsidiaries that are currently providing services in Florida.

AT&T Inc. subsidiaries operating in Florida

AT&T Communications of the Southern States, LLC, holds the following certificates and registration:

- a. Competitive Local Exchange Company (CLEC) Certificate No. 4037, issued May 7, 1996,
- b. Pay Telephone Certificate No. 8019, issued February 1, 2002, and
- c. Interexchange Company (IXC) Registration No. TJ615, issued February 1, 2002.

TCG South Florida holds the following certificate and registration:

- a. Alternative Access Vendor (AAV) Certificate No. 3519, issued through transfer on July 21, 1995 – also authorizes the company to provide CLEC services, and
- b. IXC Registration No. TI327, issued July 27, 1995.

SBC Long Distance, LLC d/b/a AT&T Long Distance holds the following certificate and registration:

- a. CLEC Certificate No. 8452, issued May 4, 2002, and
- b. IXC Registration No. TI684, issued September 3, 1997.

SNET America, Inc. d/b/a SBC Long Distance East holds the following registration:

- a. IXC Registration No. TI389, issued July 27, 1995.

BellSouth Corporation is a Georgia corporation headquartered at 1155 Peachtree Street, N.E., Atlanta, Georgia. Like AT&T Inc., BellSouth Corporation is a holding company that does not directly provide services in Florida. Through the following subsidiaries, BellSouth Corporation provides services in Florida.

BellSouth Corporation subsidiaries operating in Florida

BellSouth Telecommunications, Inc. holds the following certificates:

- a. Incumbent Local Exchange Company (ILEC) Certificate No. 8, issued January 17, 1955, and
- b. CLEC Certificate No. 4455, issued June 14, 1996.

BellSouth Long Distance, Inc. holds the following certificates and registration:

- a. CLEC Certificate No. 5261, issued November 18, 1997, and
- b. IXC Registration No. TI554, issued October 21, 1997.

The control of BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. will be transferred to AT&T Inc., and hence, BellSouth Corporation will cease to exist upon the conversion of BellSouth Corporation stock to AT&T Inc. stock. According to the Applicants, the merger will have no effect on the rates, terms, and conditions of service that BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. provide to their customers. There will not be a transfer of certificates, customer bases, or assets. Tariffs will not require amendments. Nor will any AT&T Inc. subsidiaries certificated in Florida require any changes.

The Federal Communications Commission (FCC) established a pleading cycle seeking comments or petitions on the joint application for transfer of control filed by AT&T Inc. and BellSouth Corporation (WC Docket No. 06-74). Currently, the FCC is seeking comments on the application and those comments are due by June 5, 2006. Responses to the comments are due on June 20, 2006. The FCC is tentatively scheduled to issue an Order on the AT&T Inc./BellSouth Corporation petition in October 2006. The Order will either grant the applications, grant the applications with conditions, or designate the applications for hearing.

The Commission is vested with jurisdiction over this matter pursuant to Sections 364.01, 364.33, and 364.335, Florida Statutes. Accordingly, staff believes the following recommendations are appropriate.

Discussion of Issues

Issue 1: Should the Commission approve the joint application for approval of indirect transfer of control of the facilities and operations of BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. from BellSouth Corporation to AT&T Inc.?

Recommendation: Yes, the Commission should approve the transfer of control of BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. from BellSouth Corporation to AT&T Inc. **(Buys/Kennedy/Fudge/Wiggins)**

Staff Analysis:

I. Jurisdiction

A. Section 364.33, Florida Statutes

The Commission has authority under Section 364.33, Florida Statutes, to approve an application for transfer of control. In the past, the staff has noted that this provision does not provide specific standards which the Commission may follow in making its decision to approve a transfer of control. However, staff believes that Section 364.01, Florida Statutes, implies a public interest standard that the Commission may follow when deciding whether to approve or deny transfers of control, among other transactions.

The broad legislative intent in Section 364.01, Florida Statutes, is clear: the Commission is to exercise its jurisdiction in order to protect “the public health, safety, and welfare” as it relates to basic local telecommunications services. Although there is little guidance on what constitutes the “public interest,” section 364.335, Florida Statutes, provides that “[r]evocation, suspension, transfer, or amendment of a certificate shall be subject to the provisions of this section” In developing its recommendation, staff reviewed the management, technical, and financial capability of the companies within the framework of sections 364.33 and 364.335, Florida Statutes.

II. Staff’s Findings

Historically, a public interest test has been used to determine if a change of control under 364.33, Florida Statutes, should be approved. Staff’s approach in this case is consistent with the past Commission decisions. In order to determine if the change of control was in the public interest, staff reviewed the financial, management, and technical capabilities of the Applicants to determine if these aspects of the operation would impact such items as customer rates, service quality, or the ability to invest in preparing and upgrading infrastructure as a result of the change of control.

A. Management Capability

The Applicants explain in their joint application that BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. will continue to provide service in the same manner as the companies did prior to the transfer of control. The Applicants further state that the merger will

not diminish the parties' commitment to providing the necessary resources to support the Commission's regulation of intrastate services and that AT&T Inc. intends to utilize the services of the management and employees of BellSouth Corporation following the closing of the merger.¹ Hence, it appears that the management of BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. will continue unchanged. As an incumbent Local Exchange Company originally certificated in 1955, BellSouth Telecommunications, Inc. has demonstrated the managerial capability to operate a local exchange company within the framework of public interest.

B. Technical Capability

The same networks that currently serve Florida customers will continue to serve them after the merger. BellSouth Telecommunications, Inc. will continue to provide service under its Service Guarantee Plan approved by the Commission in Order No. PSC-05-0440-PAA-TL, issued April 25, 2005, in Docket No. 050095-TL. The Applicants claim that the vertical integration of the AT&T Inc. backbone network and the BellSouth Telecommunications, Inc. local network will result in more efficient and reliable services.² Further, the Applicants claim that the merged networks will increase efficiency and reduce costs by avoiding the need for inter-networking traffic between companies, and ultimately, will result in better service and reliability for consumers.³ Thus, the merger should not lessen the Applicants' capability to provide quality service to Florida consumers.

C. Financial Capability

The merger should not affect the Applicants' combined financial capability to continue to provide services in Florida. The Applicants' operations will remain intact while they project expense and capital expenditure synergies of about \$2 billion annually by 2008 as a result of duplicative corporate overhead, network and information technology consolidation and advertising savings.⁴

The merger may affect the combined companies' debt rating and cash flow. Moody's Investors Service placed the debt ratings of both AT&T Inc. and BellSouth Corporation under review for possible downgrade. In its Global Credit Research Rating Action, dated March 6, 2006, Moody's indicated that, while it "believes the acquisition is strategically appropriate, it is nevertheless concerned that cash flow measures of leverage will be higher in 2007 than originally expected by Moody's due to both the large share buyback program⁵ as well as the costs of integrating the two firms." Fitch Ratings also placed AT&T Inc. and BellSouth Corporation on Negative Rating Watch – reflecting Fitch's need to evaluate the financial implications of the merger on the companies' debt ratings.

¹ See Joint Application for Approval of Indirect Transfer of Control of Facilities, filed March 31, 2006, in Docket No. 060308-TI, page 11, ¶ 24.

² See Joint Application, page 18, ¶ 43.

³ See Joint Application, page 18, ¶ 44.

⁴ AT&T/BS-FDR-1 000032, *Assessing The Rating Implications of the AT&T Inc./BellSouth Corp. Merger*, Standard & Poors, Credit FAQ, March 7, 2006.

⁵ AT&T plans to buy back up to \$10 million of AT&T stock over the next 22 months.

In summary, the merger may slightly lower the companies' debt ratings, but should not impact BellSouth Telecommunications, Inc.'s financial capability to continue to provide local exchange services to Florida consumers. The combined market capitalization for AT&T Inc. and BellSouth Corporation would be approximately \$165 billion.⁶

III. Conclusion

Staff believes that based upon the Applicants' management, technical, and financial capability, the transfer of control would be in the public interest. However, the Commission may choose to set the matter for hearing if the Commission believes that further scrutiny is necessary. In conclusion, staff recommends that the Commission should approve the transfer of control of BellSouth Telecommunications, Inc. and BellSouth Long Distance, Inc. from BellSouth Corporation to AT&T Inc.

⁶ The Economist, *Big is beautiful*, March 9, 2006.

Issue 2: Should the Commission file comments with the Federal Communications Commission in WC Docket No. 06-74, In Re: AT&T Inc. and BellSouth Corporation Applications for Approval of Transfer of Control?

Recommendation: Yes, staff recommends that the Commission file comments, as provided in Attachment A, to the Federal Communications Commission in WC Docket No. 06-74.

Staff Analysis: The Commission has held that “Section 364.33, Florida Statutes, gives us jurisdiction to approve the transfer of control of telecommunications facilities for the purpose of providing service to Florida consumers. It does not give us the ability to protect the competitive interests asserted by [competitors].” *See Order No. PSC-98-0702-FOF-TP, issued May 20, 1998 in Docket No. 971604-TP.* Nevertheless, staff met with several CLECs to listen to their concerns about the transfer of control. Their concerns can be divided into several categories as follows:

- Loss of a major advocate for the CLECs in AT&T,
- Continued ability to obtain reasonable access to facilities, and
- Ability to compete against such a dominant player in the wireline markets.

The CLECs addressed potential concerns for competition, but did not address immediate issues for consumers due strictly to the change of control. Staff believes that issues raised by CLECs could potentially manifest themselves, but many are speculative at this point in time. Moreover, the potential for a number of them already exist regardless of the merger. Post-merger, staff believes it will need to continue monitoring the market to ensure that AT&T and BellSouth remain in compliance with the Florida statutes. Staff believes that the Commission currently has tools to address issues that may arise in the future outside of this proceeding.

Staff believes that many of the issues presented by the CLECs are under the jurisdiction of the Federal Communications Commission (FCC) and should be addressed by that agency. The AT&T and BellSouth merger is of far greater scope than just wireline services regulated by the Commission. The merger consolidates two entities that offer wireline, wireless, Internet, voice-over-Internet protocol (VOIP), long distance, video, and other services. Various aspects of AT&T’s and BellSouth’s operations, once merged, will span the breadth of the United States and may have significant impact. The resultant entity will be, by far, the largest local exchange telecommunications provider operating within the United States.

Staff believes that a more global approach is required and the approach ultimately rests with the FCC. The FCC has recognized competitive concerns in the past, albeit not of the scope and magnitude of the AT&T and BellSouth merger. For example, in FCC WC Docket No. 05-65, In Re: Application for Consent to Transfer Control of AT&T Corp. to SBC Communications Inc., the applicants proposed merger conditions that were apparently aimed at mitigating concerns of the FCC staff, competitors, and customers. Competitors to whom staff spoke indicated that the conditions imposed by the FCC were beneficial, but they believe more are needed for the AT&T and BellSouth merger.

In a separate FCC proceeding, WC Docket No. 05-75, In Re: Applications for Consent to Transfer Control of Filed by Verizon Communications, Inc. and MCI, Inc. Verizon, filed voluntary commitments (merger conditions) in order to comfort the FCC that the merger is in the public interest.

The Commission has previously recognized that there may be a need to file comments with an appropriate federal agency. For example, in Docket 981252-TP, the merger of GTE Corporation and Bell Atlantic Corporation, the Commission issued Order No. PSC-98-1645-FOF-TP, on December 7, 1998, which provides:

In accordance with our authority under Section 364.33, Florida Statutes, to review the acquisition or transfer of majority organizational control or controlling stock ownership of a telecommunications company providing services in Florida, we have reviewed the Joint Petition of GTE and Bell Atlantic. Based upon our review, we find that it is in the public interest to approve the Joint Petition. We emphasize, however, that our approval of the Joint Petition, pursuant to our authority under Section 364.33, Florida Statutes, in no way precludes us from addressing any of our concerns that may arise regarding this transaction to the appropriate federal agency. (emphasis added)

Staff notes that section 364.012, Florida Statutes, encourages the Commission to participate in the proceedings of federal agencies in cases in which Florida's consumers may be affected. If competition were to be negatively affected by this merger, Florida's consumers could suffer negative consequences as well. By filing comments in WC Docket 06-74, the Commission may help ensure that any concerns, non-jurisdictional or otherwise, will be reviewed by an agency that has much broader powers. Any conditions that are ultimately imposed by the FCC would provide more global solutions than any that the Commission could implement on its own.

Therefore, staff recommends that the Commission file comments, as provided in Attachment A, to the Federal Communications Commission in WC Docket No. 06-74.

Docket No. 060308-TP

Date: June 12, 2006

Issue 3: Should this docket be closed?

Recommendation: The Order issued from this recommendation will become final and effective upon issuance of a Consummating Order, unless a person whose substantial interests are affected by the Commission's decision files a protest that identifies with specificity the issues in dispute, in the form provided by Rule 28-106.201, Florida Administrative Code, within 21 days of the issuance of the Proposed Agency Action Order. If the Commission's Order is not protested this docket should be closed upon issuance of the Consummating Order. **(Wiggins/Fudge)**

Staff Analysis: Staff recommends that the Commission take action as set forth in the above staff recommendation.