

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

In the Matter of the Joint Application of

EMBARQ CORPORATION AND CENTURYTEL, INC.

For Approval of Transfer of Control of United Telephone Company of the Northwest d/b/a
Embarq and Embarq Communications, Inc.

DOCKET NO. UT-082119

DIRECT TESTIMONY OF TREVOR R. ROYCROFT, Ph.D. (TRR-1T)

ON BEHALF OF

PUBLIC COUNSEL

March 4, 2009

NON-HIGHLY CONFIDENTIAL VERSION

DIRECT TESTIMONY OF TREVOR R. ROYCROFT (TRR-1T)
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TREVOR R. ROYCROFT’S EXHIBIT LIST

Exhibit No. ____ (TRR-2)	Summary of Qualifications and Experience
Exhibit No. ____ (TRR-3)	Sprint Spinoff Settlement Agreement (Docket No. UT-051291)

1 analytical responsibility at the OUCC related to telecommunications regulation
2 and policy, including incentive regulation plans. I was also involved in natural
3 gas, electric, and water utility cases, and filed testimony and supervised staff
4 involved in these areas.

5 I have been involved in higher education related to the
6 telecommunications field. From 1994 to 2004, I was a professor in the J. Warren
7 McClure School of Communication Systems Management at Ohio University. At
8 Ohio University I was granted tenure and promoted to Associate Professor in the
9 Spring of 2000. My primary areas of teaching responsibility were graduate and
10 undergraduate courses covering regulatory policy, the economics of the
11 telecommunications industry, consumer issues with telecommunications markets,
12 and telecommunications technology. I left Ohio University to pursue consulting
13 on a full-time basis at the end of 2004.

14 I have published research in refereed journals including *The Journal of*
15 *Regulatory Economics*, *Contemporary Economic Policy*, and *Telecommunications*
16 *Policy*. I have contributed chapters that have been published in book volumes
17 related to the telecommunications field. I have provided referee service to various
18 academic journals including: *The Journal of Regulatory Economics*,
19 *Telecommunications Policy*, *Social Science Computer Review*, *Utilities Policy*,
20 *Journal of Economic Studies*, and *Communications of the Association for*
21 *Information Systems*.

1 I have provided analysis and testimony as an independent consultant since
2 1994. In my role as a consultant, I have addressed a wide variety of issues
3 including: incentive regulation plans, cost-of-service studies, cost modeling,
4 service quality, merger review, and competition. I have filed testimony, reports,
5 and affidavits before state regulatory commissions, before the Federal
6 Communications Commission, and before the Canadian Radio-Television and
7 Telecommunications Commission. I have also provided expert services in class
8 action lawsuits associated with the public utility field. Attached hereto as Exhibit
9 No. ____ (TRR-2) is a true and correct copy of my most recent curriculum vitae.

10 **Q: What exhibits are you sponsoring in this proceeding?**

11 A: As noted above, Exhibit No. ____ (TRR-2) is a copy of my curriculum vitae.
12 Exhibit No. ____ (TRR-3) is a copy of the Settlement Agreement approved and
13 adopted by the Commission in Docket No. UT-051291.

14 **Q: What have you done to prepare your testimony?**

15 A: I reviewed the Joint Application of Embarq Corporation and CenturyTel, Inc.
16 (Joint Applicants) and the testimony of Joint Applicants' witnesses filed in
17 support of the Application. I prepared discovery that was served on the Joint
18 Applicants, and reviewed responses to that discovery, preparing follow-up as
19 appropriate. I reviewed the responses to discovery served on the Joint Applicants
20 by other parties. I reviewed publicly available information regarding the merger,
21 including documents filed with the Securities and Exchange Commission and the
22 Federal Communications Commission, information published by CenturyTel and

1 Embarq at the web site created to provide information about the proposed
2 merger,¹ and reports in the business press regarding the merger.

3

¹ Available at <http://www.centurytelembarqmerger.com/>.

1 (CenturyTel). As a result of the transaction, Embarq will become a wholly-owned
2 subsidiary of CenturyTel.

3 **Q: Was a similar application filed with the Federal Communications**
4 **Commission (FCC), or in other states?**

5 **A:** Yes. On November 25, 2008, Embarq and CenturyTel filed an application
6 seeking that the FCC consent to transfer control of domestic Section 214
7 authorizations held by Embarq and its subsidiaries to CenturyTel. The Joint
8 Applicants have also filed applications for state commission approval in twenty
9 other states, many of which are still pending approval.

10 **Q: Can you briefly describe the Companies being merged?**

11 **A:** Yes. CenturyTel is a Louisiana corporation headquartered in Monroe, Louisiana.
12 CenturyTel is considered to be one of the more rural of the mid-sized independent
13 incumbent local exchange carriers (ILECs).² CenturyTel provides local service in
14 Washington through four subsidiaries: CenturyTel of Washington, Inc.,
15 CenturyTel of Inter Island, Inc., CenturyTel of Paradise, Inc., and CenturyTel of
16 Cowiche, Inc. Unless otherwise noted, I will refer to these operations collectively
17 as “CenturyTel WA.” CenturyTel WA serves approximately 150,000 access lines
18 in Washington.³ According to documents filed with the FCC:

19 CenturyTel is a holding Company that conducts its business
20 operations principally through subsidiaries offering

² This point will be discussed in more detail below, which addresses documents provided to Public Counsel as part of Joint Applicant’s Response to IBEW Data Request No. 5, which includes Embarq’s Hart Scott Rodino documents: Attachment 4(c)-3 JP Morgan “Presentation to the Board of Directors,” July 18, 2008, p. 9. This document is deemed highly confidential by Joint Applicants.

³ Available at http://www.centurytelebarqmerger.com/merger_state_by_state/CenturyTel/Washington%20SFS%2008Q3.pdf.

1 communications, high-speed internet, and entertainment services in
2 small-to-mid-size cities through its copper and fiber networks. As
3 of September 30, 2008, CenturyTel operates in 25 states, providing
4 local exchange services over roughly 2.0 million telephone access
5 lines and high-speed internet connections to approximately
6 630,000 subscribers. CenturyTel's expansive product offerings
7 also include long distances [sic] services, cable television services,
8 satellite television services, Internet Protocol Television (IPTV)
9 service, and wireless services. In certain local and regional
10 markets, CenturyTel also provides telecommunications services as
11 a competitive local exchange carrier, security monitoring, and
12 other communications, and business information services. In
13 addition, CenturyTel runs a state-of-the-art fiber system, which
14 provides wholesale and retail fiber-based transportation to
15 customers in the central United States.⁴
16

17 United Telephone of the Northwest (UTNW) and Embarq

18 Communications Inc. (ECI) are wholly-owned subsidiaries of Embarq
19 Corporation. Unless otherwise noted, I will refer to Embarq's Washington
20 operations as "UTNW." UTNW serves approximately 73,000 access lines in
21 Washington.⁵ According to information filed with the FCC, Embarq Corporation:

22 [I]s a Delaware corporation headquartered in Overland Park,
23 Kansas. Embarq is a holding Company that conducts its business
24 operations principally through subsidiaries offering a complete
25 suite of communications services. As of September 30, 2008,
26 Embarq has ILEC operations in 18 states, providing local exchange
27 services over nearly 5.9 million telephone access lines and
28 broadband service to 1.4 million subscribers. For consumers,
29 Embarq offers an innovative portfolio of services that includes
30 reliable local and long distance home phone service, high-speed
31 internet access, and satellite video from DISH Network. For
32 businesses, Embarq has a competitive range of flexible and
33 integrated services designed to help businesses of all sizes be
34 productive and communicate with their customers.⁶

⁴ *Application to Transfer of Control of Domestic Authorizations Held by Embarq Corporation to CenturyTel, Inc. Under Section 214 of the Communications Act.* Federal Communications Commission, WC Docket 08-238, November 25, 2008, p. 2 (hereinafter *FCC Application*).

⁵ *Application*, p. 5.

⁶ *FCC Application*, p. 2.

1 While Embarq’s overall operations serve rural areas, it has a much more
2 substantial urban presence than does CenturyTel. This is evidenced by
3

1 differences between the two companies' reliance on state and Federal universal
2 service funding—CenturyTel receives universal service funds that amount to 12.6
3 percent of its annual revenues, while Embarq receives universal service funds that
4 amount to only about 3.6 percent of its annual revenues.

5 **Q: Can you briefly describe the merger?**

6 A: Press reports about the merger indicate that Embarq sought suitors through the
7 investment bank JP Morgan in an attempt to sell itself. However, the timing of
8 the efforts during the deepening financial crises resulted in limited interest in the
9 Company.⁷ The efforts did result in CenturyTel emerging as a suitor and
10 proposing to utilize an all-stock transaction to acquire Embarq. Under the terms
11 of the merger, Embarq shareholders will receive 1.37 shares of CenturyTel, Inc.
12 for each Embarq share.⁸

13 The merger is notable in that CenturyTel is a much smaller Company than
14 Embarq. As noted above, CenturyTel has approximately 2.0 million telephone
15 access lines, compared to Embarq's 5.9 million. Looking at a comparison of
16 revenues, CenturyTel's revenues of \$2.6 billion as of year-end 2007 were about
17 40 percent of Embarq's \$6.3 billion in revenue.⁹

⁷ "Credit Crunch Stalls Embarq's Effort to Find a Suitor," *Wall Street Journal*, October 2, 2009. Available at http://online.wsj.com/article/SB122289656118695665.html?mod=googlenews_wsj.

⁸ Annex A, Agreement and Plan of Merger, October 26, 2008.

⁹ CenturyTel and Embarq 10-K reports for the year ending December 31, 2007.

1 **B. Standard for Merger Review**

2 **Q: Can you please explain your understanding of the standard that the**
3 **Commission applies to determine whether a proposed merger should be**
4 **approved?**

5 A: While I am not an attorney, my understanding as a policy analyst is that RCW
6 80.12.020 prohibits a public utility from merging or consolidating any of its
7 franchises, properties or facilities, by any means whatsoever, whether directly or
8 indirectly, without an order from the Commission authorizing it to do so. It is
9 also my understanding that under WAC 480-143-170, if the Commission finds
10 after examination that a proposed merger is not in the public interest, it shall deny
11 the application.

12 I understand that in Docket No. UE-981627, the application of Scottish
13 Power to acquire PacifiCorp, the Commission set forth the standard for approval
14 of a merger transaction, as follows:

15 The standard in our rule does not require the Applicants to show
16 that customers, or the public generally, will be made better off if
17 the transaction is approved and goes forward. In our view,
18 Applicants' initial burden is satisfied if they at least demonstrate
19 no harm to the public interest.¹⁰

20 The Commission elaborated on this standard in 2005 Verizon and MCI merger:

21 [T]he Commission determines whether the transaction is
22 consistent with the public interest, balancing the costs and the
23 benefits for the public and for affected customers. If the costs

¹⁰ *In re Application of PacifiCorp & Scottish Power PLC*, Docket No. UE-981627, Third Supplemental Order, pp. 2-3.

1 outweigh the benefits, the result is harm and the Commission
2 should deny or condition the approval so no net harm results.¹¹

3 Finally, I understand that applicants bear the initial burden of
4 demonstrating that the transaction does no harm to the public interest.¹² I have
5 relied upon this interpretation of the standards in preparing my testimony.

6 **Q: Have Joint Applicants met their burden of showing that this merger will**
7 **result in no harm to the public interest?**

8 A: No, I do not believe that Joint Applicants have provided sufficient information to
9 demonstrate that the merger will result in no harm to the public interest. As will
10 be discussed further below, Joint Applicants do not address important issues
11 regarding how the merger will impact consumers. For example, while assuring
12 shareholders that there are substantial synergies that can be gained from
13 consolidating CenturyTel and Embarq’s operations, Joint Applicants have told
14 this Commission that “nothing will change” following the merger.¹³ However, to
15 achieve merger synergies, changes in the operations of the combined companies
16 must occur. Joint Applicants have not provided concrete information regarding
17 operational changes that will create such synergies.

18 Furthermore, given that CenturyTel WA and UTNW have abutting service
19 areas in Washington (and this combined service area also abuts additional
20 CenturyTel and Embarq service areas in Oregon), there is a much greater

¹¹ *In the Matter of the Joint Application of Verizon Communications, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger*, Docket No. UT-050814, Order Accepting Settlement, On Condition; Approving Merger, On Condition (Order No. 07), ¶ 59.

¹² *Id.*

1 potential for reorganization, consolidation, and modification of operations in
2 Washington than is the case in most other states where Joint Applicants have
3 operations.¹⁴ While Public Counsel attempted to gain information on the
4 consolidation process, Joint Applicants were unable to provide any details.¹⁵

5 **III. RISKS, ALLEGED BENEFITS, AND POTENTIAL HARMS OF THE**
6 **PROPOSED MERGER**

7 **A. Overview**

8 **Q: What are the economic characteristics of the proposed merger?**

9 A: The merger is best characterized as a “market extension” merger. With a market
10 extension merger, firms that do not have overlapping operations combine to
11 become a larger firm, with a bigger geographic footprint. The two Companies
12 involved, while offering similar services, generally do not compete head-to-head,
13 even in states like Washington where both Companies have operations.¹⁶ Thus,
14 the merger illustrates an aspect of the competitive landscape in local exchange
15 markets: i.e., rivalry is unlikely to emerge between ILECs, which have generally
16 stuck to their own turf.

17 **Q: Does the integration of CenturyTel WA and UTNW in Washington state**
18 **differ from that in other states?**

¹³ See, e.g., Direct Testimony of G. Clay Bailey, p. 13, lines 21-23; Direct Testimony of Barbara Young, p. 5, lines 73-80.

¹⁴ The combined company will have operations in 33 states following the merger. Both CenturyTel and Embarq service areas are present in ten of those states.

¹⁵ Joint Applicants’ Responses to Public Counsel Data Request Nos. 45, 46, and 133.

¹⁶ Joint Applicants Response to Public Counsel Data Request Nos.18 and 19.

1 A: Yes. CenturyTel and Embarq have abutting operating areas in Washington state.
2 In addition, the abutting service areas in Washington state are part of a larger
3

1 cluster of CenturyTel and Embarq abutting operations that extends into Oregon.

2 Overall, the operations of the two Companies in Washington and Oregon
3 form one of the larger contiguous geographic areas resulting from the
4 combination of the two Companies.¹⁷ This is a different outcome than is the case
5 for most other operating areas associated with the combined Companies. The
6 potential for reorganization associated with the operations of the two Companies
7 are greater than is the case in states where abutting service areas do not exist.
8 When asked about the plans for integrating the physical operations of the two
9 service areas in Washington, Joint Applicants could not produce any specific
10 information regarding how operations will be consolidated in Washington state.¹⁸
11 As will be discussed further below, this potential for physical integration of
12 Washington state operations may generate synergies, but also introduces
13 increased risks, and thus, as a condition of the proposed merger, the Commission
14 should place reasonable reporting requirements upon the companies in order to
15 ensure that ratepayers are not harmed by the merger.

16 **B. Risks of the Merger**

17 **Q: Does CenturyTel have experience with an acquisition of the size proposed in**
18 **this case?**

19 **A:** No. While CenturyTel has a history of acquiring companies, the acquisition of
20 Embarq will mark the largest and most complex transaction in CenturyTel's

¹⁷ See, e.g., slide 6 in the CenturyTel investor presentation, *available at* http://www.centurytelebarqmerger.com/merger_key_materials/CenturyTel_EMBARQ_IR_Presentation.PDF.

¹⁸ Joint Applicants' Response to Public Counsel Data Request Nos. 45, 46, and 133.

1 history, and will overlap with the ongoing integration of CenturyTel’s mid-2007
2 acquisition of Madison River Communications. Thus, one issue of concern is
3 whether, CenturyTel, the acquiring Company, will have difficulties integrating
4 Embarq’s operations. Prior to this transaction, the largest combination that
5 CenturyTel has been involved with occurred in 1997, when the Company
6 purchased Pacific Telecom Inc., which had 660,000 access lines. Table 1, below,
7 summarizes CenturyTel’s acquisition history since 2000.

Table 1: Summary of CenturyTel Acquisition History Since 2000		
Year	Acquisition	Number of Access Lines
2000	GTE Properties, Arkansas	230,500
2000	GTE Properties, Missouri (with Spectra)	127,000
2000	Verizon Properties, Wisconsin	133,000
2002	Verizon Properties, Alabama	300,000
2002	Verizon Properties, Missouri	354,000
2007	Madison River	170,000
Average CenturyTel Access Line Acquisitions 2000-2007		219,083
Embarq Access Lines		5,900,000
Ratio of Embarq Access Lines to Average CenturyTel Acquisition Access Lines from 2000 to 2007		26.9

1 Table 1 illustrates that CenturyTel’s acquisition of Embarq, which has
2 about 5.9 million access lines, represents an acquisition that is about 27 times
3 larger than the average number of access lines that CenturyTel has added through
4 a merger transaction since 2000.¹⁹ Thus, CenturyTel’s efforts to integrate
5 Embarq’s operations might be viewed as a “tail wagging the dog” integration
6 process—Embarq’s substantially larger size will present CenturyTel with
7 challenges that it has not faced with its previous acquisitions. Confronting these
8 challenges may have a negative impact on CenturyTel WA and UTNW
9 ratepayers.

10 Given the size and complexity of the project, it is reasonable for this
11 Commission to require that CenturyTel have a well conceived and executable
12 plan for integration, especially in areas that have the potential to have a direct
13 impact on CenturyTel WA and UTNW ratepayers. Absent this information, the
14 Commission will be unable to determine whether the proposed merger results in
15 no harm to the public interest.²⁰

16 **Q: Has Embarq’s management expressed additional concerns?**

17 **A: [Begin Highly Confidential] XX**
18 **XX**

¹⁹ Transaction history provided in response to Joint Applicants’ response to IBEW Set I, IBEW Data Request No. 28. In this response Joint Applicants identify the 2002 Verizon transactions as a combined purchase.

²⁰ As is discussed further below, Public Counsel requested specific information regarding Joint Applicants’ post-merger plans for Washington. In each instance, Joint Applicants indicated that any post-merger plan for Washington state was unavailable. See Joint Applicants’ Responses to Public Counsel Data Request Nos. 45, 46; and 133.

- 1 • complexities associated with managing the combined
- 2 businesses;
- 3 • integrating personnel from the two companies while
- 4 maintaining focus on providing consistent, high quality
- 5 products and customer service;
- 6 • potential unknown liabilities and unforeseen increased
- 7 expenses, delays or regulatory conditions associated
- 8 with the merger; and
- 9 • performance shortfalls at one or both of the two
- 10 companies as a result of the diversion of management’s
- 11 attention caused by completing the merger and
- 12 integrating the companies’ operations.²²

13 Given challenges posed by the size of the Embarq acquisition, the
14 cautionary statements regarding the “diversion of management’s attention” are
15 important for this Commission to keep in mind when considering the potential
16 impact of this merger on CenturyTel WA and UTNW ratepayers. CenturyTel
17 goes on to say:

18 In addition, CenturyTel and Embarq have operated and, until the
19 completion of the merger, will continue to operate, independently.
20 It is possible that the integration process could result in the
21 diversion of each Company’s management’s attention, the
22 disruption or interruption of, or the loss of momentum in, each
23 Company’s ongoing businesses or inconsistencies in standards,
24 controls, procedures and policies, any of which could adversely
25 affect our ability to maintain relationships with customers and
26 employees or our ability to achieve the anticipated benefits of the
27 merger, or could reduce the earnings or otherwise adversely affect
28 the business and financial results of the combined Company.²³

29 In light of these potential problems, it is essential that this Commission
30 establish, as enforceable conditions of this merger, a monitoring framework to
31 ensure that CenturyTel WA and UTNW’s management keeps proper focus on

²² CenturyTel Form S4, December 20, 2008, pp. 16-17.

²³ *Id.* at p. 17.

1 factors that are critical to CenturyTel WA and UTNW's ratepayers, such as
2 service quality and broadband deployment. A reasonable monitoring framework
3 will be discussed later in this testimony.

4

1 **C. Claimed Benefits of Merger**

2 **Q: Do Joint Applicants provide a clear statement of how the benefits of the**
3 **proposed merger will impact CenturyTel WA and UTNW ratepayers?**

4 A: No. Joint Applicants provide little information regarding how the proposed
5 merger will generate benefits or avoid harms for Washington ratepayers. Instead
6 of specific information regarding how benefits will arise or how harms will be
7 avoided, Joint Applicants provide general discussions of broad concepts, such as
8 improvements in economies of scale and scope²⁴ and claims that the merger
9 provides benefits associated with financial strength.²⁵ As I will discuss further
10 below, it is conceivable that benefits will arise for the combined Company in
11 these areas. However, the critical component that is missing from Joint
12 Applicants' presentation is any explanation of how these benefits will flow to
13 ratepayers in Washington. Where Joint Applicants offer more specific
14 suggestions of possible merger benefits, for example, claiming that the merger
15 will lead to the offering of innovative services in Washington,²⁶ when pressed for
16 details through discovery, none were provided. Public Counsel's attempts to
17 quantify these benefits in Washington through discovery resulted in Joint
18 Applicants failing to identify any new services that might be offered or

²⁴ Direct Testimony of Barbara Young, p. 7, lines 125-128.

²⁵ *Id.* at p. 6, lines 97-98.

²⁶ Joint Application, p. 7; Direct Testimony of G. Clay Bailey, p. 6, lines 4-6.

1 incremental investment in CenturyTel WA and UTNW’s service area that could
2 benefit ratepayers.²⁷

3 **1. Economies of Scale – Customer Density**

4 **Q: Joint Applicants claim that the merger will result in “greater economies of**
5 **scale.”²⁸ What are economies of scale?**

6 A: Economies of scale are cost efficiencies that arise as a business expands. In the
7 local exchange industry, there are two main drivers associated with scale
8 economies. The first and most powerful is customer density. Because local
9 exchange technology is characterized by high fixed costs, increasing customer
10 density in a given area will result in improved economies of scale as the fixed
11 costs can be spread over a larger customer base, and unit costs can be reduced.
12 Secondary drivers of scale economies in the local exchange industry are
13 associated with the potential for the consolidation of managerial overhead, buying
14 power improvements, capital cost savings, and integration of back office
15 operations. For example, if a call center can be regionalized then redundant state-
16 level call centers can be consolidated.

17 **Q: Will the merger result in increased customer density and improved scale**
18 **economies?**

19 A: This merger will do nothing to increase customer density within CenturyTel WA
20 and UTNW’s service area, or in any other area currently served by CenturyTel

²⁷ See, e.g., Joint Applicants’ Responses to Public Counsel Data Request Nos. 60 and 144.

²⁸ Application, ¶ 17.

1 and Embarq. Rather, the merger cobbles together geographically disparate local
2 exchange service areas, with no resulting increase in customer density.

3 However, aside from the customer density issue, compared to other states
4 the post-merger Company may be able to achieve greater scale economies from
5 consolidation in Washington state, where CenturyTel WA and UTNW have
6 abutting service areas in Franklin and Benton counties. As a result of these
7 abutting service areas, consolidation in operations associated with outside plant
8 maintenance and repair, or network upgrade are possible.

9 Joint Applicants, however, have not been able to provide information
10 regarding this potential consolidation. When asked in discovery regarding the
11 combined Company's plans for integration of maintenance and repair operations
12 in their abutting service areas in Washington, the Company responded, "[w]here
13 the networks overlap, it is anticipated that the similarities of the networks would
14 provide the opportunity that technicians would/could support both networks."²⁹

15 Joint Applicants indicate, however, that they do not believe that the CenturyTel
16 and UTNW service areas overlap Washington.³⁰ Thus, the impact of
17 consolidation on the combined companies' Washington state operations has not
18 been reported by Joint Applicants. However, it is difficult to believe that there
19 will be no consolidation of repair and maintenance operations in Washington
20 state. While such a consolidation could lead to higher levels of operating
21 synergies, consolidation could also lead to harms to ratepayers in Washington.

²⁹ Joint Applicants' Response to Public Counsel Data Request No. 46.

1 This is why the conditions that I recommend regarding reporting associated with
2 repair and maintenance operations, as discussed later in this testimony, are
3 reasonable.
4

³⁰ Joint Applicants' Response to Public Counsel Data Request No. 133.

1 **2. Economies of Scale -- Secondary Drivers**

2 **Q: Do Joint Applicants provide sufficient evidence of how efficiencies will arise**
3 **from other sources?**

4 A: No. For the merger to generate cost savings and efficiencies associated with
5 increased scale, it must be the case that there will be changes in the operations of
6 the two companies. Yet, the testimony of the Joint Applicants' witnesses describe
7 a post-merger operation that will have little change. For example, Joint
8 Applicants' witness, Ms. Young, states the following regarding the operational
9 impact of the merger:

10 There will be no immediate effect on the organization and
11 operations of the Regulated Entities. The Transaction will occur at
12 the holding Company level. As a result, the Regulated Entities
13 will retain the same corporate identities and continue to exist and
14 operate as individual, separate companies.³¹

15 However, while stating that there will be little change, it is clear from information
16 obtained through discovery that changes are planned that will result in cost
17 savings. It is also possible that these changes could negatively impact CenturyTel
18 WA and UTNW ratepayers.

19 **Q: Will the merger impact business and repair office operations?**

20 A: Yes. When asked through discovery whether there was a post-merger plan for
21 business-office call center consolidation, Joint Applicants responded as follows:

22 Yes, at some point the business office call center operations will be
23 integrated. And, while we have started preliminary reviews of the
24 joint operations, at this point in time, we do not have specific
25 timelines for the integration of the call centers. As with most of

³¹ Direct Testimony of Barbara Young, p. 5, lines 72-76.

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]³⁵ [REDACTED]
4 [REDACTED]
5 [REDACTED]³⁶
6 [REDACTED]
7 [REDACTED]
8 [REDACTED]
9 [REDACTED] [End]

10 **Highly Confidential]**

11 **Q: Beyond cost savings, Joint Applicants indicate that consolidation could result**
12 **in benefits from the “combined pool of technical expertise from which to**
13 **draw.” Is it reasonable to expect that CenturyTel WA and UTNW’s**
14 **ratepayers will benefit from this aspect of consolidation?**

15 **A:** Given the information provided by Joint Applicants, it is unclear how benefits
16 would arise that would positively impact ratepayers in Washington. In response
17 to discovery regarding how these benefits might emerge, Joint Applicants state:

18 Where the networks overlap, it is anticipated that the similarities of
19 networks would provide the opportunity that technicians
20 would/could support both networks.³⁷

³⁵ Document provided to Public Counsel labeled “Attachment 4(c)-16, CenturyTel, Inc., November 12, 2008,” titled “Forest Board Presentation, September 15, 2008, p. 19. This document is listed in the CenturyTel HSR documents as attachment 4(c)-16. The document has three dates: On the cover page the dates November 12, 2008 and September 15, 2008 appear. On the numbered page “1” the date September 2008 appears.

³⁶ Joint Applicants’ Response to IBEW Data Request No. 7.

³⁷ Joint Applicants’ Responses to IBEW Data Request No. 27.

1 If the combined Company can consolidate some of its operations in
2 Washington, there is a potential for cost savings. However, Joint Applicants have
3 not revealed how or if this consolidation might take place, as previously
4 mentioned, they also indicate that they do not consider the CenturyTel WA and
5 UTNW service areas to be overlapping.³⁸

6 **Q: More specifically, are there potential benefits from combined technical**
7 **expertise associated with long-distance services or fiber networks?**

8 A: No. In the area of long distance operations, Embarq has no long distance facilities
9 of its own, and resells Sprint Nextel long distance services.³⁹ CenturyTel provides
10 long distance services through its own facilities, and through resale of other long-
11 distance carriers' services.⁴⁰ CenturyTel indicates that this arrangement will
12 continue for some period after the merger.⁴¹ Thus, the merger brings no new
13 technology, nor the advantages of facilities-based long distance provision to
14 CenturyTel WA and UTNW ratepayers. CenturyTel, also alleges benefits of
15 CenturyTel's "extensive fiber backbone network" described by Mr. Bailey.
16 However, according to discovery responses, this fiber network "does not provide
17 service in Washington at this time" and that "there are no current deployment
18 schedules nor are there plans to connect the Washington network to the
19 CenturyTel Lightcore network."⁴² Thus, this fiber network will not directly
20 benefit CenturyTel WA and UTNW ratepayers, and the benefits associated with a

³⁸ Joint Applicants' Responses to Public Counsel Data Request Nos. 45, 46, and 133.

³⁹ Embarq Form 10-K for the year ending December 31, 2007, p. 5.

⁴⁰ CenturyTel Form 10-K for the year ending December 31, 2007, no page number.

1 “combined pool of technical expertise” associated with long distance operations
2 also appear to be limited as a result.

3 **Q: Can you say more about the potential harms to ratepayers that may result**
4 **from consolidation?**

5 A: Yes. As mentioned in previous answers, consolidation can result in disruptions in
6 customer service that may harm CenturyTel WA and UTNW’s ratepayers. While
7 Joint Applicants indicate, in response to discovery, that they will take care to
8 “insure a smooth transition,”⁴³ given the lack of any detail of how the future plans
9 might unfold, or even any examples of how CenturyTel has dealt with back office
10 integration in the past, it is difficult for this Commission to conclude that
11 CenturyTel WA and UTNW’s ratepayers will not experience harms as a result of
12 consolidation. Given that CenturyTel is undertaking the acquisition of a size of
13 which it has no similar previous experience, it is reasonable for this Commission
14 to expect a higher degree of specificity regarding the post-merger consolidation
15 plans. It is also reasonable for this Commission to place conditions on the merger
16 associated with the consolidation process and its impact on service quality to
17 ensure that harms do not befall CenturyTel WA and UTNW’s ratepayers.

18 **3. “Revenue Synergies” and Rate Changes**

19 **Q: Do Joint Applicants indicate that the merger will result in rate stability for**
20 **CenturyTel WA and UTNW ratepayers?**

⁴¹ Joint Applicants’ Response to Public Counsel Data Request No. 134.

⁴² Joint Applicants’ Response to Public Counsel Data Request No. 67.

⁴³ Joint Applicants’ Response to Public Counsel Data Request No. 38.

1 A: Yes. Joint Applicants’ witness G. Clay Bailey states “the services provided by
2 Embarq and CenturyTel, and the rates and terms under which they are offered,
3 will not change as a result of the Transaction.”⁴⁴ Information obtained through
4 discovery indicates that this is not the case. Rather, **[Begin Highly Confidential]**

5 **XX**

6 **XX**

7 **XXXXXXXXXXXXXXXXXXXX** **[End Highly Confidential]**

8 **Q: What are “revenue synergies”?**

9 A: “Revenue synergies” reflect CenturyTel’s belief that it can “improve” on
10 Embarq’s current revenue profile by applying CenturyTel sales and pricing
11 practices to Embarq’s operations. **[Begin Highly Confidential]** **XXXXXXXXXX**

12 **XX**

13 **XX**

14 **XXXXXXXXXXXXXXXXXXXX** **[End Highly Confidential]**

15 **Q: What is CenturyTel’s general strategy regarding revenue synergies?**

16 A: CenturyTel management’s revenue synergy analysis states that following the
17 merger, the combined Company should **[Begin Highly Confidential]**

18 **XX** **[End**

19 **Highly Confidential]**⁴⁵

⁴⁴ Direct Testimony of G. Clay Bailey, p. 14, lines 9-11.

⁴⁵ Joint Applicants’ Response to IBEW Data Request No. 5, “Pine Revenue Synergy Analysis,” Embarq HSR Document, Attachment 4(c)-15, November 12, 2008, p. 2. This document is identified in the Embarq HSR documents as Attachment 4(c)-15, and is identified as “undated slides.” The cover page has a date of November 5, 2008. What appears to be an identical document is identified as Attachment 4(c)-9 to the

1 **Q: What areas does CenturyTel believe offer immediate promise with regard to**
2 **price increases in the Embarq service area?**

3 A: CenturyTel identifies **[Begin Highly Confidential]** **XXXXXXXXXXXXXXXXXX**
4 **XX**
5 **XX**
6 **XXXXXX [End Highly Confidential]** ⁴⁶

7 This strategy does not provide benefits of the merger to UTNW’s
8 ratepayers, and instead inflicts quantifiable harms. CenturyTel’s management
9 projects that its revenue synergy strategy for the three services discussed above
10 will generate, over a five-year period, **[Begin Highly Confidential]**

11 **XX** ⁴⁷
12 **XX**
13 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX** ⁴⁸ **XXXXXXXXXXXXXXXXXXXXXXXXXXXX**

14 **XXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Highly Confidential]** the “revenue
15 synergies,” will result in harms to UTNW ratepayers that are not offset by any

CenturyTel HSR documents. This document has the dates November 12, 2008 and September 11, 2008 on the cover page.

⁴⁶ *Id.*
⁴⁷ Joint Applicants’ Response to IBEW Data Request No. 5, “Pine Revenue Synergy Analysis,” Embarq HSR Document, Attachment 4(c)-15, November 12, 2008, p. 11. The dollar value reported is the sum of the rate increases shown on p. 11. *See also*, Joint Applicants’ response to Public Counsel Data Request No. 140.

⁴⁸ Distribution of the revenue increase is based on the share of UTNW access lines, out of all Embarq access lines. According to documents provided to Public Counsel, United WA has **[Begin Highly Confidential]** **XXXXXXXXXXXXXXXXXXXX** **[End Highly Confidential]**. CenturyTel HSR Attachment 4(c)-10, corrected page 7. As a point of clarification, line count information that is used in the workpaper “WA_Synergy_Total_Workpaper_HIGHLY_CONFIDENTIAL_3-4-2009.xls” is from Embarq HSR attachment 4(c)-2, from the slide deck therein called “CenturyTel April 10, 2008,” p. 4. These line counts were selected from among the various sources in the overall HSR filing as they report line counts for the same date for both companies.

1 other benefit of the merger identified by Joint Applicants. As I will discuss later,
2 conditions must be placed on this merger to offset this harm.

3

1 **4. Financial Soundness**

2 **Q: What other merger benefits do Joint Applicants identify?**

3 A: Joint Applicants state that the merger will build “greater financial strength and
4 stability for the combined companies.”⁴⁹

5 **Q: Can you briefly summarize the financial outcome that the Joint Applicants
6 project?**

7 A: According to Joint Applicants’ witness Mr. Gast, the financial post-merger
8 financial profile of the combined companies will be favorable:

9 The combined CentryTel/Embarq Company will result in the
10 largest mid-sized communications Company, with . . . on a pro
11 forma basis, revenue of \$8.8 billion, EBITDA of \$4.2 billion,
12 leverage of 2.1 times EBITDA and free cash flow of
13 approximately \$1.8 billion based on anticipated full run-rate
14 synergies. . . . It is also anticipated that the combined
15 CenturyTel/Embarq operations will have financial metrics of those
16 companies that have been rated “investment grade” by major
17 ratings agencies.⁵⁰

18 Thus, Joint Applicants project a positive financial outcome of the
19 combination, and conclude that the combination will lead to a “stronger and more
20 financially capable enterprise.”⁵¹

21 **Q: What are the “run-rate” synergies mentioned by Mr. Gast?**

22 A: Joint Applicants indicate that run-rate synergies are the total annual savings that
23 will be realized following the integration of the two companies, and all synergies

⁴⁹ Direct Testimony of Barbara Young, p. 6, line 98. *See also*, Direct Testimony of G. Clay Bailey, p. 8, line 12; Direct Testimony of Mark A. Gast, p. 4, line 2 to p. 5, line 15.

⁵⁰ Direct Testimony of Mark A. Gast, p. 4, line 18 to p. 5, line 4.

⁵¹ Direct Testimony of Mark A. Gast, p. 5, lines 21-22.

1 are realized.⁵² As will be discussed further below, these synergies reflect both
2 cost savings and revenue increases anticipated by Joint Applicants.⁵³

3 **Q: Is the improvement in financial strength as clear cut as Joint Applicants**
4 **allege?**

5 A: No. The assessment cited above overlooks significant risks. For example, the
6 combining companies have substantially differing reliance on state and Federal
7 universal service funding. In 2007, Embarq received about \$226 million in state
8 and Federal universal service funds, which equates to about 3.6 percent of
9 Embarq's net operating revenues.⁵⁴ On the other hand, CenturyTel, which has
10 substantially lower operating revenues, received about \$336 million in state and
11 Federal universal service funds, equating to 12.6 percent of CenturyTel operating
12 revenues.⁵⁵ Because universal service programs are in a state of flux, CenturyTel
13 faces a substantially higher risk associated with reductions in universal service
14 funding than does Embarq. In addition, CenturyTel, because of its substantially
15 more rural characteristics, is also more reliant on access charge revenues than
16 Embarq. Given that access charge reform is also a possibility, the transaction
17 increases risk for Embarq, and UTNW ratepayers. **[Begin Highly Confidential]**

18 ~~XX~~

19 ~~XX~~

20 ~~XX~~

⁵² Joint Applicants' Response to Public Counsel Data Request No. 49(a).
⁵³ Joint Applicants' Response to Public Counsel Data Request No. 142.
⁵⁴ Embarq 10-K for the year ending December 31, 2007, pp. 15 and 29.

1 **XXXXXX [End Highly Confidential]**⁵⁶ Additional analysis conducted by JP
2 Morgan for Embarq notes that the prospects of a CenturyTel combination would
3 join Embarq **[Begin Highly Confidential]** **XXXXXXXXXXXXXXXXXXXXXXXXXXXX**
4 **[End Highly Confidential]** and raised the issue of the **[Begin Highly**
5 **Confidential]** **XX**
6 **XXXXXXXXXXXXXXXXXXXXXXXXXXXX [End Highly Confidential]**⁵⁷

7 On a combined basis, CenturyTel’s operations are more rural than
8 Embarq’s and thus are subject to a higher degree of risk associated with the
9 factors discussed above. These risks could have an adverse impact on the
10 combined Company’s financial ratings, should universal service support be
11 reduced, or if access charges are reformed. This fact was also acknowledged by
12 CenturyTel in its November 20, 2008 Form S-4:

13 CenturyTel receives a substantial portion of its revenues from the
14 federal Universal Service Fund, which is referred to as the USF,
15 and, to a lesser extent, intrastate support funds. These
16 governmental programs are reviewed and amended from time to
17 time, and CenturyTel cannot assure you that they will not be
18 changed or impacted in a manner adverse to CenturyTel.⁵⁸

19 Following the merger, these risks could negatively impact both CenturyTel WA
20 and UTNW’s ratepayers, and for UTNW’s ratepayers, risks increase compared to
21 the pre-merger environment due to the greater exposure to USF risks. As a result,

⁵⁵ CenturyTel 10-K for the year ending December 31, 2007, no page number.
⁵⁶ Joint Applicants’ Response to IBEW Data Request No. 5, Document provided to Public Counsel as a part of Attachment 4(c)2, “CenturyTel, April 10, 2008,” p. 14. This document is part of the Embarq HSR documents.
⁵⁷ Joint Applicants’ Response to IBEW Data Request No 5, Document provided to Public Counsel as part of Attachment 4(c)-3, JP Morgan “Presentation to the Board of Directors,” July 18, 2008, p. 9. This document is part of the Embarq HSR documents.

1 it is appropriate that conditions are placed on this merger that protect UTNW's
2 ratepayers from the increased risk associated with the addition of CenturyTel's
3 more rural operations with Embarq.

4 **Q: Is CenturyTel's dividend policy of concern?**

5 A: Yes. It is important to note that the post-transaction financial strategy identified
6 by CenturyTel may result in priorities that are not consistent with the interests of
7 CenturyTel WA and UTNW's ratepayers. Prior to announcing the acquisition of
8 Embarq, CenturyTel had been in the midst of a \$750 million stock buyback.

9 According to CenturyTel:

10 Each Company plans to continue its current dividend policy
11 through the close of the transaction. CenturyTel has suspended its
12 current share repurchase program pending completion of this
13 transaction. Post closing, subject to its intention to maintain an
14 investment grade credit rating, *CenturyTel expects to continue its*
15 *current dividend policy and to return a substantial portion of the*
16 *combined Company's free cash flow to shareholders through*
17 *opportunistic share repurchase programs.*⁵⁹

18 While it is laudable that CenturyTel has stated an objective to maintain an
19 investment grade rating, it is important to note the fact that CenturyTel has also
20 maintained focus on increasing its dividends. According to CenturyTel, "the year
21 2008 marks CenturyTel's 35th consecutive year to increase common dividends."⁶⁰
22 The year 2008 also witnessed a special third-quarter dividend payout that handed
23 CenturyTel shareholders an additional \$65 million on top of an increased

⁵⁸ CenturyTel Form S-4, November 20, 2008, p. 20.

⁵⁹ CenturyTel Press Release, October 27, 2008, emphasis added. Available at http://www.centurytel.com/Pages/AboutUs/PressRoom/pressRelease.jsp?page=Corporate/Press_Release66.html.

⁶⁰ "Dividend/Stock Split," available at <http://ir.centurytel.com/phoenix.zhtml?c=112635&p=irol-dividends>.

1 quarterly dividend.⁶¹ CenturyTel’s corporate outlook regarding dividend payouts
2 could result in a diversion of funds from other critical uses such as network
3 maintenance, customer service, or broadband deployment or upgrade.

4 Accordingly, as I discuss in greater detail later, it is reasonable for this
5 Commission to impose conditions on this merger that ensure that the priorities of
6 the post-merger Company result in high-quality service and adequate investment.

7 **5. Competition and Risk**

8 **Q: Do Joint Applicants indicate that there will be benefits of the merger with**
9 **regard to competition?**

10 A: Yes. Mr. Bailey states that the merger will introduce benefits associated with
11 producing a “viable wireline platform” that will encourage intermodal
12 competition.⁶² However, the merger may cause increased competitive risks for
13 CenturyTel WA ratepayers due to exposure to Embarq’s operations in markets
14 that are subject to relatively higher levels of competition, or which are in areas of
15 the country, such as Nevada and Florida, which are being more negatively
16 impacted by the economic downturn. These risks warrant the imposition of
17 reasonable safeguards.

18 **Q: While CenturyTel is more rural, do Embarq’s more urban characteristics**
19 **introduce an alternative source of risk due to higher competition in urban**
20 **areas?**

⁶¹ Joint Applicants’ Response to Public Counsel Data Request No. 136.

⁶² Direct Testimony of G. Clay Bailey, p. 13, lines 4-6.

1 Thus, Embarq's competitive position may be stabilizing regarding cable company
2 competition. However, relative to conditions for CenturyTel in Washington,
3 some Embarq properties outside of Washington may face higher competition risk,
4 or higher risks due to the economic downturn. Unless adequate safeguards are
5 implemented, the merger may result in new risks being borne by CenturyTel WA
6 ratepayers as a result of the merger.

7 **Q: Joint Applicants' witness Ms. Young states that UTNW has lost nearly 23**
8 **percent of its retail access lines since 2001.⁶⁴ This seems to indicate a**
9 **substantial competitive impact on UTNW, is there more to the story?**

10 **A:** Yes, Ms. Young overstates the line losses experienced by UTNW. Since 2001,
11 UTNW has expanded the variety of access lines that it offers its customers.
12 Because UTNW now has both broadband and switched access lines, it is a logical
13 error to evaluate UTNW's market status by focusing on switched lines alone. By
14 marketing broadband services, UTNW has encouraged its customers to replace at
15 least some of their UTNW switched access lines with Embarq broadband
16 connections. When UTNW's broadband connections are taken into account, the
17 competitive loss experienced by UTNW is nowhere near the 23 percent of retail
18 access lines identified by Ms. Young. For example, in 2008 in the residential
19 market, UTNW sold **[Begin Highly Confidential] XXXXXX [End Highly**
20 **Confidential]** fewer total connections (switched access lines plus broadband)

⁶⁴ Direct Testimony of Barbara Young, p. 8, lines 145-146.

1 than it did in 2001.⁶⁵ There is no question that UTNW faces some degree of
2 competition from cable rivals, and wireless cord cutting but the impact on UTNW
3 is not as severe as Ms. Young indicates.

4

⁶⁵ Joint Applicants' Response to Public Counsel Data Request No. 62.

1 **6. New Products and Broadband**

2 **Q: Joint Applicants indicate that the merger will encourage the deployment of**
3 **“growth products and services, including broadband and wireless data**
4 **offers.”⁶⁶ Do Joint Applicants offer sufficient support for this claim?**

5 A: No. In response to discovery in this case regarding general or specific plans
6 regarding the deployment or introduction of new services, Joint Applicants
7 indicate that they can provide no information regarding new broadband or
8 wireless data products “until the transaction is complete and the necessary
9 decisions have been made on how to best integrate the two companies.”⁶⁷
10 Elsewhere, Joint Applicants indicate that consolidation and integration may take
11 up to three years.⁶⁸ Thus, consolidation may actually interfere with the
12 deployment of new services. This could be a significant potential downside of the
13 proposed merger. CenturyTel is undertaking an acquisition of unprecedented size
14 and will face numerous challenges associated with the integration of the
15 operations of the two companies.⁶⁹ It is not unreasonable to anticipate that the

⁶⁶ Application, ¶ 28.

⁶⁷ Joint Applicants’ Response to Public Counsel Data Request No. 47.

⁶⁸ See, e.g., Joint Applicants’ Response to Public Counsel Data Request No. 37.

⁶⁹ With regard to the challenges posed by the merger, Joint Applicants respond as follows:

With regard to specific challenges and opportunities, they were as varied as the companies being acquired. With each acquisition, there are numerous system integration issues and changes that were implemented, based upon dedicated teams of employees from both companies. Here, by way of example, is a sample list of the types of systems that are involved in a merger situation:

- End User Billing and Customer Care systems
- Technician work force management systems
- Financial and accounting systems
- Human Resource and payroll systems
- Operations Support systems
- Provisioning Systems

1 scale and complexity of the operational integration could distract management
2 from network improvement.

3 **Q: What is IPTV and how does IPTV fit into this merger's execution?**

4 A: IPTV is Internet protocol television. CenturyTel has begun IPTV trials in other
5 states,⁷⁰ thus, if the merger were to cause the acceleration of IPTV deployment in
6 Washington, a benefit would arise.

7 IPTV is associated with a service platform where video services are
8 packetized and delivered over a high-speed data connection. While IPTV is
9 focused on the delivery of video services, the deployment of IPTV consists, in
10 large part, of upgrading ILEC local exchange networks to deliver higher data
11 communications speeds, data speeds in excess of those associated with
12 conventional asymmetric digital subscriber line (ADSL) service.⁷¹ By upgrading
13 their local exchange networks, ILECs can enhance the capabilities of the legacy
14 copper distribution facilities that are in place to create a platform that is capable of
15 delivering very high-speed data services. With this upgraded high-speed data

Telephone Switches and Networks
Payment Systems
Carrier Access billing systems
Web Portals
High Speed Internet and Dial Up Platforms
Employee Benefits and Compensation systems
Ecommerce and Electronic Billing Systems
Collections Systems
Repair and Trouble Resolution Systems
Traffic and Usage Processing Systems
SS7 Networks
Email Systems
Plant Inventory Systems

1 platform, IPTV allows the delivery of standard television programs and video
2 content, and pay-per-view video.

3 To successfully deploy IPTV, the ILEC must “shorten” the copper portion
4 of the local loop. The shorter copper portion of the local loop can then be utilized
5 with advanced DSL platforms such as Very High Bitrate DSL (VDSL). To
6 achieve the shorter copper loops, fiber optic cable must be pushed deeper into the
7 distribution area, thus requiring additional investment by the ILEC. Once
8 deployed, the ILEC will be able to provision higher data speeds for the delivery of
9 Internet access service, thus the network upgrades associated with IPTV
10 deployment are also associated with improvements in broadband deployment.

11 **Q: In how many markets has CenturyTel deployed IPTV?**

12 A: CenturyTel has deployed IPTV service trials in two markets.⁷²

13 **Q: Does the deployment of IPTV impact the economies of scope that are**
14 **available from the merger?**

15 A: Yes. Economies of scope arise when a shared production facility is utilized to
16 produce multiple products or services. If the combined Company upgrades
17 facilities and deploys IPTV, it can expand the economies of scope that are
18 available.

⁷⁰ Joint Applicants’ response to Public Counsel Data Request No. 147.

⁷¹ Of course, IPTV also requires that the ILEC establish sources of content for its video services.

⁷² Joint Applicants’ Response to Public Counsel Data Request No. 147.

1 **Q: According to CenturyTel’s evaluation of Embarq’s operations, does**
2 **CenturyTel believe that Washington markets will be a priority for IPTV**
3 **deployment?**

4 **A: [Begin Highly Confidential] XX**
5 **XX**
6 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX**⁷³ **[End Highly Confidential] In**
7 response to discovery, Joint Applicants state that Washington markets were not
8 studied with regard to their overall suitability for a CenturyTel IPTV
9 deployment.⁷⁴ This apparent lack of priority for Washington operations of the
10 combined Company indicates that network upgrades in Washington are not a
11 priority for CenturyTel. Thus, it does not seem likely that the merger will result in
12 timely advanced broadband network upgrades associated with IPTV in
13 CenturyTel WA and UTNW’s service areas.

14 **Q: What were Embarq’s pre-merger plans for deployment of advanced**
15 **broadband facilities?**

16 **A: According to Embarq documents, [Begin Highly Confidential] XXXXXXXX**
17 **XX**
18 **XX**
19 **XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX** **[End Highly Confidential]** This level of
20 investment for Embarq-wide operations is not sufficient to bring state-of-the-art

⁷³ “Pine Revenue Synergy Analysis,” Attachment 4(c)-9 to CenturyTel HSR Appendix that was provided in response to IBEW-5. This document is deemed Highly Confidential by Joint Applicants.

⁷⁴ Joint Applicants’ Response to Public Counsel Data Request No. 144.

1 broadband to UTNW’s service area. However, given the merger, even this
2 modest commitment of investment reserve to the deployment of advanced
3 broadband is at risk.

4 **Q: Joint Applicants mention the deployment of wireless broadband and**
5 **CenturyTel’s recent acquisition of licenses for 700 MHZ spectrum as a**
6 **benefit of the merger.⁷⁵ Are these alleged benefits likely to emerge?**

7 **A:** It does not seem reasonable to expect that CenturyTel WA and UTNW ratepayers
8 will benefit from CenturyTel’s 700 MHZ licenses. According to discovery
9 responses, CenturyTel’s 700 MHZ licenses cover “Walla Walla and Columbia
10 counties and CenturyTel’s Eureka and Starbuck exchanges are the only
11 CenturyTel or Embarq exchanges included within the license boundary area.”⁷⁶
12 When questioned by an investment analyst about CenturyTel’s plans for
13 expanding its 700 MHZ footprint in light of the Embarq merger, Glen Post,
14 CenturyTel’s Chairman and CEO stated:

15 **[Begin Highly Confidential]**

16 XXX
17 XXX
18 XXX
19 XXX
20 XXX
21 XXXXXXXXXXXXXXX⁷⁷

22 **[End Highly Confidential]**

⁷⁵ Direct Testimony of G. Clay Bailey, p. 11, line 23 to p. 12, lines 1-3.

⁷⁶ Joint Applicants’ Responses to Public Counsel Data Request No. 64.

⁷⁷ Document identified as Attachment 4(c)-12 to the CenturyTel HSR, with the title “CenturyTel Embarq MERGER Transcript--prepared by Tony Davis, Vice President-Investor Relations (CenturyTel). The document has two dates on the cover page—November 12, 2008 and October 27, 2008, p. 11. This document was provided in response to IBEW-5.

1 This statement does not support Joint Applicants' claim that the benefits of the
2 700 MHZ spectrum will be forthcoming at the consummation of the merger. It
3 also indicates that those alleged benefits may never emerge.

4

1 **IV. MERGER CONDITIONS**

2 **Q: Do you believe that this Commission should place conditions on this merger?**

3 **A:** Yes. As discussed above, the merger introduces a substantial degree of risk, and
4 the Commission must ensure that CenturyTel WA and UTNW's ratepayers are
5 insulated from this risk. The Commission must ensure that the merger does not
6 harm the public interest. As a result, it is appropriate to place conditions on the
7 merger to prevent harm to CenturyTel WA and UTNW ratepayers. It is also
8 reasonable for this Commission to ensure that ratepayers receive some benefits
9 from this merger, as there are quantifiable harms for UNTW ratepayers that result
10 from the merger, and merger benefits can act to offset these harms.

11 **Q: What impact will this merger have on the conditions that were approved by**
12 **the WUTC in the Sprint/Embarq Spinoff Case?**

13 **A:** The Settlement Agreement approved by the Commission in that case (hereinafter
14 referred to as "Spinoff Settlement Agreement")⁷⁸ contains important conditions
15 associated with the treatment of Sprint's directory publishing operations, and the
16 amortization of a portion of that sale. The Spinoff Settlement Agreement also
17 included provisions associated with constraints on the recovery of separation
18 costs; provided a service guarantee that provided bill credits for non-performance;
19 specified customer notice requirements; identified conditions associated with

⁷⁸ *In the Matter of the Request of Sprint Nextel Corporation for an Order Declining to Assert Jurisdiction Over or, in the Alternative, Application of Sprint Nextel Corporation for Approval of the Transfer of Control of United Telephone Company of the Northwest and Sprint Long Distance, Inc. From Sprint Nextel Corporation to LTD Holding Company*, WUTC Docket No. UT-051291, Order Approving and Adopting Settlement Agreement. Exhibit No. ____ (TRR-3) contains a copy of the Settlement Agreement.

1 transactions with affiliates; and imposed finance conditions that caused increased
2 reporting and limits on dividend payments from UTNW to its parent in the event
3 that certain trigger conditions occurred.⁷⁹ According to Joint Applicants, this
4 merger will result in no impact on the ten-year annual directory sale amortization
5 of \$1.451 million.⁸⁰ With regard to the service guarantee established in that case,
6 Joint Applicants also indicate that there will be no change.⁸¹ These are
7 appropriate outcomes. However, as I will discuss below, there are other aspects
8 of the Spinoff Settlement Agreement that should extended to apply to this merger.

9 **Q: Do you believe that as a condition of this merger the Commission should**
10 **require that the Spinoff Settlement Agreement service guarantee extend to**
11 **CenturyTel WA as well as UTNW?**

12 **A:** Yes, I believe that this is a reasonable condition to place on the merger. The
13 Spinoff Settlement Agreement condition required that UTNW adopt an automatic
14 credit provision for each installation commitment missed due to reasons within
15 the Company's control. The credit was set at a fixed \$15 for residential and \$25
16 for basic business customers.⁸² Consolidation in Washington may impact
17 installation operations of the combined Company. It is reasonable to extend this
18 incentive structure to the combined Company, and to extend the requirement for a
19 period comparable to the duration of the conditions in the Spinoff Settlement

⁷⁹ The trigger conditions related to the relationship between the average market values of Embarq's common equity, as it related to the book value of Embarq's net debt, and whether or not the Embarq retained investment grade rating. *See*, Exhibit No. ____ (TRR-3).

⁸⁰ Joint Applicants' Response to Public Counsel Data Request No. 14 (a).

⁸¹ Joint Applicants' Response to Public Counsel Data Request No. 14 (b).

⁸² *See*, Exhibit No. ____ (TRR-3) at ¶ 7 (Subsection (E)(3) titled "Service Guarantee").

1 Agreement. I believe that this condition should apply to the combined Company
2 until the end of 2012.⁸³ As is the case in the Spinoff Settlement Agreement, the
3 combined Company should have the ability to re-evaluate and file to withdraw or
4 offer a different plan after the 2012 date.

5 **Q: The Spinoff Settlement Agreement also specified finance conditions. Will the**
6 **merger have an impact on these finance conditions?**

7 A: Yes. According to Joint Applicants, sections 6.a.i., 6.a.ii., 6.c., and 6.f. will be
8 impacted by the merger. Joint Applicants state that “[p]ost-merger, the financial
9 evaluations and restrictions included in provisions 6.a.i., 6.a.ii., 6.c., and 6.f. that
10 previously were based on Embarq Corporation will be based on the post-merger
11 combined CenturyTel. The remaining conditions outlined in Section 6 of the
12 Settlement Agreement will continue to apply to United Telephone of the
13 Northwest.”⁸⁴

14 **Q: Do you believe that these finance conditions should be expanded to also cover**
15 **CenturyTel WA?**

16 A: Yes. It seems unreasonable to allow the finance conditions to apply only to
17 UTNW following the merger. For example, requiring UTNW to increase
18 reporting should CenturyTel no longer retain an investment grade rating, but not
19 requiring CenturyTel WA to do the same would result in an unbalanced
20 requirement, especially in light of the potential for integration of operations

⁸³ The Spinoff Settlement Agreement variously imposed conditions for periods of three or four years. Year-end 2012 is likely to be 3.5 years after the merger is finalized. *See*, Exhibit No. ____ (TRR-3).

⁸⁴ Joint Applicants’ Response to Public Counsel Data Request No. 16.

1 between the two companies in Washington state. The requirement regarding
2 expense reporting contained in Section 6.b. of the Settlement agreement would be
3 difficult to interpret given the merger, especially if, for example, network
4 maintenance or repair expenses for the two companies were to be blended as a
5 result of the merger.⁸⁵ Similarly, the risks arising from this merger that are
6 associated with the combined companies' operations outside of Washington state
7 will impact both CenturyTel and UTNW ratepayers. Thus, extending the
8 previous finance conditions to CenturyTel WA provides a balanced set of
9 protections for the Washington ratepayers of the post-merger Company. In
10 addition to applying the finance conditions to CenturyTel WA, I believe that it is
11 reasonable to extend the duration of the requirement for both CenturyTel WA and
12 UTNW until year-end 2012.

13 **Q: The Spinoff Settlement Agreement also contained provisions related to**
14 **customer notice. Should similar conditions be placed on this merger?**

15 **A:** Yes. CenturyTel WA and UTNW should be required to provide individual
16 written notice to their ratepayers regarding the merger, the new company name,
17 and any changes to the bill format. The combined Company should be required to
18 work with the Commission's Staff and Public Counsel on all notice issues
19 associated with the merger.

⁸⁵ In response to discovery, Joint Applicants indicate that they are currently developing a "one network" approach to DSL deployment, that include "joint network plans" for the combined company. *See*, Joint Applicants' Response to Public Counsel Data Request No. 131.

1 **Q: The Spinoff Settlement Agreement addressed changes in long distance**
2 **carriers resulting from the spinoff. Do similar issues arise here?**

3 A: It is possible that they will. In response to discovery, Joint Applicants indicate
4 that “it is anticipated that the combined Company will eventually consolidate the
5 long distance operations of the two long distance subsidiaries.”⁸⁶ When this
6 consolidation does take place, customers of either CenturyTel’s or UNTW’s
7 current long distance affiliate who will be transferred to the new long distance
8 affiliate should have the option to choose another long distance carrier within
9 ninety (90) days of receiving a thirty-day (30) written notice of the transfer.
10 Consumers choosing a long distance provider other than the new CenturyTel
11 affiliate should not be charged the Primary Interexchange Carrier (PIC) charge.⁸⁷
12 The notice provided customers should contain information on how to select the
13 long distance provider of their choice without paying the PIC charge.

14 **Q: What dollar value of merger synergies have Joint Applicants identified?**

15 A: According to CenturyTel, company-wide annual synergies can be achieved that
16 will total \$400 million per year, by the end of a three-year period.⁸⁸

17 **Q: Do Joint Applicants explain how any merger synergies will be shared with**
18 **CenturyTel WA and UTNW ratepayers?**

⁸⁶ Joint Applicants’ Response to Public Counsel Data Request No. 134.

⁸⁷ Joint Applicants indicate that no PIC charge will apply if CenturyTel WA or UTNW customers are transferred to the new CenturyTel long distance affiliate. *See*, Joint Applicants’ Response to Public Counsel Data Request No. 41.

⁸⁸ “CenturyTel and EMBARQ agree to merge,” CenturyTel Press Release, October 27, 2008. *Available at* http://www.centurytel.com/Pages/AboutUs/PressRoom/pressRelease.jsp?page=Corporate/Press_Release66.html.

1 A: No. Joint Applicants do not identify how synergy benefits will flow-through to
2 CenturyTel WA and UTNW ratepayers.

3 **Q: Should these merger synergies be shared with CenturyTel WA and UTNW’s**
4 **ratepayers?**

5 A: Yes, sharing of these synergies is essential. The merger raises considerable risks

6

1 for both CenturyTel WA and UTNW ratepayers, and causes quantifiable harms
2 for UTNW ratepayers. Sharing of merger synergies provides a reasonable means
3 of contributing to the satisfaction of this statutory requirement that the merger not
4 harm ratepayers. As noted by the Commission in its evaluation of synergy
5 sharing in another merger, “commitments, in conjunction with other commitments
6 that cap allocated costs and provide direct credits to customers, provide adequate
7 assurance that there is no financial harm to customers from the transaction.”⁸⁹

8 **Q: What portion of the synergies should be associated with CenturyTel WA and**
9 **UTNW?**

10 A: I believe that it is reasonable to associate \$9.5 million per year of the run rate
11 synergies with CenturyTel WA and UTNW’s operations.⁹⁰ I developed this value
12 based on the \$400 million in company-wide synergies identified by CenturyTel,
13 and on access line counts for CenturyTel WA and UTNW. The \$400 million in
14 system-wide synergies reflects cost savings, and rate increases (the so-called
15 “revenue synergies”) that will be targeted at Embarq customers alone. I
16 developed the \$9.5 million per year based on CenturyTel WA and UTNW’s
17 access line count relative to the combined Company, and this portion of the
18 synergies associated with cost reductions was then associated with CenturyTel
19 WA and UTNW’s operations. For the revenue synergies, which are targeted at

⁸⁹ *In the Matter of the Joint Application of MDU Resources Group, Inc. and Cascade Natural Gas Corporation For an Order Authorizing Proposed Transaction*, Docket No. UG-061721, Final Order (Order No. 06), ¶ 16.

⁹⁰ Recall that the “run-rate” synergies are the level of synergies expected once integration has been completed. In the analysis that follows, I follow Joint Applicants’ assumption that these run rate synergies will not be fully achieved until the third year following the merger.

1 Embarq and UTNW, I utilized an allocation factor that reflected UTNW's access
2 line count relative to Embarq's overall line count. I believe that it is reasonable to
3 estimate that a total of \$26.4 million in synergies are associated with the
4 Washington state operations of the combining companies through the end of
5 2012. I believe that these synergies should be shared with CenturyTel WA and
6 UTNW ratepayers until the end of 2012, through an approach which results in a
7 total of \$13.3 million in synergies flowing to the ratepayers of the combined
8 Company.

9 **Q: How should these synergies be shared?**

10 A: These synergies should be applied as a rate credit on UTNW and CenturyTel WA
11 ratepayers' monthly bills. For the balance of 2009 following the merger's final
12 approval, rate credits of \$1.25 per month should be applied. For the years 2010
13 through 2012, the credit should be \$2.00 per month. This provides a direct
14 approach to sharing merger benefits, as it represents an approximate 50/50 sharing
15 of the run-rate synergies that are reasonably associated with the Washington
16 operations of the combined companies.

17 **Q: Does this sharing of merger benefits insure that the merger will do no harm**
18 **to Washington ratepayers?**

19 A: Not alone, no. It is appropriate that other conditions be placed on the merger to
20 offer additional protection to CenturyTel and UNTW's ratepayers.

21 **Q: Will the combined Company undergo a name change?**

1 A: The companies should be required to file a broadband improvement plan for their
2 Washington state service areas.⁹³ The objective of this plan should be to improve
3 DSL availability in UTNW’s service area to achieve a similar level of availability
4 as is currently the case for CenturyTel WA.

5 **Q: Should the Commission place conditions on the merger regarding stand-**
6 **alone DSL?**

7 A: Yes. The Commission has recently required deployment of stand-alone DSL as a
8 condition of the Verizon and MCI merger.⁹⁴ In its Order approving the merger,
9 the Commission highlighted the issue, stating, “the importance of stand-alone
10 DSL has been recognized at both state and federal levels.”

11 CenturyTel WA and UTNW currently do not offer stand-alone DSL to
12 residential customers.⁹⁵ It is my understanding that CenturyTel is currently
13 marketing a stand-alone DSL product in some jurisdictions called “Pure
14 Broadband,” for \$29.95 per month.⁹⁶ I believe that the combined Company
15 should be required to offer a similar product in Washington for a price that does
16 not exceed \$29.95 per month for a minimum of three years.

⁹³ In response to discovery, Joint Applicants state: “We will establish a ‘one network’ approach to DSL deployment in Washington and other states of operations with a common network engineering team with a shared network strategy. Our Teams are in the process of developing joint Network plans for the combined company, which are in the early stages of development.” Joint Applicants’ Response to Public Counsel Data Request No. 131. The reporting requirement could be leveraged off of the apparent ongoing planning underway at CenturyTel.

⁹⁴ *In the Matter of the Joint Application of Verizon Communications, Inc. and MCI, Inc. For Approval of Agreement and Plan of Merger*, Docket No. UT-050814, Order Accepting Settlement, On Condition; Approving Merger, On Condition (Order No. 07), ¶ 150 (requiring Verizon to deploy DSL in its services “as quickly as possible and at the latest, within twelve months of the merger closing date to the extent stated in the condition of the order”).

⁹⁵ Joint Applicants’ Response to Public Counsel Data Request Nos. 27 and 34.

⁹⁶ See, <http://www.givemepure.com/>.

1 **Q: Should the Commission place conditions on the merger regarding call center**
2 **and billing system changes?**

3 A: Yes. Given the lack of specifics that Joint Applicants have provided regarding the
4 integration of their operations, I believe that the Commission should require that a
5 quarterly report on the integration of business and repair office operations and
6 billing systems be filed with the Commission for the first three years following
7 the merger, and annually after that. The report should identify changes in staffing
8 or operations at former CenturyTel and Embarq call centers, and how newly
9 integrated call centers are being designed and staffed to satisfy Washington’s
10 service quality standards regarding speed of answer. The speed of answer should
11 also be included in the report as well as whether the Company has met the
12 standard. The report should also describe remedial action taken by the Company
13 in the event that standard is not met.

14 **Q: Should the Commission place conditions regarding network maintenance**
15 **and repair?**

16 A: Yes. The Commission should require, for the first three years following the
17 merger, a quarterly report that discusses any consolidation of network operations
18 and staff in the CenturyTel WA and UTNW service areas. This report should
19 identify the number of Company personnel that are associated with the
20 maintenance and repair of CenturyTel WA and UTNW’s network facilities,
21 including outside plant. Annual reports should be filed thereafter. The level of,
22 and changes to the level, of maintenance and repair expense and maintenance and

1 repair personnel should be described in this report, and changes in staffing and
2 expense levels should be explained.⁹⁷

3 **Q: Are there any other issues associated with service quality reporting of that**
4 **you believe the Commission should be aware?**

5 A: As discussed earlier in this testimony, Joint Applicants have not been able to
6 identify their plans for consolidation of CenturyTel WA and UTNW operations.
7 If operational consolidation does occur, service quality reporting issues may
8 emerge. I believe that the Companies should be required to inform the
9 Commission of consolidation plans and implementation as they occur, and at that
10 point the Commission may need to address how service quality reporting (or other
11 reporting matters) will be addressed.

12 **Q: Should the Commission place any conditions on the merger regarding**
13 **LifeLine programs?**

14 A: Yes. The Company should be required to take specific steps to increase the
15 number of customers enrolled in its LifeLine program. CenturyTel LifeLine
16 subscription declined between 2004 and 2008. Steps should be taken to reverse
17 this decline. The combined Company should be required to publish a brochure
18 unique to the combined Company in Washington that it would then distribute to
19 local public assistance offices and other appropriate locations in each county in
20 their service territory. This marketing effort will be helpful in informing low-

⁹⁷ According to the Joint Applicants' responses to discovery CenturyTel WA's 2007 regulated plant facilities maintenance for 2007 was \$29,533,000. For UTNW, the corresponding amount of \$10,655,000. *See*, Joint Applicants' Responses to Public Counsel Data Request Nos. 118 and 120.

1 income consumers, and those who work with low-income consumers, about
2 LifeLine benefits, and the name change that Joint Applicants are planning. Also,
3 the Company should be required to do two bill inserts a year for the next three
4 years informing customers of the Lifeline program.⁹⁸ Based on responses to
5 discovery, CenturyTel appears to have a superior approach to LifeLine service
6 than does UTNW. I believe that ratepayers will be better served if the combined
7 Company adopts CenturyTel practices system wide in Washington. Changes in
8 the combined Company's approach to LifeLine should be reported to the
9 Commission. In addition, quarterly reports on the number of LifeLine customers
10 should be provided to Commission.

11 **Q: Should the Commission place any conditions on the merger regarding the**
12 **marketing of basic telephone service?**

13 A: Yes. Embarq's web site currently advertises a product, available in UTNW's
14 service area, called "Basic Home Phone" service, for \$29.95 per month (prior to
15 taxes and fees).⁹⁹ However, this service is not basic service,¹⁰⁰ but instead
16 provides consumers a range of vertical features, voice mail, and access to optional
17 long distance plans. I have no objection to Embarq offering such a service
18 package. However, it is not "basic" phone service, and fails to address the
19 availability of stand-alone basic service, as specified in UTNW's tariff. I believe
20 that the Commission should require basic phone service be correctly identified on

⁹⁸ CenturyTel indicates that it already does a twice yearly bill insert. *See*, Joint Applicants' Response to Public Counsel Data Request No. 79.

⁹⁹ *See*, <https://www.embarq.com/Residential/Voice/NewServicePlans>.

1 the combined Company’s web site, and promoted with visibility similar to the
2 combined Company’s service packages promoted on the combined Company’s
3 web site.

4 **Q: Does this conclude your testimony at this time?**

5 A: Yes.

¹⁰⁰ UTNW’s tariff identifies flat-rate local service at rates of either \$17.85 or \$18.80. *See*, WN U-3, Schedule AE-1, Original Sheet 6.