

**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Joint Application of

QWEST COMMUNICATIONS  
INTERNATIONAL INC. AND  
CENTURYTEL, INC.

For Approval of Indirect Transfer of Control of  
Qwest Corporation, Qwest Communications  
Company LLC, and Qwest LD Corp.

**DOCKET NO. UT-100820**

**REBUTTAL TESTIMONY OF**

**G. CLAY BAILEY**

**ON BEHALF OF**

**CENTURYLINK, INC.**

**NOVEMBER 1, 2010**

**REDACTED  
HIGHLY CONFIDENTIAL VERSION**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is G. Clay Bailey and my business address is 100 CenturyLink Drive, Monroe,  
3 Louisiana 71203.

4  
5 **Q. WHO IS YOUR EMPLOYER AND WHAT IS YOUR POSITION?**

6 A. I am employed as Senior Vice President and Treasurer for CenturyLink, Inc.  
7 (“CenturyLink,” or the “Company”).

8  
9 **Q. ARE YOU THE SAME G. CLAY BAILEY WHO SUPPLIED DIRECT**  
10 **TESTIMONY IN THIS PROCEEDING ON MAY 21, 2010?**<sup>1</sup>

11 A. Yes. I am.

12  
13 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

14 A. I am providing rebuttal testimony concerning financial and related issues raised in certain  
15 testimonies in the proceeding before the Washington Utilities and Transportation  
16 Commission (“Commission”) related to the proposed merger (the “Transaction”) of  
17 Qwest Communications International, Inc. (“Qwest”) and CenturyLink. Specifically, I  
18 will address the testimonies of Mr. Rick T. Applegate<sup>2</sup> and Mr. Mark J. Vasconi<sup>3</sup>, who

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<sup>1</sup> Direct Testimony of G. Clay Bailey, CenturyLink, Joint Application of Qwest Communications International, Inc. and CenturyLink, Inc. for approval of indirect transfer of control of Qwest Corporation, Qwest Communications Company, LLC and Qwest LD Corp. Docket No. UT-100820, May 21, 2010 [hereafter “Bailey Direct”].

<sup>2</sup> Testimony of Rick T. Applegate, Staff of Washington Utilities and Transportation Commission, In the Matter of Joint Application of Qwest Communications International, Inc. and CenturyLink, Inc. for approval of indirect transfer of control of Qwest Corporation, Qwest Communications Company, LLC and Qwest LD Corp., Docket No. UT-100820, September 27, 2010 [hereafter “Staff, Applegate”].

1 provided testimony on behalf of the Staff of the Commission (collectively “Staff”); Mr.  
2 Timothy Gates<sup>4</sup> and Dr. August Ankum<sup>5</sup>, who provided responsive testimony on behalf  
3 of Integra Telecom of Washington, Inc., Electric Lightwave, Inc., Advanced TelCom,  
4 Inc., and United Communications, Inc. d/b/a Unicom (collectively “Integra”); tw telecom  
5 of Washington, LLC; Covad Communications Company; Level 3 Communications, LLC;  
6 McLeodUSA Telecommunications Services Inc., d/b/a PAETEC Business Services;  
7 Charter Fiberlink WA-CCVII, LLC; and Cbeyond Communications LLC (collectively,  
8 these competitive local exchange carriers are the “Joint CLECs”); Mr. James Appleby<sup>6</sup>,  
9 who provided responsive testimony on behalf of Sprint Nextel Corporation (“Sprint  
10 Nextel”); and Mr. Charles King<sup>7</sup>, who provided responsive testimony on behalf of The  
11 Department of Defense and all other Federal Executive Agencies (“DOD”). My rebuttal  
12 testimony regarding financial and related issues is to be read in conjunction with the  
13 rebuttal testimonies provided by other witnesses representing CenturyLink and Qwest

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<sup>3</sup> Testimony of Mark J. Vasconi, Staff of Washington Utilities and Transportation Commission, In the Matter of Joint Application of Qwest Communications International, Inc. and CenturyLink, Inc. for approval of indirect transfer of control of Qwest Corporation, Qwest Communications Company, LLC and Qwest LD Corp., Docket No. UT-100820, September 27, 2010 [hereafter “Staff, Vasconi”].

<sup>4</sup> Responsive Testimony of Timothy J Gates on behalf of Integra Telecom of Washington, Inc., Electric Lightwave, Inc., Advanced TelCom, Inc., and United Communications, Inc. d/b/a Unicom (collectively “Integra”); tw telecom of washington llc; Covad Communications Company; Level 3 Communications, LLC; McLeodUSA Telecommunications Services, Inc., d/b/a PAETEC Business Services; Charter Fiberlink WA-CCVII, LLC; and Cbeyond Communications LLC, Docket No. UT-100820, September 27, 2010 [hereafter “Joint CLECs, Gates”].

<sup>5</sup> Responsive Testimony of August H. Ankum, Ph.D. on behalf of Integra Telecom of Washington, Inc., Electric Lightwave, Inc., Advanced TelCom, Inc., and United Communications, Inc. d/b/a Unicom (collectively “Integra”); tw telecom of washington llc; Covad Communications Company; Level 3 Communications, LLC; McLeodUSA Telecommunications Services, Inc., d/b/a PAETEC Business Services; Charter Fiberlink WA-CCVII, LLC; and Cbeyond Communications LLC, Docket No. UT-100820, September 27, 2010 [hereafter “Joint CLECs, Ankum”].

<sup>6</sup> Testimony of James A. Appleby, Sprint Nextel Corporation, In the Matter of Joint Application of Qwest Communications International, Inc. and CenturyLink, Inc. for approval of indirect transfer of control of Qwest Corporation, Qwest Communications Company, LLC and Qwest LD Corp., Docket No. UT-100820, September 27, 2010 [hereafter “Sprint Nextel, Appleby”].

<sup>7</sup> Responsive Testimony of Charles W. King on behalf of The Department of Defense and all other Federal Executive Agencies, In the Matter of Joint Application of Qwest Communications International, Inc. and CenturyLink, Inc. for approval of indirect transfer of control of Qwest Corporation, Qwest Communications Company, LLC and Qwest LD Corp., Docket No. UT-100820, September 27, 2010 [hereafter “DOD, King”].

1 (“Joint Applicants”). I have reviewed and agree with the rebuttal testimonies presented  
2 by those other Joint Applicant witnesses.

3  
4 **Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

5 A. I will respond to the Staff and intervenor testimonies noted above regarding financial  
6 concerns raised in the various testimonies, principally based on the proposed Staff  
7 conditions. I will address the following general matters:

- 8 1. The standard of review applied and the approach used in evaluating the  
9 proposed Transaction, notably based on the testimonies of Mr. Vasconi and  
10 Mr. Applegate;
- 11 2. The financial analyses of Mr. Applegate that lead him to conclude that no  
12 deterioration in the combined company’s financial condition (i.e., financial  
13 harm) is likely to result from the Transaction;
- 14 3. The additional financial analyses and recommendations of Mr. Vasconi;
- 15 4. Perspectives on the appropriate use of the Risk Factors section of the  
16 Securities and Exchange Commission (“SEC”) Form S-4 filing (“S-4”) in  
17 this proceeding;<sup>8</sup>
- 18 5. The Joint CLECs’ recommendation that the Joint Applicants should be  
19 required to prove affirmative benefits and share synergy savings with  
20 wholesale or other customers in Washington;
- 21 6. Other financial issues raised by intervenor witnesses; and

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<sup>8</sup> CenturyLink SEC Form S-4, filed July 16, 2010, available at  
<http://www.sec.gov/Archives/edgar/data/18926/000095012310066042/y84818a1sv4za.htm#113>.

1           7. Staff recommendations regarding proposed financial conditions.

2  
3           **I. THE STANDARD OF REVIEW APPLIED AND THE APPROACH USED**  
4                   **IN EVALUATING THE PROPOSED TRANSACTION, NOTABLY**  
5                   **BASED ON THE TESTIMONIES OF MR. VASCONI AND MR.**  
6                   **APPLEGATE.**

7 **Q. WHAT IS YOUR UNDERSTANDING OF THE STANDARD OF REVIEW TO BE**  
8 **APPLIED BY THE COMMISSION IN THIS TRANSFER OF CONTROL**  
9 **PROCEEDING?**

10 A. I am not an attorney, but I have reviewed the testimony of Staff lead witness Mr.  
11 Vasconi, who states that the “standard used by the Commission in reviewing an  
12 application such as this is a ‘no harm’ standard.”<sup>9</sup> I also reviewed the testimony of Staff  
13 witness Mr. Applegate who provides financial analyses of the proposed Transaction, and  
14 he affirms that the Commission “will approve [the merger] if the record demonstrates that  
15 ‘no harm’ will occur as a result.”<sup>10</sup> Finally, I have read the Washington statute at 80.12  
16 RCW, which, as I understand the section, establishes a standard of review under which  
17 the Commission should approve the application for transfer. In summary, my layman’s  
18 opinion is that the Joint Applicants are required to demonstrate that the proposed  
19 Transaction does not result in “harm” to the companies’ customers in Washington. My  
20 rebuttal testimony, therefore, will focus on the financial factors surrounding the proposed  
21 merger to demonstrate that, at a minimum, there is no harm to Washington customers,

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<sup>9</sup> Staff, Vasconi, p. 9, lines 5-6.

<sup>10</sup> Staff, Applegate, p. 3, lines 5-7.

1 and in all likelihood Washington and Washington customers will benefit as a result of the  
2 proposed Transaction.

3  
4 **Q. DOES STAFF FINANCIAL WITNESS APPLGATE USE THIS “NO HARM”**  
5 **STANDARD IN HIS REVIEW OF THE FINANCIAL FACTORS RELATED TO**  
6 **THE TRANSACTION?**

7 A. Yes. Mr. Applegate states that he has identified “several potential harms,” which he  
8 assesses, and then he recommends specific conditions to protect against those “potential  
9 harms.” In general, Mr. Applegate considers whether financial aspects of the proposed  
10 Transaction might cause a “deterioration of the financial condition of the Combined  
11 Company,” which he uses as the measure for financial harm.<sup>11</sup> I will discuss in more  
12 detail below that Mr. Applegate reviews a number of potential risks that *might* cause  
13 public interest harm; however, he concludes that none of those scenarios are likely to  
14 result in a meaningful deterioration or degradation of the combined company’s financial  
15 condition. As such, Mr. Applegate concludes on the basis of his “more conservative  
16 analysis and . . . financial conditions [that] . . . the financial aspects of this Transaction  
17 meet the Commission’s ‘no harm’ standard.”<sup>12</sup> I will provide more specific responsive  
18 testimony to Mr. Applegate’s “more conservative analysis” and to his proposed  
19 conditions, but I believe that Mr. Applegate understands and generally has assessed the  
20 financial matters in a balanced manner. I concur in Mr. Applegate’s conclusions that the  
21 various potential risks he raises are unlikely to cause deterioration in CenturyLink’s

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<sup>11</sup> Staff, Applegate, p. 5, lines 12-15.

<sup>12</sup> Staff, Applegate, p. 28, lines 5-8.

1 financial condition, and therefore, it is improbable that there will be any Transaction-  
2 related harm to Washington customers.

3  
4 **Q. DOES STAFF WITNESS VASCONI USE A “NO HARM” STANDARD IN HIS**  
5 **REVIEW OF THE FINANCIAL FACTORS RELATED TO THE**  
6 **TRANSACTION?**

7 A. Not in my opinion. Mr. Vasconi states the standard correctly, according to my layman’s  
8 understanding of the law, but testifies very shortly thereafter that he is “concerned that  
9 synergy savings estimated by the Applicants *will not provide any benefits* to Washington  
10 customers.”<sup>13</sup> [Emphasis added.] Mr. Vasconi then sponsors several financial conditions  
11 that are in addition to those proposed by Mr. Applegate. Through those recommended  
12 conditions the lead Staff witness attempts to achieve financial outcomes that exceed, as I  
13 will show, what could be termed as outcomes consistent with a “no harm” standard.  
14 Additionally, Mr. Vasconi presents other conditions, sponsored by himself or other Staff,  
15 which appear to exceed the requirements of a “no harm” standard. The responses of the  
16 Joint Applicants to many of those additional proposed Staff conditions will be provided  
17 by witnesses other than myself. With respect to the financial conditions, Mr. Vasconi’s  
18 primary additional recommendations are Conditions 43 through 45 that include constant  
19 levels of capital expenditures over the three years following the merger close.<sup>14</sup> I will  
20 explain in my rebuttal testimony that the per-line capital expenditures and the DSL  
21 commitments that Mr. Vasconi is proposing clearly represent financial “net benefits” (not

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<sup>13</sup> Staff, Vasconi, p. 10, lines 24-25.

<sup>14</sup> Staff, Vasconi, p. 18, line 20 through p. 19, line 4.

1 the avoidance of harm) and will limit the Company's ability to determine how best to use  
2 its capital in responding to market and customer demands. CenturyLink objects to Mr.  
3 Vasconi's attempt to modify the standard of review in order to obtain financial benefits as  
4 a condition to receiving approval of the proposed Transaction. CenturyLink's objection  
5 is not because the Company intends to withhold appropriate investment and broadband  
6 deployment in Washington, but because the competitive market requires financial  
7 flexibility in terms of the allocation of capital resources during this period of industry  
8 transformation.

9  
10 **Q. IS IT PRUDENT THAT THE STAFF AND THE JOINT CLECS SHOULD SEEK**  
11 **INCREMENTAL BENEFITS FROM THE PROPOSED TRANSACTION TO**  
12 **OFFSET THE UNCERTAINTIES IN THIS OR IN ANY OTHER MERGER IN**  
13 **WASHINGTON?**

14 A. No. CenturyLink believes that "risks" should be assessed in terms of their probability  
15 and whether they truly flow from a proposed merger, and where appropriate, protective  
16 conditions should be defined narrowly to address a specific harm that likely will be a  
17 direct result of the transaction under review. For example, there are currently service  
18 quality standards determined by the Commission and by the terms of contractual  
19 agreements with other carriers. These service quality protections were considered  
20 sufficient to protect CenturyLink and Qwest customers in Washington prior to the  
21 announcement of the proposed Transaction, and the existing rules, regulations and  
22 contract terms should be sufficient to protect against performance shortfalls of the  
23 combined company, in the unlikely event such shortfalls were to occur. In addition,

1 CenturyLink believes that incremental broadband commitments, mandated capital  
2 expenditures and new obligations addressed in other testimonies are not required to  
3 satisfy the “no harm” standard, but are attempts to modify the standard to achieve  
4 benefits for specific intervenors. CenturyLink believes that it should be held to the  
5 statutory requirements and contractual obligations of Qwest and the Company, but  
6 objects to redirection of its cash flows when the result might not be in the best interests of  
7 its customers, and, therefore, might not be in the best interests of employees, public  
8 policy, and other stakeholders. In response to the question raised by Staff and intervenor  
9 witnesses regarding potential risks or new uncertainties, I submit that the strongest  
10 testimony that CenturyLink can provide, which is more tangible and concrete than any  
11 speculative risk or harm raised by the Staff or intervenor witnesses, is the Company’s  
12 long history of providing service consistent with customer interests, including improved  
13 services after the consummation of the Company’s many previous acquisitions. I note  
14 that no testimony from Staff or the intervenor witnesses has presented substantive  
15 evidence or data to show any probability that CenturyLink will fail to meet any of the  
16 Washington policy objectives or statutory requirements, as I understand them, such that  
17 the Company’s historical record is outweighed. CenturyLink is a consistent provider of  
18 high-quality services that are customer-centric, and the Company has proven its  
19 commitment to the customers and communities it serves in every acquisition it has  
20 completed over the last twenty years.

21  
22 **Q. ARE YOU SAYING THAT CENTURYLINK BELIEVES THERE ARE NO RISKS**  
23 **RELATED TO THE PROPOSED TRANSACTION?**

1 A. No. CenturyLink acknowledges the potential risks—faced by all companies—associated  
2 with running a business, particularly in the local telecommunications industry. The  
3 Company does not seek to trivialize potential risks in merger and acquisition transactions.  
4 As the Commission understands, all businesses cope with potential risks in the ordinary  
5 course of operating and certainly in conjunction with strategic initiatives such as mergers,  
6 acquisitions, growth projects, etc. What sets exceptional companies apart from others is  
7 how well they recognize and mitigate the inevitable risks. The noteworthy point is that  
8 the shareholders of Qwest and CenturyLink, the vast majority of whom are experienced  
9 institutional investors, were aware of the potential risks and benefits associated with the  
10 Transaction, and voted overwhelmingly to approve the Transaction. CenturyLink  
11 believes that its long track record of strong and responsible operating results provides  
12 investors, customers, employees and the Commission with a tangible indication that the  
13 Company is capable of avoiding risks that may confront the combined company’s  
14 operations.

15  
16 **Q. BECAUSE THERE ARE POTENTIAL RISKS, DOES THAT MEAN IT IS**  
17 **APPROPRIATE THAT THE COMMISSION SHOULD IMPOSE CONDITIONS?**

18 A. Not necessarily. CenturyLink urges the Commission to focus its review of the proposed  
19 Transaction on the Washington “no harm” standard. CenturyLink strongly believes  
20 conditions that require unnecessary restrictions on the operation of the business or on the  
21 use of capital should be avoided. “Unnecessary” restrictions are those that have no  
22 certain harm against which they protect, and are those that potentially frustrate the  
23 appropriate operating flexibility of a company that is competing in a challenging

1 economic environment and changing industry. CenturyLink does not oppose reasonable  
2 regulatory oversight or existing service quality standards, but it cautions against  
3 excessive new restrictions that impact how a company can exercise its management  
4 discretion to operate its business. Today, the Company cannot predict precisely what will  
5 happen with new technology developments or competition. CenturyLink and Qwest seek  
6 to gain increased financial flexibility to achieve a stronger balance sheet, improved  
7 efficiency, best practices, better purchasing power, and increased access to debt and  
8 equity capital. These are not vague assertions, but are foundational pillars of the rationale  
9 for the proposed Transaction. The underlying purpose of CenturyLink's business  
10 approach remains the same as it has always been—to serve customers more effectively  
11 and efficiently. If no harm related to the Transaction is demonstrated—as opposed to  
12 speculative potential risks—then conditions are not warranted under the Washington  
13 standard of review. CenturyLink urges the Commission to avoid imposing unnecessary  
14 conditions that can increase costs, interfere with management discretion, divert  
15 management attention, and alter the competitive balance in a way that ultimately may  
16 harm, not benefit, Washington customers.

17  
18 **Q. CAN YOU SUMMARIZE FROM A FINANCIAL POINT OF VIEW WHY THE**  
19 **PROPOSED TRANSACTION IS EXPECTED TO BENEFIT WASHINGTON**  
20 **CUSTOMERS AND, AT THE VERY LEAST, MEETS THE WASHINGTON “NO**  
21 **HARM” STANDARD OF REVIEW?**

22 **A.** Yes. The merger is a direct and constructive response to industry pressures. Competition  
23 in the telecommunications industry is robust and is increasing in terms of business

1 services provided by competitive local exchange carriers (“CLECs”), and residential and  
2 business services provided by cable operators, including those that sponsor voice over  
3 Internet protocol (“VoIP”) services. Wireless carriers also are capturing a very large  
4 percentage of the marketplace, particularly among residential subscribers—it is generally  
5 accepted that currently more than 25% of the residential telephone customer base has  
6 “cut the cord.”<sup>15</sup> Telecommunications is no longer a monopoly business, except by the  
7 most narrow of definitions (for industry sub-segments that have little relevance in  
8 understanding overall industry dynamics).<sup>16</sup> Illustrating the competitive pressures, Qwest  
9 reported total access lines that fell by 10.5% year-over-year at the end of the second  
10 quarter of 2010, while CenturyLink reported an 8.0% decline pro forma (adjusting for the  
11 acquisition of Embarq Corporation (“Embarq”)).<sup>17</sup> Technologies are changing as

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<sup>15</sup> Dan Frommer, *Almost a Third of U.S. Households Have Cut the Landline Cord*, SFGate (San Francisco Chronicle), August 18, 2010, available at <http://www.sfgate.com/cgi-bin/article.cgi?f=/g/a/2010/08/18/businessinsider-chart-of-the-day-almost-a-third-of-us-households-have-cut-the-landline-cord-2010-8.DTL>; Frommer states that “[a]lmost 30% of U.S. households have cut the cord, up from about 25% a year ago, via a Citi Investment Research report by analyst Jason Bazinet.” At the end of 2009, the Center for Disease Control reported that 24.5% of homes were wireless-only; see Stephen J. Blumberg, Ph.D., and Julian V. Luke, Division of Health Interview Statistics, *National Center for Health Statistics, Wireless Substitution: Early Release of Estimates From the National Health Interview Survey, July-December 2009*, available at <http://www.cdc.gov/nchs/data/nhis/earlyrelease/wireless201005.pdf>. See, also, Dane Jasper, *Why Include Phone*, September 9, 2010, Sonic.net CEO, available at <http://corp.sonic.net/ceo/2010/09/09/why-include-phone/>.

<sup>16</sup> Mr. Appleby notes that the “Merged Firm will increase its market-share of Washington ILEC lines to 74%.” See, Sprint Nextel, Appleby, p. 5, lines 7-8. However, Mr. Appleby fails to note that the appropriate market is not “ILEC lines” but rather telecommunications customers. The most recent report from the FCC on *Trends in Telephone Service* (as of December 31, 2008) included Table 8.5 that showed Washington state with 3,386,000 switched and voice landline connections; of those 2,367,000 were ILEC lines, which were 70% of the total. However, the appropriate universe is larger than landline services, as wireless continues to capture market share at a rapid rate. Wireless connections in Washington, according to the FCC, at the end of 2008 were 5,624,000 (Table 11.1); available at [http://www.fcc.gov/Daily\\_Releases/Daily\\_Business/2010/db0930/DOC-301823A1.pdf](http://www.fcc.gov/Daily_Releases/Daily_Business/2010/db0930/DOC-301823A1.pdf). Thus, the statewide market share of landline connections for all ILECs was 70% (which was likely somewhat lower in the more densely populated Qwest and CenturyLink regions), and statewide ILEC lines were 26% of total connections if one includes all wireless and non-ILEC connections.

<sup>17</sup> Qwest Communications 2010: Second Quarter Historical Financial Info, August 4, 2010, available at <http://investor.qwest.com/index.php?s=68>. CenturyLink Reports Second Quarter 2010 Earnings, August 4, 2010, available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzkyMDAyfENoaWxkSUQ9Mzk2MzQxfFR5cGU9MQ==&t=1>, p. 12.

1 customers are demanding higher throughput for data and a range of new applications,  
2 including those provided by wireless carriers (that are in the process of introducing 4G  
3 technologies) or cable television companies (that are moving toward very high-speed  
4 DOCSIS 3.0 services).

5  
6 From a financial point of view, the wireline telecommunications industry is coping with a  
7 shrinking base of voice-only customers (generally contracting between 6% and 12%  
8 annually), greater risks in terms of deploying technologies (with uncertainty surrounding  
9 how far fiber should be pushed toward the premises), pressures on margins and cash  
10 flows (as most carriers are reporting at least some margin compression), more critical  
11 scrutiny from debt and equity investors (among the major carriers only three, including  
12 CenturyLink, have corporate credit ratings that are investment grade), the need to  
13 rationalize operations to achieve efficiencies (such that rapid consolidation is occurring in  
14 the industry, including among the largest carriers), and pending federal financial  
15 regulatory reforms. The financial benefits of the proposed Transaction, therefore, are  
16 centered on creating a combined company with greater scope and scale, strong financial  
17 characteristics (low leverage, prudent payout ratio, diversification of markets and revenue  
18 sources, etc.), and the ability to generate significant free cash flows. It is also important  
19 to note that the combined company is not acquiring any new debt as the Transaction is a  
20 stock-for-stock merger. The combined company is positioning itself to generate  
21 incremental cash flows through synergies and incremental revenues from expanded  
22 service offerings based on the combination of CenturyLink and Qwest assets. The result  
23 will be higher cash flows that can be used to fund operations, invest in new service

1 capabilities, and reduce debt from current levels, which are affirmative benefits of the  
2 merger. In addition, CenturyLink believes that the merged company's market  
3 capitalization will provide a larger and more liquid equity base (more shares outstanding  
4 and a higher market capitalization). All else being equal, the increase in market  
5 capitalization generally improves access to capital markets, which is an important  
6 consideration for the Commission in this review process. Finally, the combined company  
7 will be run by a management team that has been effective in responding to customers, in  
8 generating better efficiencies through synergies and more efficient operations, and in  
9 investing in network and services.

10  
11 Based on the financial benefits of the proposed Transaction, CenturyLink believes that  
12 the Washington "no harm" approval standard has been satisfied. As such, the imposition  
13 of unnecessary conditions could undermine the expected financial benefits and hinder the  
14 Company's ability to respond flexibly to the rapidly changing and increasingly  
15 competitive telecommunications marketplace—a result which would harm Washington  
16 customers and public policy.

17  
18 **II. THE FINANCIAL ANALYSES OF MR. APPEGATE THAT LEAD HIM**  
19 **TO CONCLUDE THAT NO DETERIORATION IN THE COMBINED**  
20 **COMPANY'S FINANCIAL CONDITION (I.E., FINANCIAL HARM) IS**  
21 **LIKELY TO RESULT FROM THE TRANSACTION.**

22  
23 **Q. PLEASE COMMENT ON STAFF WITNESS APPEGATE'S SUMMARY OF**  
24 **THE RATIONALE FOR THE PROPOSED TRANSACTION.**

1 A. Mr. Applegate testifies in a single sentence response that the rationale for the merger is  
2 that “[t]he Combined Company should benefit from economies of scale.”<sup>18</sup> CenturyLink  
3 agrees that the merged company will benefit from improved economies of scale, which  
4 are expected to generate improved efficiencies and increased cash flows that can be used  
5 to better serve the Company’s customers. CenturyLink also believes that the rationale  
6 includes the ability to combine complementary capabilities and assets, including transport  
7 and local access, to offer a broader range of products and services to our customers.  
8 Finally, CenturyLink and Qwest seek to diversify their operations, thereby improving the  
9 overall risk profile of the merged company’s business. All of these “rationales” should  
10 make the Company a better, more capable service provider for Washington and  
11 Washington customers.

12

13 **Q. WHAT IS THE OVERRIDING FINANCIAL RISK THAT CONCERNS MR.**  
14 **APPLEGATE AND HOW DOES HE PROPOSE TO ASSESS THE RISK?**

15 A. Mr. Applegate primarily is concerned with assessing the potential for deterioration in the  
16 financial condition of the combined company as a result of the proposed Transaction.<sup>19</sup>  
17 Mr. Applegate focuses his evaluation of the combined company’s financial condition on  
18 three metrics: (i) earnings before interest, taxes, depreciation and amortization  
19 (“EBITDA”), (ii) long-term debt, and (iii) free cash flow after dividends.<sup>20</sup> CenturyLink  
20 agrees that the three metrics identified by Mr. Applegate highlight, at least generally, the  
21 financial health of a company and are consistent with the rationale for the merger. As

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<sup>18</sup> Staff, Applegate, p. 5, lines 6-8.

<sup>19</sup> Staff, Applegate, p. 5, lines 12-15.

<sup>20</sup> Staff, Applegate, p. 5, lines 17-20.

1 such, the metrics provide a reasonable basis for assessing the financial risks associated  
2 with the proposed Transaction.

3

4 **Q. WHAT ARE THE PRIMARY POTENTIAL RISK FACTORS THAT SERVE AS**  
5 **THE BASIS FOR MR. APPEGATE’S ASSESSMENT?**

6 A. The financial factors analyzed by Mr. Applegate are: (i) integration expenses to be  
7 incurred by CenturyLink, (ii) the combined company’s ability to integrate and generate  
8 the expected synergies, (iii) CenturyLink’s assumption of additional debt, (iv) financial  
9 impacts of continuing access line losses, and (v) any material adverse litigation outcomes,  
10 particularly the KPNQwest litigation.<sup>21</sup> I will address each of these factors below in my  
11 testimony.

12

13 **Q. WHAT IS MR. APPEGATE’S ASSESSMENT OF THE RISK OF FINANCIAL**  
14 **HARM RELATED TO ONE-TIME INTEGRATION COSTS?**

15 A. Mr. Applegate prepared confidential Table 2 that summarizes the expected one-time  
16 operating and capital integration costs, and how those nonrecurring costs will be phased-  
17 in over the 2011-2015 time period.<sup>22</sup> Mr. Applegate then assessed those costs relative to  
18 the combined company’s expected financial performance, concluding that the integration  
19 costs are \*\*\*BEGIN HIGHLY CONFIDENTIAL “REDACTED XXXXXXXX

20 XX”<sup>23</sup>

21 END HIGHLY CONFIDENTIAL \*\*\* As such, the Staff financial witness concludes

<sup>21</sup> Staff, Applegate, p. 8, lines 1-16.

<sup>22</sup> Staff, Applegate, p. 9, lines 1-6.

<sup>23</sup> Staff, Applegate, p. 9, lines 16-17.

1 that “integration costs should not cause the financial condition of the Combined  
2 Company to deteriorate.”<sup>24</sup> Thus, by Mr. Applegate’s own definition, the integration  
3 costs should not be expected to cause harm to Washington or Washington customers.  
4 CenturyLink agrees with Mr. Applegate’s assessment.

5  
6 **Q. DO YOU HAVE ANY COMMENTS ON MR. APPLGATE’S ANALYSIS OF**  
7 **THE COMBINED COMPANY’S ABILITY TO GENERATE THE EXPECTED**  
8 **SYNERGY SAVINGS AND CASH FLOW IMPROVEMENTS?**

9 A. Yes. Mr. Applegate prepared Highly Confidential Table 3 that summarizes the annual  
10 impact of merger-related one-time integration costs (discussed above) and expected  
11 synergies between 2011 and 2015.<sup>25</sup> Regarding the level of expected synergies, Mr.  
12 Applegate clearly states, “My analysis has not indicated any major flaws or weaknesses  
13 in CenturyLink’s estimated synergy values,” as he believes the Transaction “undoubtedly  
14 presents opportunities to eliminate redundant functions or to achieve economies of  
15 scale.”<sup>26</sup> CenturyLink agrees with Mr. Applegate’s assessment that the expected  
16 synergies are reasonable and achievable. In addition, Mr. Applegate indicates that “[a]  
17 failure to achieve synergies probably would not result in a degraded financial  
18 condition.”<sup>27</sup> Since the Staff financial witness has defined financial harm as deterioration  
19 in financial condition, the conclusion must be that even if the combined company does  
20 not achieve the expected synergies—which are reasonable and achievable—it is

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<sup>24</sup> Staff, Applegate, p. 9, lines 13-14.

<sup>25</sup> Staff, Applegate, p. 10, line 7 through p. 11, line 16.

<sup>26</sup> Staff, Applegate, p. 12, lines 6-9.

<sup>27</sup> Staff, Applegate, p. 10, lines 12-13.

1 improbable that harm will result. Finally, based on Highly Confidential Table 3, Mr.  
2 Applegate concludes that, regarding the effects on cash flows after the one-time  
3 integration costs and the expected synergies over the forecasted 2011-2015 period, the  
4 net impact is \*\*\*BEGIN HIGHLY CONFIDENTIAL “REDACTED XXXXXXXXXX  
5 XX.”<sup>28</sup> END HIGHLY  
6 CONFIDENTIAL\*\*\* In short, Mr. Applegate affirms the financial logic of the merger  
7 and demonstrates that the combined company’s financial condition is not likely to  
8 deteriorate—financial harm is not likely to occur—as a result of transaction-related costs  
9 and synergies.

10  
11 **Q. WHAT IS MR. APPEGATE’S ASSESSMENT RELATED TO**  
12 **CENTURLINK’S “ASSUMPTION OF SUBSTANTIAL DEBT”?**

13 A. Mr. Applegate notes the pro forma \$19.5 billion in total debt, which includes Qwest’s  
14 debt of \$11.5 billion that will be assumed by the combined company in the proposed  
15 merger. On the basis of Highly Confidential information, Mr. Applegate also assesses  
16 the modeled debt maturities for the combined company over the next several years,  
17 concluding the CenturyLink’s pro forma cash flows should provide it \*\*\*BEGIN  
18 HIGHLY CONFIDENTIAL “REDACTED XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX  
19 XXXX.” END HIGHLY CONFIDENTIAL\*\*\*<sup>29</sup> The Staff financial witness then  
20 reviews the published opinions of the three major credit rating agencies. Mr. Applegate  
21 concludes that a ratings downgrade of post-merger CenturyLink’s debt could result in

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<sup>28</sup> Staff, Applegate, p. 11, lines 15-16.  
<sup>29</sup> Staff, Applegate, p. 12, lines 15-21.

1 public interest harm, because customer rates might rise to accommodate the possibly  
2 higher cost of capital and because investment might suffer as the Company calculates a  
3 lower net present value (“NPV”) of future investments that are discounted using what  
4 might be a higher cost of capital.<sup>30</sup> To manage the risk of harm that he believes he has  
5 identified, Mr. Applegate then proposes a condition about which I will comment in the  
6 final section of my testimony below.

7  
8 **Q. DO YOU AGREE WITH MR. APPLGATE’S ASSESSMENT OF THE RISKS**  
9 **ASSOCIATED WITH CENTURLINK HAVING A HIGHER LEVEL OF DEBT?**

10 A. No. I disagree with him for three reasons. First, Mr. Applegate is assessing the  
11 possibility that the merged company’s credit rating will be lower than that of  
12 CenturyLink today. Mr. Applegate’s conclusion is that more costly debt capital may  
13 create a greater risk of harm (not actual harm). However, Mr. Applegate’s commentary  
14 overlooks that 88% of the access lines (based on 2009 pro forma lines) of the merged  
15 company in Washington are customers who currently are served by Qwest. As will be  
16 discussed later, Qwest’s credit rating likely will be *improved* as a result of the proposed  
17 Transaction. Accordingly, Mr. Applegate’s argument can be reversed. In fact, the  
18 overwhelming majority of customers of the pro forma company in Washington will  
19 *benefit* from a *lower cost of capital* and, with respect to future investment, will *benefit*  
20 from an *NPV that is higher* (based on a lower discount rate) than might have been  
21 calculated before the proposed Transaction.

22  

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<sup>30</sup> Staff, Applegate, p. 16, line 16 through p. 17, line 7.

1 **Q. WHAT IS THE SECOND REASON FOR YOUR DISAGREEMENT WITH MR.**  
2 **APPLEGATE CONCERNING THE RISKS ASSOCIATED WITH HIGHER**  
3 **DEBT?**

4 A. Mr. Applegate assumes that CenturyLink will make investment decisions significantly on  
5 the basis of slightly higher or slightly lower discount rates that affect the NPV of those  
6 investments. He is not correct. First, as was just explained, the Qwest investments will  
7 be evaluated in light of *improved (lower)* discount rates, which is therefore a benefit.  
8 Second and more important, CenturyLink makes investment decisions based on the  
9 potential for multiple benefits, including the introduction of new products and the  
10 deployment of advanced technologies that position the Company to be responsive to  
11 customers, to reduce maintenance expenses, to accommodate growth, to fulfill carrier of  
12 last resort obligations, among others. The very slight differences associated with what  
13 might be higher or lower discount rates will almost certainly *not* be determinative in  
14 capital investment decisions when combined with the multitude of other considerations  
15 that affect investment commitments. Mr. Applegate's concern that investment will be  
16 affected by potentially slightly higher or lower costs of capital is not only speculative, but  
17 it is based on too narrow a perspective regarding the criteria by which CenturyLink  
18 evaluates investment decisions.

19  
20 **Q. WHAT IS THE FINAL REASON THAT YOU OBJECT TO MR. APPLEGATE'S**  
21 **ASSESSMENT OF THE CREDIT PROFILE OF THE MERGED COMPANY?**

22 A. Mr. Applegate is attempting to assess the possible credit rating of the combined company  
23 at one specific point in time—at the close of the merger. However, Mr. Applegate

1 already has explained that the merged company expects to generate increased efficiencies  
2 and cash flows over time and should have the discretion to pay down debt. The benefit,  
3 therefore, of ongoing improvements in cash flows could *enhance the longer-term credit*  
4 *profile* of the merged company compared with the standalone credit characteristics of  
5 Qwest or CenturyLink. That is, even if a temporary credit downgrade were to occur, it is  
6 expected that CenturyLink will work to regain its investment grade credit rating, possibly  
7 achieving higher ratings and lower capital costs than it would have as a standalone  
8 company. The Joint Applicants believe that the merged company's operating  
9 performance and financial strength will be strengthened materially due to this merger, in  
10 part based on the Company's estimates that the longer-term synergies will generate an  
11 NPV of \$3.3 billion.<sup>31</sup> Sound financial decisions require a longer-term view of whether  
12 the combination benefits customers and the service provider over the foreseeable future.  
13 The Company is confident that the vast majority of Washington customers will benefit  
14 from the combination from day one, and the entire Company's cost of capital will be  
15 improved *relative to what it might have been the case if the merger were not to occur.*

16  
17 **Q. PLEASE COMMENT ON MR. APPLGATE'S ANALYSES RELATED TO**  
18 **ACCESS LINE LOSSES, DECLINING REVENUES, AND THE POSSIBLE**  
19 **IMPACT ON CASH FLOWS AFTER DIVIDENDS.**

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<sup>31</sup> See CenturyLink and Qwest Merger Conference Call, April 22, 2010, [hereafter "Merger Conference Call"]; available at <http://phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MzA0MDUyNnxDaGlsZEIEPTM3ODA0M3xUeXBIPtI=&t=1>, slide 9.

1 A. Mr. Applegate assesses CenturyLink's pro forma combined projection model for the  
2 years 2011 through 2015, and attempts to test certain assumptions included in the Highly  
3 Confidential model used by the Company. Specifically, Mr. Applegate evaluates the  
4 revenue projections and other inputs to judge the relative risk associated with the  
5 Company's projections. I will briefly address certain misunderstandings reflected in Mr.  
6 Applegate's concerns regarding certain model assumptions.

7  
8 First, Mr. Applegate believes that the average monthly revenue per line assumption in the  
9 model is too low because the companies' Washington metrics are higher.<sup>32</sup> The reality is  
10 that the projection model is for the combined company's nationwide operations.  
11 Therefore, the assumption inputs should reflect national data, not Washington-specific  
12 metrics as suggested by Mr. Applegate. In addition, theoretically increasing the average  
13 monthly revenue per line assumption in the model, as Mr. Applegate suggests, while  
14 raising the level of revenues lost due to access line declines, ultimately would result in  
15 greater projected revenues and cash flows for post-merger CenturyLink. This is because  
16 the higher per unit revenue assumption would be multiplied by *all* of the combined  
17 company access lines, generating a revenue increase substantially higher than the  
18 incremental revenue loss used by Mr. Applegate. As such, the actual impact of Mr.  
19 Applegate's suggested theoretical change would be positive, not negative. The answer,  
20 however, is that the average monthly revenue per line assumptions in the model are set  
21 appropriately based on national data, and Mr. Applegate is incorrect in suggesting that  
22 the assumptions should be increased to reflect Washington-specific metrics. The same

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<sup>32</sup> Staff, Applegate, p. 21, lines 7-12.

1 issues can be raised with Mr. Applegate’s contention regarding the margin assumptions  
2 in the CenturyLink forecasts—national, not Washington-specific, inputs must be used in  
3 the total company model, and increasing the assumed margins theoretically would  
4 enhance the combined company’s total EBITDA by a far greater amount than the  
5 incremental margin reduction due to line losses. In any event, accepting for argument’s  
6 sake Mr. Applegate’s approach to adjusting the projections as quantified in his testimony,

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14 XXEND

15 HIGHLY CONFIDENTIAL\*\*\*

16  
17 **Q. MR. APPLGATE ALSO RAISES THE POTENTIAL RISK OF GOODWILL**  
18 **IMPAIRMENT AND NOTES THE INCREASE IN CENTURYLINK’S**  
19 **GOODWILL AS A RESULT OF THE PROPOSED TRANSACTION.<sup>34</sup> ARE THE**  
20 **POTENTIAL CONCERNS RELATED TO GOODWILL LIKELY TO CAUSE**  
21 **HARM TO WASHINGTON CUSTOMERS?**

<sup>33</sup> Staff, Applegate, p. 22, lines 3-5.

<sup>34</sup> Staff, Applegate, p. 20, lines 9-13 and FN 21.

1 A. No. Goodwill is an accounting convention that permits a company to book on its balance  
2 sheet the value of intangible assets that may not be captured in the tangible assets or  
3 liabilities accounts. While goodwill most often is created when a premium is paid in an  
4 acquisition, it is also used to account for the value of licenses, customer lists, or other  
5 intangible assets. By contrast with book accounting conventions, most businesses  
6 generally are valued on the basis of their potential to generate cash flows, regardless of  
7 the tangible or intangible nature of the assets on the balance sheet. Whatever the level of  
8 goodwill on a company's balance sheet, it is the company's ability to generate cash flows  
9 that in most cases will drive the value and sustainability of the business.

10

11 It is correct that, due to current accounting rules, goodwill cannot be amortized on the  
12 income statement, and that a "test" occurs at regular intervals to determine whether the  
13 value captured in goodwill has declined ("goodwill impairment"), which could lead to  
14 lower book earnings if there were a write-down in value. However, the reduction in book  
15 earnings is non-cash in nature, which is the critical insight. If cash is unaffected, then  
16 regardless of changes in the value of goodwill, the same level of cash flows remain  
17 available to fund operating expenses, investment, service of equity and debt, etc.  
18 Investors focus on cash flows. This past summer, CenturyLink disclosed in SEC filings  
19 the estimated goodwill that will be created as a result of the acquisition of Qwest, as Mr.  
20 Applegate notes. However, there was no material negative change in CenturyLink's  
21 share price as a result of this disclosure. Investors understand that the creation of  
22 goodwill and any potential future goodwill impairment charge will have no impact on the  
23 cash flow generation capabilities of the combined company. Changes in the value of

1 goodwill do not, of themselves, create volatility in cash flows or a risk to the economic  
2 value of the company, and therefore, do not create harm for customers.

3  
4 **Q. PLEASE COMMENT ON MR. APPLGATE'S ASSESSMENT OF THE**  
5 **KPNQWEST LITIGATION.**

6 A. Mr. Applegate testifies concerning the pending litigation related to the partnership  
7 between Qwest and the Dutch national telecommunications company, KPN. Mr.  
8 Applegate states that this merger might “expose an even greater portion of Washington  
9 telecommunications services to what would be isolated nonsystematic risks of a single  
10 company.”<sup>35</sup> The Staff financial witness also acknowledges that “the magnitude of [the  
11 litigation’s] impact is neither known nor measurable.”<sup>36</sup> CenturyLink recognizes that  
12 there is a risk that the KPNQwest litigation will result in an adverse outcome. However,  
13 the same risk exists today for Qwest and its customers, which constitute approximately  
14 88% of the pro forma company’s Washington customers. While more customers (the  
15 current CenturyLink Washington customers) would be exposed to the risk in the post-  
16 merger company, the risk would be spread over a larger nationwide customer base,  
17 thereby reducing the per-customer exposure to that risk. Further, the merged company  
18 expects to generate synergies, so that the available cash would presumably render the  
19 Company better able to resolve any negative litigation outcomes, if those were to occur.  
20 On balance, CenturyLink believes that the risk per customer is significantly reduced by  
21 virtue of the merger, which is again a net benefit to Washington customers.

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<sup>35</sup> Staff, Applegate, p. 23 lines 8-10.

<sup>36</sup> Staff, Applegate, p. 23, lines 3-5.

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**III. THE ADDITIONAL FINANCIAL ANALYSES AND  
RECOMMENDATIONS OF MR. VASCONI.**

**Q. ARE THERE SPECIFIC ALLEGED FINANCIAL “RISKS” RELATED TO THE  
PROPOSED TRANSACTION THAT CONCERN MR. VASCONI?**

A. Mr. Vasconi indicates that he has some concern that the estimated synergies will not benefit Washington customers—despite the fact that the Staff lead witness already has asserted correctly that a “no harm” standard of review is applicable—and he is concerned that the combined company eventually will increase rates.<sup>37</sup>

**Q. CAN YOU RESPOND TO MR. VASCONI’S CONCERNS REGARDING  
SYNERGIES, AND WHETHER OR NOT THE SYNERGIES MAY PROVIDE  
BENEFITS TO WASHINGTON CUSTOMERS?**

A. It is somewhat difficult to understand what are Mr. Vasconi’s concerns regarding the expected synergies. On the one hand, Mr. Vasconi seems to be seeking benefits for Washington from the synergies, which would go beyond what is required for approval of the Transaction under the “no harm” standard of review. On the other hand, the Staff lead witness seems concerned that achieving the synergies and enhancing the cash flows of the combined company somehow creates a “risk that maintenance as well as investment in Washington will be reduced.”<sup>38</sup> This second concern appears to be the source of proposed Conditions 43 and 44, which I will address in more detail below. However, the summary response is that the proposed synergy levels are achievable—as

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<sup>37</sup> Staff, Vasconi, p. 10, lines 24-26.  
<sup>38</sup> Staff, Vasconi, p. 11, lines 1-2.

1 Staff witness Mr. Applegate reinforces—and the combined company is expected to  
2 generate sufficient cash flows from operations, regardless of whether or not the synergies  
3 are achieved, so that CenturyLink’s investment in the combined Washington operations  
4 will not be put at risk.

5  
6 **Q. CAN YOU RESPOND TO STAFF WITNESS LIU’S CONCERN THAT**  
7 **CENTURYLINK SHOULD BE REQUIRED TO DEDICATE A “FAIR PORTION**  
8 **OF ITS SYNERGY SAVINGS TO THE STATE OF WASHINGTON”?**<sup>39</sup>

9 A. Yes. First, my understanding is that the Commission is evaluating whether the proposed  
10 Transaction meets a “no harm” standard of review. Staff witness Liu is seeking  
11 incremental assurances and benefits that are not present today, despite the fact that no  
12 related harm resulting from the Transaction has been identified. Second, CenturyLink  
13 has indicated repeatedly that it is committed to funding ongoing network investment that  
14 supports its customers’ demands, as Mr. Jones explains in his testimony. Both  
15 CenturyLink and Qwest have invested significantly and consistently in their Washington  
16 networks in order to provide their customers with access to advanced services. In  
17 addition, CenturyLink understands that the future of the telecommunications industry is  
18 based on broadband, and the Company is committed strategically to expanding its  
19 broadband capabilities. With broadband currently available to approximately BEGIN  
20 HIGHLY CONFIDENTIAL REDACTED END HIGHLY CONFIDENTIAL of Qwest’s  
21 Washington residential households and BEGIN HIGHLY CONFIDENTIAL REDACTED  
22 END HIGHLY CONFIDENTIAL of CenturyLink’s residential households in the

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<sup>39</sup> Staff, Liu, p. 5, lines 8-10.

1 state, the companies have demonstrated their commitment—based on their business  
2 strategies—to invest in Washington. Therefore, based on the Company’s consistent  
3 track-record of investment, CenturyLink believes that the broadband investment  
4 commitment proposed by Staff is unnecessary to assure that the Company will do all in  
5 its power to serve its customers’ needs. Third, CenturyLink is working to achieve  
6 appropriate financial flexibility—which is a fundamental rationale and benefit of the  
7 proposed Transaction—to respond constructively to the Company’s increasingly  
8 competitive markets. I use the word “constructively” because CenturyLink is “building”  
9 the robust cash flows, high-quality assets, sound balance sheet, and experienced  
10 personnel to achieve goals that are entirely consistent with the public interest goals of the  
11 Commission. Specifically, that “construction” includes increased cash flows that should  
12 allow the Company to maintain an appropriately conservative capital structure, respond  
13 to market forces, price competitively, implement new technologies, and attract and retain  
14 a superior workforce. Respectfully, I note that neither the Commission nor CenturyLink  
15 knows what competitive conditions will be in three or five years, as technologies change,  
16 or competitors gain support for services in high-cost regions, or margins compress, or the  
17 federal government alters decades of regulatory systems. CenturyLink is seeking through  
18 this merger to achieve greater flexibility to serve its Washington customers and compete  
19 effectively. As such, micromanagement of the Company’s cash flows through mandated  
20 broadband investment levels has the potential effect of damaging the financial flexibility  
21 that a prudent and long-term communications operator requires and easily could result in  
22 the inefficient deployment of scarce capital resources. Thus, CenturyLink believes that  
23 specific capital commitments can have the unintended consequence of being harmful in a

1 rapidly changing competitive and technologically-driven telecommunications  
2 marketplace. Given these risks and the Company's well-established track-record of  
3 broadband investment in Washington, no capital commitment is required to ensure that  
4 Washington and Washington customers will not be harmed by and in fact will benefit  
5 from the proposed Transaction.

6  
7 **Q. WHAT IS MR. VASCONI'S CONCERN REGARDING POTENTIAL FUTURE**  
8 **RATE INCREASES?**

9 A. Mr. Vasconi indicates that "the merged entity *may attempt* to recover costs associated  
10 with the Transaction through eventual rate increases for residential services or basic  
11 business services." [Emphasis added.] As such, Mr. Vasconi indicates clearly through  
12 the language in his testimony that the rate increase concern is not a harm resulting from  
13 the Transaction, but reflects a speculative possibility that the Company might *attempt* to  
14 change rates in the future.

15  
16 **Q. DOESN'T DOD WITNESS MR. KING RAISE A SOMEWHAT SIMILAR**  
17 **CONCERN THAT THE INTEGRATION WILL REQUIRE INVESTMENT**  
18 **BEFORE THE REALIZATION OF SYNERGIES, CAUSING HIM TO**  
19 **RECOMMEND A THREE-YEAR RATE CAP ON BASIC BUSINESS**  
20 **SERVICES?<sup>40</sup>**

21 A. Yes. Mr. King states that he does "not necessarily" oppose the transaction, as  
22 CenturyLink is a larger, financially healthier company compared with other acquirers of

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<sup>40</sup> DOD, King, p. 17, lines 20-30.

1 ILEC properties, and has a “trouble-free” history.<sup>41</sup> However, Mr. King cites a concern  
2 related to the source of funding for the integration expenses.<sup>42</sup> Mr. King then speculates  
3 that “costs will be incurred before the benefits of the synergies are felt, so that they  
4 represent a new net requirement for funds. Left unstated is where the money for these  
5 transition costs will come from . . . . CenturyLink may look to its local operations,  
6 including those in Washington, to meet the urgent requirement to increase revenue.”<sup>43</sup>  
7 Thus, Mr. King is concerned that “additional revenue” in the form of rate increases will  
8 be required to pay for integration costs.<sup>44</sup>

9  
10 **Q. CAN YOU ADDRESS MR. VASCONI’S AND MR. KING’S CONCERNS**  
11 **REGARDING THE SYNERGIES AND INTEGRATION COSTS, AND**  
12 **WHETHER THESE TRANSACTION-RELATED FACTORS WILL CAUSE THE**  
13 **COMBINED COMPANY TO INCREASE RATES OR REDUCE INVESTMENT?**

14 A. Yes. Regarding potential future rate impacts, Mr. Vasconi and Mr. King are incorrect, as  
15 no rate increases will be required to pay for the Transaction costs or the integration  
16 process. In addition, CenturyLink has indicated clearly that rates, if and when they are  
17 changed, will be altered only in conformity with proper regulatory review and negotiated  
18 terms, as rate changes were handled before the merger. The simple response to the Staff

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<sup>41</sup> DOD, King, p. 11, lines 19-27.

<sup>42</sup> DOD, King, p. 13, lines 2-18.

<sup>43</sup> DOD, King, p. 13, lines 16-18.

<sup>44</sup> DOD, King, p. 16, lines 21-23; “Based on the foregoing, I believe that basic business services are most susceptible to unilateral rate increases motivated by the need to raise revenue to implement the merger.” Mr. King also incorrectly alleges that the post-merger company may need to engage in “cost cutting in the form of reduced resources, including capital investment and the manpower devoted to plant maintenance and customer service.” DOD, King, p. 20, lines 11-13. As indicated, post-merger CenturyLink’s free cash flow generation, even before synergies, will be sufficient to cover the integration costs, making Mr. King’s cost cutting “concern” moot.

1 and DOD witnesses is that post-merger CenturyLink will have the ability to pay for one-  
2 time transaction and integration costs out of pre-synergy cash flow generated by the  
3 combined operations; and network investment will not be put at risk nor will ratepayers  
4 be burdened with one-time merger costs. The Company anticipates generating annual  
5 “excess” free cash flow that, based on 2009 pro forma results *and before including any*  
6 *synergies*, would be \$1.7 billion. This residual cash flow assumes that the Company has  
7 paid all operating expenses, *and* invested approximately \$2.4 billion in capital plant, *and*  
8 met its dividend obligations to equity-holders who supply critical capital. The one-time  
9 integration expenses are expected to be \$650 million to \$800 million, with another \$150  
10 million to \$200 million in one-time capital costs.<sup>45</sup> In addition, the integration expenses  
11 will not occur in a single year immediately after closing, but are expected to be phased-in  
12 over five years, while the one-time capital costs will be incurred over a shorter multi-year  
13 period. CenturyLink believes that the post-merger company will be able comfortably to  
14 fund *one-time* integration and transaction costs, which, at the highest estimated level,  
15 *total* an aggregate \$1.0 billion (the combination of the high figures of the ranges for one-  
16 time integration and capital costs) and are expected to be spread over a multi-year period.  
17 Additionally, as has been the experience of the Company in previous transactions,  
18 including the Embarq acquisition, CenturyLink begins to realize synergies immediately  
19 after the consummation of the merger, providing a still larger buffer for the merged  
20 company to fund one-time integration and transaction costs without reducing network  
21 investment or raising rates. As such, Mr. Vasconi’s speculations regarding rate increases

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<sup>45</sup> DOD, King, p. 12, lines 21-24; Mr. King reports that the high end of the one-time integration costs is \$850, but the announced range is \$650 million to \$800 million, as found in the Merger Conference Call, slide 13.

1 and underinvestment that might harm Washington customers are not based on the  
2 financial data presented in this case, nor are they based on the Company's long record. In  
3 addition, Mr. King's proposed condition requiring a three-year cap on basic business  
4 services rates is entirely unnecessary as his foundational concern about the source of  
5 funding is also contrary to the financial evidence.

6  
7 **Q. GIVEN THE STAFF'S AND MR. KING'S CONCERNS ABOUT THE**  
8 **SYNERGIES, ARE THE PUBLISHED SYNERGY TARGETS**  
9 **EXTRAORDINARILY LARGE OR AGGRESSIVE IN THE PROPOSED**  
10 **TRANSACTION?**

11 A. No, they are not. The reality is that the estimate of \$575 million in operating expense  
12 savings is approximately 7% of Qwest's 2009 cash operating costs. Further, the synergy  
13 targets are modest compared with synergy expectations announced in other ILEC  
14 mergers. Illustrating the reasonableness of the expected synergies for the proposed  
15 Transaction, the estimates (operating costs and capital expenditure savings) as a  
16 percentage of cash operating costs are below the 11% expected cost savings announced  
17 when CenturyTel merged with Embarq, and are well below other merger-related  
18 synergies from ILEC transactions that generally have been 20%+ of the target company's  
19 cash operating costs in recent years, as verified by independent financial analysts.<sup>46</sup> In  
20 addition, as I noted earlier, the Staff financial witness, Mr. Applegate, states that his  
21 "analysis has not indicated any major flaws or weaknesses in CenturyLink's estimated

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<sup>46</sup> Simon Flannery, *CenturyTel: 1Q10 Preview: Awaiting Embarq Synergy/Integration Update and Additional Color on Qwest Deal*, Morgan Stanley Research, North America, April 29, 2010.

1 synergy values” and that the Transaction “undoubtedly presents opportunities to  
2 eliminate redundant functions or to achieve economies of scale.”<sup>47</sup>

3  
4 **Q. DOES THE SYNERGY TARGET CREATE AN INCREMENTAL RISK FOR**  
5 **CLECS, BASED ON INVESTOR EXPECTATIONS, AS SUGGESTED BY MR.**  
6 **GATES?**

7 A. No. Mr. Gates states that the merged company will be seeking “to find synergies [and] it  
8 will be under pressure to produce meaningful dividends, pay down debt and invest in  
9 advanced services” which might result in making wholesale service a “low . . .  
10 priority.”<sup>48</sup> CenturyLink’s management believes the estimated synergies can be achieved  
11 while continuing to provide high-quality service to customers and to invest in the  
12 network. As noted above, using pro forma 2009 financials, *before any expected*  
13 *synergies*, the merged CenturyLink and Qwest estimate that, after meeting all operating,  
14 capital and financial costs, the combined company would have had about \$1.7 billion in  
15 remaining cash flow—without assuming any synergies—that could be used for additional  
16 investment (beyond the \$2.4 billion in capital investment noted above), debt repayment,  
17 and other appropriate uses. As such, CenturyLink expects to be financially sound even if  
18 no synergies are achieved and, therefore, will not be unduly pressured by investors or  
19 other stakeholders. CenturyLink understands its business, and its priorities are aligned  
20 with successfully managing and operating the business in a manner that benefits its  
21 customers and other key stakeholders.

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<sup>47</sup> Staff, Applegate, p. 12, lines 6-9.

<sup>48</sup> Joint CLECs, Gates p. 28, lines 13-16.

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**Q. YOU NOTED ABOVE THAT IT APPEARS THAT MR. VASCONI’S CONCERN REGARDING THE REALIZATION OF SYNERGIES HAS CAUSED HIM TO PROPOSE CONDITIONS RELATED TO CAPITAL INVESTMENT IN WASHINGTON. PLEASE COMMENT ON PROPOSED STAFF CONDITION 43, WHICH REQUIRES THAT, FOR THREE YEARS, CENTURYLINK WOULD INVEST TOTAL ANNUAL CAPITAL EXPENDITURES IN THE WASHINGTON NETWORK NO LESS THAN THE AVERAGE ANNUAL LEVEL INVESTED BETWEEN 2005 AND 2009.<sup>49</sup>**

A. CenturyLink strongly objects to Mr. Vasconi’s proposed condition as quantifiably unreasonable. Staff witness Vasconi proposes that annual capital expenditures in Washington for the combined company should be totaled each year between 2005 and 2009. Then the five-year average annual level of capital expenditures should be computed, and, according to Mr. Vasconi, the post-merger Company should be required to make the same average level of annual investment in Washington for each of the three years following the merger close. However, Mr. Vasconi fails to acknowledge that both CenturyLink and Qwest have had declining numbers of access lines in its regulated business over 2005 to 2009 period and likely will experience ongoing access line contraction over the next years. If Staff’s assumption is that the combined company invested at an appropriate level in 2007 (the middle year of the proposed five-year benchmark period), it should be clear that total investment going forward should be *lower*, all else being equal, because the number of access lines is contracting at a sharp

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<sup>49</sup> Staff, Vasconi, p. 18, lines 20-25.

1 rate and a constant level of total investment would result in rapidly increasing per-line  
 2 investment that is not justified from a financial perspective. A closer examination of a  
 3 simplified illustrative analysis as found in Table 1 reveals the problem with Staff’s  
 4 proposed Condition 43.

**Table 1: Analyzing per line capital expenditures per Staff Condition 43**

	Assumed avg (2005-2009)					Analysis for 2013 or 2014, depending on which is year 3			
	2007	2008	2009	2010	2011	2012	2013	2014	
Assumed annual capex	\$ 10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	\$10,000	
Assumed average lines at 8.5% annual line loss	100	92	84	77	70	64	59	54	
Assumed average capex per line	\$ 100	\$ 109	\$ 119	\$ 131	\$ 143	\$ 156	\$ 170	\$ 186	
% increase per line compared with 2007	0.0%	9.3%	19.4%	30.5%	42.7%	55.9%	70.4%	86.2%	

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7  
8 The analysis begins with illustrative 2007 figures (the middle year of the five-year  
 9 benchmark period, which for lines and capex are assumed to be approximately the  
 10 average for the five-year period), assuming the combined company averaged \$10,000 in  
 11 total capital expenditures and had 100 average access lines in that year. Thus, in 2007 the  
 12 pro forma company would have invested \$100 per average line in the hypothetical  
 13 analysis. If one assumed that access lines were contracting annually at an 8.5% rate, the  
 14 effect by 2013 (if that were the third year according to Condition 43) would be to  
 15 *increase* the investment per line by 70% (that is, 170% of the 2007 capital expenditures  
 16 per line), or to *increase* the investment per line by 86% (that is, 186% of the 2007 capital  
 17 expenditures per line) if 2014 were the third year. The access line contraction might be  
 18 higher or lower than 8.5%, but CenturyLink suggests that 8.5% is a reasonable figure as  
 19 CenturyLink’s pro forma<sup>50</sup> company-wide annual line loss was reported as 8.0% in the

<sup>50</sup> A “pro forma” adjustment is necessary because CenturyLink completed the Embarq acquisition mid-year 2009.

1 second quarter of 2010 and Qwest's current annual rate of total access line decline was  
2 reported at 10.5% in the second quarter of 2010. If an access line loss rate higher than  
3 8.5% were assumed in the illustration, the per-line investment percentage increases  
4 would be *higher still*. Such a formulaic increase in per-line investment would almost  
5 certainly be economically unjustifiable and in all probability requires over-investment  
6 that could harm, not benefit, Washington ratepayers.

7  
8 **Q. ARE THERE OTHER OBJECTIONS TO PROPOSED STAFF CONDITION 43?**

9 A. Yes. There are several other problems with Condition 43. First, capital expenditures in a  
10 state (or on a company-wide basis) are higher or lower in any given year due, for  
11 example, to whether there is a need for replacement of higher-cost components such as  
12 switches, expansion of network because of economic growth, or fiber builds to businesses  
13 or homes, among other factors. It is not prudent for the Commission to compel a  
14 company to dedicate any specific level of capital expenditures, particularly when the  
15 Commission is able to monitor the performance of the network and customer satisfaction  
16 in terms of existing service quality metrics, which are the best test of ongoing service.  
17 Second, ILECs today are operating in a highly competitive business that requires flexible  
18 allocations of capital. Conflicts for the use of capital include capital expenditures in  
19 other jurisdictions (e.g., service centers or transport) which could be beneficial to  
20 Washington customers, debt repayment that ultimately may lower the per-unit costs of  
21 services, the acquisitions of new assets or service capabilities that benefit many or all  
22 customers, among others. Accordingly, a limitation on the allocation of capital is  
23 potentially a harmful approach, particularly when it is clear that customers derive benefits

1 from a variety of uses of capital. Third, it is possible that the investment levels  
2 recommended by Staff will not be reasonable in light of the market demand, and the risk  
3 is that CenturyLink will be required to dedicate capital in Washington in a way that is not  
4 economically justified, as noted above. No such requirement exists at the present, and no  
5 potential harm has been demonstrated to justify such a condition. Finally, it is important  
6 to note that Moody's Investors Service ("Moody's") has indicated that its affirmation to-  
7 date of CenturyTel's credit ratings "assumes that any conditions that may be imposed will  
8 not have a material impact on the Company's financial profile."<sup>51</sup> CenturyLink is  
9 concerned that proposed conditions that have meaningful financial impacts could be  
10 perceived by the credit rating agencies as negatively affecting the Company's financial  
11 profile. Such a result would have the probable effect of increasing the merged  
12 company's cost of capital. CenturyLink believes that this potentially unintended  
13 consequence of certain types of conditions should be given serious consideration by the  
14 Commission. Therefore, Staff's proposed Condition 43 is not acceptable to CenturyLink  
15 because it is inconsistent with the current telecommunications business environment and  
16 is more likely to harm, rather than benefit, Washington customers.

17  
18 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION 44.**

19 A. Mr. Vasconi proposes that maintenance capital expenditures for the CenturyLink and  
20 Qwest operations in Washington should remain at the same level as that of the average

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<sup>51</sup> Moody's Investors Service, "Rating Action: Moody's changes CenturyTel's outlook to negative; reviews Qwest's ratings for upgrade," April 22, 2010, p.1.

1 annual maintenance capital expenditures between the years 2005 and 2009.<sup>52</sup> Proposed  
2 Condition 44, which appears to be a subset of proposed Condition 43, is objectionable for  
3 virtually the same reasons as I outlined above in response to proposed Condition 43.  
4 That is, as access lines contract and maintenance investment is held constant, the growth  
5 in per-line maintenance capital expenditures would be expected to expand at high rates,  
6 similar to the illustration in Table 1, which is unreasonable. As the Commission  
7 understands, maintenance capital expenditures will vary from one year to the next based  
8 on a variety of factors, and an approach that mandates in advance a constant level of  
9 maintenance investment is far too inflexible. Additionally, the Commission has service  
10 quality metrics to ensure that customers' needs are met satisfactorily, which presumably  
11 captures the most important information about whether a carrier is failing to maintain its  
12 network plant. And, finally, no such minimum investment requirement exists in  
13 Washington at the present and there is no defined or even suggested harm resulting from  
14 the Transaction against which proposed Condition 44 protects. It could be suggested that  
15 a required level of maintenance capital expenditures creates risks if the Company is  
16 compelled to divert capital from important other uses to investments that may not be  
17 necessary.

18  
19  
20 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION 45.**

21 A. Mr. Vasconi also sponsors proposed Condition 45 that is effectively a footnote to  
22 proposed Conditions 43 and 44 related to suggested compulsory levels of total and

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<sup>52</sup> Staff, Vasconi, p. 18, lines 26-31.

1 maintenance annual capital expenditures. In spite of the mandated levels of capital  
2 expenditures proposed for total network investment and maintenance expenditures, Mr.  
3 Vasconi also recommends that any incremental investments in digital subscriber line  
4 (“DSL”) technologies in Washington, pursuant to the Staff’s other conditions, should not  
5 be included in the calculations of annual capital expenditures to comply with proposed  
6 Conditions 43 and 44. Proposed Condition 45 is unreasonable. First, investment  
7 required to provide broadband (i.e., DSL) services often includes network maintenance  
8 and upgrades. Second and more fundamentally, CenturyLink objects as Staff’s three  
9 proposed investment conditions (43-45) combine to (i) require the dedication of  
10 unreasonably high levels of per-line investment to network plant, (ii) create an inflexible  
11 micromanagement of the business in a way that currently is not imposed on Qwest or  
12 CenturyLink or other competing carriers in the state, and (iii) restrict the application of  
13 cash resources from other beneficial uses, potentially creating harm for Washington  
14 customers. With respect to this last point, management of CenturyLink constantly  
15 evaluates how much capital to dedicate to operating the business, improving the balance  
16 sheet, preserving or attracting the best employees, researching new products, and  
17 upgrading the network in a variety of ways. The adoption of Mr. Vasconi’s set of three  
18 financial conditions would constrain unnecessarily the Company’s ability to manage its  
19 business in a highly competitive and rapidly changing marketplace.

20  
21 **IV. PERSPECTIVES ON USE OF THE RISK SECTION OF THE FORM S-4**  
22 **IN THIS PROCEEDING.**

1 **Q. SEVERAL OF THE INTERVENOR WITNESSES CITE THE SEC FORM S-4**  
2 **THAT CENTURYLINK FILED ON JULY 16, 2010, NOTING THE “RISK**  
3 **FACTORS” ASSOCIATED WITH THE TRANSACTION AS REASONS TO BE**  
4 **CONCERNED. CAN YOU RESPOND?**

5 A. Yes. Obviously, there are numerous benefits associated with the Transaction, which also  
6 are detailed in the CenturyLink S-4 and in the CenturyLink and Qwest testimonies in this  
7 proceeding. Mr. Applegate includes the “Risk Factors” from CenturyLink’s Form S-4 in  
8 his Exhibit RTA-4, and he states that “this section has an intended audience of securities  
9 regulators and the broader investment community, [but] this Commission should  
10 consider the risks it discloses.”<sup>53</sup> Certain other intervenor witnesses discuss the “Risk  
11 Factors” as if CenturyLink is suggesting some degree of probability that OSS systems  
12 will be changed or that integrations or other risks noted are *likely* problems.<sup>54</sup> That is  
13 categorically untrue. It is important to understand the purpose of the “Risk Factors”  
14 section in SEC filings by companies with publicly-traded securities. These items are  
15 mentioned as a matter of full disclosure of any and all potential risks to shareholders, as  
16 would be included in any public company’s SEC Form S-4 or annual Form 10-K. As  
17 described, these “Risk Factors” represent general recitals of potential risks of which  
18 companies and the public are generally well aware. The disclosure of “Risk Factors”  
19 provides legal protection to investors and to a company whose securities are publicly-  
20 traded; but the disclosures are not intended to suggest that the risks are likely outcomes.  
21 Mr. Applegate is correct when he testifies that it is important to understand the purpose

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<sup>53</sup> Staff, Applegate, p. 7, lines 16-18.

<sup>54</sup> Joint CLECs, Ankum, p. 50, lines 1-28; Dr. Ankum cites risks related to expenses to argue that CenturyLink “has put CLECs on notice to expect changes.”

1 of the “Risk Factors” section in SEC filings by companies with publicly-traded  
2 securities. As noted previously, CenturyLink has a long history of successfully executing  
3 ILEC transactions, a fact that underscores that the Company fully understands the  
4 importance of the customer, and is capable of managing operating risks, and delivering  
5 superior service through these types of combinations. In summary, there is no evidence  
6 that failures or problems occurred in previous CenturyLink transactions in spite of the  
7 disclosure of similar “Risk Factors” in prior SEC filings, and CenturyLink believes there  
8 is little likelihood that those types of problems will occur in the proposed Transaction. I  
9 also believe that, if undue emphasis were placed upon the “Risk Factors” filed with the  
10 SEC, mergers and financings for new investment likely would never occur. As noted  
11 earlier, despite the cited “Risk Factors,” recently the shareholders of CenturyLink and  
12 Qwest overwhelmingly approved the proposed transaction because they concluded that  
13 the likely benefits of the proposed merger outweighed the potential risks.

14  
15 **Q. ARE ALL OF THE S-4 RISK FACTORS THE RESULT OF THE PROPOSED**  
16 **TRANSACTION?**

17 A. No. In fact, the S-4 operating risks cited include those that are industry-related as well as  
18 transaction-related. CenturyLink and Qwest will face many of the potential risks with or  
19 without the merger, that is, the companies may not be able to retain key employees;  
20 access lines losses could lead to financial pressures; competitive pressures could  
21 intensify; technology changes could put the companies at risk; the industry is undergoing  
22 change and the companies cannot assure that their diversifications will be successful; the  
23 companies may not be able to grow through future acquisitions; in the future, the

1 relationship with other key communications companies may be at risk; and network  
2 disruptions could harm performance. Mr. Applegate notes, in particular, certain  
3 integration-related risks listed in the S-4, noting that CenturyLink may be subjected to  
4 conditions by regulatory authorities; CenturyLink will incur substantial merger-related  
5 expenses; the Company may not be successful in integrating the businesses such that it  
6 can realize anticipated benefits; CenturyLink will serve additional urban markets where it  
7 has less experience competing; and future results may be affected if CenturyLink does  
8 not effectively manage expanded operations.<sup>55</sup> If one considers many of the potential  
9 risks outlined above, it is apparent that these are general disclosures of what might go  
10 wrong in any business in the telecommunications industry, and the merger-related items  
11 are potential costs which are typical in any combination, against which the thoughtful  
12 investor or observer or manager will weigh the potential benefits associated with greater  
13 efficiencies and capabilities. When CenturyLink operates its business or engages in  
14 acquisitions, the Company works to identify any and all potential risks. To point to the  
15 “Risk Factor” discussion in the S-4 filing does not provide any evidence that the  
16 intervenors or Staff have assessed the risks. The Joint Applicants’ boards of directors,  
17 management and investors believe that the potential risks are manageable and there is a  
18 net benefit to the Company’s core operations—serving the customer base—in moving  
19 forward.

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<sup>55</sup> Staff, Applegate, p. 8, lines 1-16.

1           **V.    THE CLECS' RECOMMENDATION THAT CENTURYLINK AND**  
2                           **QWEST SHOULD BE REQUIRED TO SHARE SYNERGY SAVINGS**  
3                           **WITH WHOLESALE CUSTOMERS.**

4   **Q.    PLEASE RESPOND TO THE INTERVENOR WITNESSES WHO ARGUE THAT**  
5           **THE COMMISSION SHOULD REQUIRE SHARING OF THE FINANCIAL**  
6           **BENEFITS OF THE MERGER?**

7    A.    Dr. Ankum, Mr. Gates and Mr. Appleby each argue that wholesale customers should  
8           “share” in the benefits that flow from the merger. Mr. Appleby testifies that his  
9           company, Sprint Nextel, seeks not only to be protected from risks associated with the  
10          Transaction, but also that Sprint Nextel should be a direct beneficiary of lower wholesale  
11          rates resulting from an allocation of merger synergy savings that are calculated on the  
12          basis of Washington’s percentage of the total company’s access lines.<sup>56</sup> Dr. Ankum  
13          testifies similarly: “And without a concrete commitment that allows CLECs to *rightfully*  
14          *share in the cost-savings* the combined company achieves, this will be very low on  
15          CenturyLink’s priority list post-transaction.”<sup>57</sup> [Emphasis added.] Mr. Gates argues that  
16          “CenturyLink should not be permitted to keep all of the benefits of increased economies  
17          and efficiencies for itself.”<sup>58</sup> As such, the intervenor witnesses are not satisfied that the  
18          Commission should find “no harm,” consistent with the Washington standard of review.  
19          In contrast, the Joint CLEC intervenors contend that the Commission should permit

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<sup>56</sup> Sprint Nextel, Appleby, p. 21, lines 2-7.

<sup>57</sup>Joint CLECs, Ankum, p. 64, lines 4-7.

<sup>58</sup>Joint CLECs, Gates, p.114 lines 10-12; Mr. Gates footnotes the concept, citing to the FCC’s *Local Competition Order* (“Order”) from 1996, ¶11, and his footnote selectively states “...the local competition provisions of the Act require that these economies be shared with entrants.” In reality, the Order’s paragraph concerns setting initial rules based on “economies of density, connectivity, and scale [that have] traditionally . . . been viewed as creating a natural monopoly.” Nowhere does the FCC’s Order suggest that there should be a sharing of economic benefits resulting from a merger.

1 competitive and wholesale carriers to share in the direct financial benefits of the  
2 Transaction. CenturyLink disagrees. CenturyLink believes that the Company should be  
3 subject to the same regulations and agreements that are currently in force, but should not  
4 be obligated to make additional financial concessions that protect against no probable  
5 harms. In fact, there are more appropriate venues for resolving rate issues or enforcing  
6 negotiated agreements, and CenturyLink submits that a merger proceeding is not the  
7 forum to alter rules, terms and regulations.

8  
9 **Q. PLEASE RESPOND TO CERTAIN INTERVENOR WITNESSES' ARGUMENT**  
10 **THAT THE MERGED COMPANY SHOULD "SHARE" DIRECTLY WITH**  
11 **WHOLESALE CUSTOMERS THE FINANCIAL BENEFITS THAT FLOW**  
12 **FROM THE PROPOSED TRANSACTION.**

13 A. CenturyLink believes that the intervenors have no right to claim a financial share of the  
14 efficiencies or other benefits. First, CenturyLink believes that the Commission is  
15 evaluating this Transaction to determine whether the merger results in "no harm," in part  
16 as measured by the merged company's financial capabilities. Second, the intervenors  
17 here are recommending the redirection of cash flows narrowly to benefit CLECs and  
18 other wholesale customers, in spite of the fact that wholesale-specific synergies are  
19 estimated to be only approximately 2% of the entire synergy savings. Third,  
20 CenturyLink and Qwest are committed to achieving financial flexibility to respond to its  
21 customers and market conditions—through improved balance sheet characteristics,  
22 network investment, more compelling service offerings, or some combination of these or  
23 other benefits. Importantly, the two Joint Applicants have made a commitment to merge,

1 to bear the integration risk, and to create a stronger service provider for the benefit of all  
2 Washington customers. On the contrary, the Joint CLECs are not putting any capital at  
3 risk as part of the proposed Transaction, are not incurring any of the transaction costs,  
4 and are not taking any of the risks to create a stronger service provider for Washington.  
5 As such, there is no rational basis for directing a dedicated new financial benefit from the  
6 Transaction to wholesale and CLEC customers.

7  
8 **Q. AS AN ELEMENT OF ANALYZING WHETHER THE COMMISSION**  
9 **“SHOULD CONSIDER . . . IF CENTURYLINK SHOULD BE REQUIRED TO**  
10 **SHARE MERGER SYNERGIES WITH ITS WHOLESALE CUSTOMERS,” MR.**  
11 **APPLEBY POINTS TO CENTURYLINK’S “HIGH” DIVIDEND.<sup>59</sup> CAN YOU**  
12 **COMMENT?**

13 A. Yes. Mr. Appleby is focused on reducing access rates in Washington; CenturyLink  
14 believes that a merger proceeding is not the correct venue for building such a record or  
15 determining access rates. Second, Mr. Appleby testifies about economic costs in a  
16 narrow manner, which does not include any analysis of the network investment costs that  
17 are real “economic” costs that, due to policy decisions, historically have been matched in  
18 part with access revenues.<sup>60</sup> Third, if Mr. Appleby is correct about the economic windfall  
19 in combining long-distance services with local access operations, it is difficult to  
20 understand why Verizon Communications Inc.’s (“Verizon”) or Sprint Nextel itself  
21 divested ILEC operations over recent years. The answer is, of course, that ILEC

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<sup>59</sup> Sprint Nextel, Appleby, p. 17, line 11 through p. 18, line 6.

<sup>60</sup> Sprint Nextel, Appleby, p. 6, lines 10-11.

1 operations are very costly to build and maintain, particularly in a period in which wireless  
2 operators, such as Sprint Nextel, are capturing significant market share in terms of “lines”  
3 and minutes. The economic windfall does not exist in spite of Mr. Appleby arguments,  
4 and the actions of Verizon and Sprint Nextel regarding their ILEC operations are tangible  
5 evidence of that fact. Fourth, to justify his access-related arguments, Mr. Appleby raises  
6 a non-access issue (CenturyLink’s dividend policy) to argue that the Company is  
7 generating excess profits.

8  
9 **Q. IS THE LEVEL OF CENTURYLINK’S DIVIDEND AN INDICATION THAT**  
10 **THE COMPANY HAS EXCESS PROFITS?**

11 A. No. CenturyLink’s dividend level is appropriate in a slow growth industry. However,  
12 Mr. Appleby urges the Commission to reflect on the “high level” of CenturyLink’s  
13 dividend, as he apparently believes the dividend is an indication that the Company is  
14 generating profits that should be shared with wholesale customers.<sup>61</sup> In response,  
15 CenturyLink reaffirms that equity investors deserve to be compensated for their capital,  
16 just as debt-holders deserve to be paid interest. Dividends are an important component in  
17 paying for the use of equity capital in an industry—such as wireline  
18 telecommunications—in which earnings growth (in normal economic and market  
19 conditions often a proxy for share-price appreciation potential) is slow. Retaining ready  
20 access to capital is important in a capital-intensive business. CenturyLink’s equity  
21 investors are provided a competitive, market-based return, while additional free cash flow  
22 prudently is retained for network investment, debt reduction, or other appropriate uses.

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<sup>61</sup> Sprint Nextel, Appleby, p. 25, lines 5-17.

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**Q. IS THE CENTURYLINK DIVIDEND TOO HIGH AND DOES IT REPRESENT A RISK?**

A. No. CenturyLink pays dividends out of cash flows available after meeting all other obligations including the costs of operating the business and capital investment. The Company believes it has adopted a prudent approach as it pays dividends at a level that, as a percentage of its free cash flow, is *lower* than that paid by any of its peers. Specifically, the merged company’s pro forma dividend payout ratio (dividends paid divided by free cash flow after operating costs and capital expenditures are paid), based on 2009 figures and before any assumed synergies, is estimated to be approximately 50.4%, which is lower than the ratio for Windstream Corporation, d/b/a Windstream Communications (“Windstream”) (53% at year end 2009) and Frontier Communications Corporation (“Frontier”) (60%), which are the peer companies in the wireline-only industry.<sup>62</sup> Additionally, AT&T’s payout ratio at year-end 2009 was 56%, while Verizon’s payout ratio was 71%. And, assuming that the merged company is able to achieve estimated synergies, CenturyLink’s payout ratio, based on pro forma 2009 cash flows, is expected to be 45.1%, making it even lower (better) when compared with the merged company’s peers. Without appropriate levels of dividend payments, the Company would be subjected to higher capital risks. The Company is confident that its dividend policy is conservative compared with other peer carriers.

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<sup>62</sup> Merger Conference Call, slides 7 and 11.

1 **Q. IS MR. APPLEBY CORRECT WHEN HE ARGUES THAT CENTURYLINK**  
2 **SHOULD BE COMPARING ITS DIVIDEND POLICY TO THE BROADER**  
3 **STANDARD & POOR'S ("S&P") 500 AND NOT SIMPLY TO OTHER ILECS?<sup>63</sup>**

4 A. No. The characteristics of other companies in the S&P 500 vary widely in terms of  
5 potential for stock price appreciation, risk, capital intensity and other factors. The  
6 appropriate comparison is always to the peer group to determine how investors view a  
7 specific industry and the way in which they expect to be compensated. In fact, financial  
8 analysts, who advise institutional and retail investors, focus their analysis and  
9 publications on specific industries because the appropriate investor comparisons are  
10 within an industry group, and then they compare the risks, opportunities, valuations, and  
11 competitive performance of those industries relative to the overall market. The correct  
12 comparison of payout ratios is to the industry peers and CenturyLink's ratio is more  
13 favorable (meaning a lower percentage of free cash flow is paid out to shareholders) than  
14 the ratios at Windstream and Frontier, which are peer companies, and more favorable  
15 even than the ratios at AT&T and Verizon.

16

17 **Q. CAN YOU COMMENT ON MR. APPLEBY'S ANALYSIS OF CENTURYLINK'S**  
18 **STOCK PRICE APPRECIATION?**

19 A. Yes. Mr. Appleby argues that the level of the dividend cannot be explained by the slow  
20 growth in the industry as CenturyLink's stock price has outperformed the level of  
21 appreciation of the S&P 500 over the recent year and five years.<sup>64</sup> The argument ignores

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<sup>63</sup> Sprint Nextel, p. 26, lines 1-15.

<sup>64</sup> Sprint Nextel, Appleby, p. 26, line 16 through p. 29, line 7.

1 significant factors related to why the CenturyLink share price outperformance has  
2 occurred. Specifically, the financial market conditions and overall economic  
3 environment of the last two years (the “Great Recession”) have been far from typical.  
4 Profound fear has driven many investors out of the stock market entirely, and has caused  
5 a flight from investments that are dependent on economic growth to investments that are  
6 more “defensive.” Thus, slower-growth and higher-dividend stocks of companies that  
7 are less cyclical in nature (such as telecom companies) have performed relatively better  
8 than the overall market in this extraordinarily difficult investment period. There is no  
9 question, however, that investors in a normal market environment will evaluate total  
10 expected compensation for the use of their capital—calculating likely price appreciation  
11 (typically based on growth prospects), dividend yields, risk and other factors. Mr.  
12 Appleby is incorrect when he argues that dividend levels are not matched with stock price  
13 appreciation to determine overall expected equity returns, and his relative performance  
14 “analysis” is based on and influenced by a highly distorted market environment.

15  
16 **VI. OTHER FINANCIAL ISSUES RAISED BY INTERVENOR WITNESSES**

17 **Q. PLEASE COMMENT ON THE CONCERNS RAISED BY THE INTERVENOR**  
18 **WITNESSES REGARDING THE POTENTIAL RISKS DUE TO INCREASED**  
19 **LEVELS OF DEBT ON THE MERGED COMPANY’S BALANCE SHEET.**

20 A. Representing the CLECs, Mr. Gates testifies that CenturyLink “will have *more than*  
21 *quadrupled* its debt load in approximately three years.”<sup>65</sup> [Emphasis in the original.]  
22 What Mr. Gates fails to mention is that the merged company will be far larger, and, as

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<sup>65</sup> Joint CLECs, Gates, p. 78, lines 17-18.

1 important, will generate significantly larger levels of cash flows to service its debt.  
2 Illustrating the proportionate growth in operating cash flow to support investment and  
3 debt, CenturyLink's EBITDA at the end of 2006 was \$1.2 billion and, at the end of 2007,  
4 EBITDA was \$1.3 billion, while the pro forma EBITDA for the combined company at  
5 the end of 2009 was approximately \$8.2 billion.<sup>66</sup> Accordingly, the pro forma 2009  
6 EBITDA is higher by 6.9 times from 2006 and by 6.2 times from 2007. Further, the  
7 Company intends within three-to-five years to generate synergies that will result in  
8 annual operating cash flows that improve by \$575 million and an annual capital  
9 expenditure benefit that is estimated at \$50 million. Thus, the Company expects to  
10 produce operating cash flows that permit incremental reductions of debt and incremental  
11 investments in plant and services. This increased capacity to strengthen the merged  
12 company's balance sheet is a financial benefit for customers, employees and all the other  
13 stakeholders.

14  
15 **Q. CAN YOU PROVIDE ADDITIONAL COMMENT ON THE DEBT LEVERAGE**  
16 **OF THE PRO FORMA COMPANY?**

17 A. Yes. While CenturyLink's pro forma net leverage (Net Debt-to-EBITDA) will rise  
18 modestly in the near term from the current level of 2.0 times, the Net Debt-to-EBITDA  
19 for Qwest should be reduced through the combination. Qwest's net leverage is expected  
20 to improve from 2.7 times at the end of 2009 to the pro forma 2009 net leverage for the

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<sup>66</sup> The EBITDA in 2006 (in thousands) was \$1,189,044 and in 2007 was \$1,329,333; see 2007 CenturyTel SEC Form 10-K, available at <http://www.sec.gov/Archives/edgar/data/18926/000001892608000004/form10k2007.htm>; 2006 D&A was \$523,506 and operating income was \$665,538, while 2007 D&A was \$536,255 and operating income was \$793,078.

1 merged company, which is estimated to be 2.4 times before including the positive impact  
2 of expected synergies and 2.2 times after including the full run-rate synergies.<sup>67</sup> The  
3 combined company's leverage level is more favorable, even before synergies, than the  
4 2009 net leverage of the two most comparable companies in the incumbent local  
5 exchange carrier industry—Windstream and Frontier—and, again, is better than that of  
6 Qwest.<sup>68</sup> If the Commission considers that, at the end of 2009, approximately 88% of the  
7 pro forma company's Washington customers (those from legacy Qwest) will be served by  
8 a merged company with a net leverage ratio *below* that of Qwest today, the conclusion  
9 should be that this improved leverage ratio is a net benefit for the vast majority of the pro  
10 forma company's customer base. In addition, as I have stated, the combined company is  
11 not acquiring any new debt as the Transaction is a stock-for-stock merger, and the  
12 combined company is positioning itself to generate incremental cash flows through  
13 synergies and incremental revenues from expanded service offerings based on the  
14 combination of CenturyLink and Qwest assets.

15  
16 **Q. IS IT CORRECT THAT THE MERGED COMPANY'S DEBT MAY NOT BE**  
17 **RATED INVESTMENT GRADE AFTER THE CLOSE OF THE**  
18 **TRANSACTION?**

19 A. Yes, it is possible that one or several of the credit rating agencies could rate the merged  
20 company's debt below investment grade. It also is possible that some of the merged  
21 company's debt could be rated investment grade and that other debt could be rated non-

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<sup>67</sup> See Merger Conference Call, slides 7 and 12.

<sup>68</sup> Merger Conference Call, slide 12.

1 investment grade (as is the case with Qwest today). As explained above, Qwest, which  
2 will contribute approximately 88% of the pro forma company's Washington lines, is  
3 expected to have a stable or higher credit rating, *which presumably will not slip*, since it  
4 is combining with a company that has a higher credit rating. In fact, all three of the major  
5 credit rating agencies have noted that Qwest's debt possibly could be upgraded in the  
6 future as a result of the proposed Transaction. Moody's, at the time of its recent upgrade  
7 of Qwest's debt to one step below investment grade, stated that Qwest's ratings *remain*  
8 *on review for upgrade*, as the planned acquisition "could lead to a further improvement in  
9 Qwest's credit profile."<sup>69</sup> In addition, S&P revised its outlook on Qwest's debt to  
10 "CreditWatch Positive" on April 22, 2010, when the Qwest-CenturyLink merger was  
11 announced, because of S&P's assessment that the combination might result in improved  
12 financial characteristics for Qwest.<sup>70</sup> Finally, Fitch Ratings improved its outlook on  
13 Qwest's ratings to "Watch Positive" that same day, again as a result of the announced  
14 combination.<sup>71</sup> The possible improved credit rating for the state's largest  
15 telecommunications carrier immediately after the close of the proposed Transaction is  
16 clearly a significant net benefit to Washington customers.

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<sup>69</sup> "Moody's upgrades Qwest rating," Bloomberg BusinessWeek, August 13, 2010, available at <http://www.businessweek.com/ap/financialnews/D9HINI3G0.htm>.

<sup>70</sup> Standard & Poor's Global Credit Portal, Ratings Direct, "Qwest 'BB' Rating On Watch Positive," April 22, 2010, p. 2.

<sup>71</sup> Fitch Ratings, *Fitch Places CenturyTel's Ratings on Watch Negative; Qwest's Ratings on Watch Positive*, April 22, 2010.

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**VII. STAFF RECOMMENDATIONS REGARDING PROPOSED FINANCIAL CONDITIONS.**

**Q. PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO. 1 THAT PRINCIPALLY REQUIRES QUARTERLY REPORTING OF THE MERGED COMPANY’S INTERCOMPANY TRANSACTIONS INVOLVING THE WASHINGTON SUBSIDIARIES.**

A. Staff Condition No. 1 proposes that, for five years following the merger close, the merged company and the operating companies in Washington shall “submit quarterly reports to the Commission listing for each entity the account balances of intercompany receivables and payables, including the beginning balance of each, the change for the quarter and the ending balance [and] . . . for each quarter the dividend that CenturyLink declares to be paid to its shareholders (in total and per share).”<sup>72</sup> CenturyLink and Qwest currently provide reports to the Commission that include data regarding intercompany transactions. In addition, information regarding CenturyLink’s dividend payments is readily available to the public in SEC filings. As such, CenturyLink believes that this proposed Condition adds unnecessary costs to the merged company, and therefore potentially harms Washington customers. CenturyLink and Qwest comply, and will continue to comply, with all statutes and regulations that apply regarding intercompany transaction reporting and the reporting of dividend payments.

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<sup>72</sup> Staff, Vasconi, p. 19, lines 8-20.

1 **Q. PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO.**  
2 **2 THAT REQUIRES THAT WASHINGTON CUSTOMERS SHOULD NOT**  
3 **BEAR ANY HIGHER CAPITAL COSTS THAT OCCUR AS A RESULT OF THE**  
4 **PROPOSED TRANSACTION.**

5 A. The Staff proposes that future analyses of “cost of capital for the purposes of any results  
6 of operations must be based upon ‘investment grade’ debt and equity.”<sup>73</sup> Staff points to  
7 CenturyLink’s current investment grade debt rating, and notes that Washington  
8 customers should not be required to bear higher capital costs that might result from the  
9 proposed Transaction. CenturyLink objects to proposed Staff Condition No. 2, which is  
10 unclear and possibly could deprive the Company of important rights. First of all,  
11 CenturyLink assumes that proposed Condition No. 2 refers only to “investment grade”  
12 debt as the Company is unaware of any investment institution that provides “investment  
13 grade” equity ratings. Second, CenturyLink believes that it is unreasonable for the Staff  
14 to request the Company to forfeit its rights to include its actual costs, including cost of  
15 capital, in future regulatory proceedings. The reality is that Qwest’s Washington  
16 customers (88% of the pro forma company’s lines in the state) will benefit from a  
17 potentially *improved cost of capital* due to the Transaction. So, while legacy  
18 CenturyLink Washington customers (12% of the pro forma company’s lines in the state)  
19 potentially may incur a slightly higher cost of capital at the outset, the net effect should  
20 be no significant change in the cost of capital, if one averages the effect over all  
21 Washington customers. As such, proposed Condition No. 2 does not address any likely  
22 harm to Washington customers and, therefore, is unnecessary. In addition, CenturyLink

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<sup>73</sup> Staff, Vasconi, p. 19, lines 21-26.

1 believes that the computation of the hypothetical cost of capital that is “a result of this  
2 transaction” is an exercise that could cause confusion, dispute and frustration because of  
3 the ambiguities surrounding such a calculation. Third, CenturyLink notes that there are  
4 many factors affecting credit ratings, including the credit agencies’ view of the entire  
5 industry, overall market conditions, as well as factors that are specific to the Company.  
6 This proposed Condition invites disputes over whether and how much the Transaction, as  
7 an independent factor, affects the combined company’s subsequent credit rating, and  
8 what the standalone companies’ credit ratings might have been absent the Transaction.  
9

10 **Q. PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO.**  
11 **4 THAT SUGGESTS THAT CENTURYLINK SHOULD REPORT TO THE**  
12 **COMMISSION ON THE REALIZATION OF “SYNERGY SAVINGS”**  
13 **RESULTING FROM THE PROPOSED TRANSACTION.**

14 A. CenturyLink notes that such reporting is very difficult to track as the Company does not  
15 have specific systems for verifying and reporting on a semi-annual basis “[c]osts and  
16 projected savings associated with each respective activity on a CenturyLink total  
17 company basis; . . . [c]onsolidation and organizational changes to network operations and  
18 staffing levels in the Washington operations; . . . [and i]mpacts on Washington operations  
19 and customers.”<sup>74</sup> Not only is the condition vague and overly broad (e.g., “impacts on  
20 Washington operations and customers”), but, as time passes, it will become increasingly  
21 difficult to discern what is a merger-related synergy and what is an ongoing business  
22 decision. Finally and possibly more fundamental, proposed Condition No. 4 does not

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<sup>74</sup> Staff, Vasconi, p. 20, lines 6-11.

1 protect against any defined potential harm to Washington or Washington customers. If  
2 the proposed condition is somehow related to concerns regarding service quality, there  
3 are service quality standards and reporting requirements that provide more direct and  
4 helpful information to the Commission. As such, Staff's proposed Condition No. 4 is  
5 unnecessary and should not be adopted by the Commission.

6  
7 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION NO. 5 THAT**  
8 **REQUIRES THE MERGED COMPANY TO HOLD HARMLESS RETAIL AND**  
9 **WHOLESALE CUSTOMERS FOR "INCREASES IN OVERALL**  
10 **MANAGEMENT COSTS THAT RESULT FROM THE TRANSACTION."**<sup>75</sup>

11 A. As part of a comprehensive settlement agreement recommending an approval of the  
12 proposed Transaction, CenturyLink could agree to a condition similar to Staff's proposed  
13 Condition No. 5, if that Condition is defined more specifically so that the Company  
14 agrees not to seek recovery from its customers of any corporate overhead allocated  
15 Transaction-related costs. CenturyLink does not agree to forfeit rights to set its prices at  
16 levels that compensate the Company for factors other than the defined corporate overhead  
17 allocated Transaction-related costs.

18  
19 **Q. PLEASE COMMENT ON STAFF'S PROPOSED FINANCIAL CONDITION NO.**  
20 **6 THAT REQUIRES THAT THE MERGED COMPANY WILL NOT SEEK TO**  
21 **RECOVER "ANY SEPARATION, BRANDING AND TRANSITION COSTS."**<sup>76</sup>

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<sup>75</sup> Staff, Vasconi, p. 20, lines 12-15.

<sup>76</sup> Staff, Vasconi, p. 20, lines 16-28.

1 A. As part of a comprehensive settlement agreement recommending an approval of the  
2 proposed Transaction, CenturyLink could agree to a condition similar to Staff's proposed  
3 Condition No. 6.

4

5 **Q. PLEASE COMMENT ON STAFF'S PROPOSED FINANCIAL CONDITION NO.**  
6 **7 THAT REQUIRES THAT "CENTURYLINK MAY NOT ENCUMBER THE**  
7 **WASHINGTON ASSETS" OF THE MERGED COMPANY.<sup>77</sup>**

8 A. CenturyLink believes that Staff's proposed Condition No. 7 is unnecessarily broad and  
9 would limit the Company's flexibility to manage its operations in order to best meet  
10 customer needs and respond to changing market conditions. Staff has not demonstrated  
11 any harm to Washington or Washington customers resulting from the proposed  
12 Transaction that would require imposition of such a condition. The Company would be  
13 willing to agree, as part of a comprehensive settlement agreement recommending an  
14 approval of the merger, that it would not encumber the combined company's Washington  
15 assets except as allowed by Chapter 80.08 of the Revised Code of Washington.

16

17 **Q. PLEASE COMMENT ON STAFF'S RECOMMENDED FINANCIAL**  
18 **CONDITION NO. 8 THAT PROPOSES THAT "[W]ITHIN 30 DAYS AFTER THE**  
19 **DAY THE TRANSACTION CLOSES, CENTURYLINK MUST NOTIFY STAFF**  
20 **OF THE CENTURYLINK POST-TRANSACTION CONSOLIDATED NET**  
21 **DEBT/EBITDA AND THE PRICE PER SHARE USED TO DETERMINE**

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<sup>77</sup> Staff, Vasconi, p. 20, lines 29-31.

1           **TRANSACTION SHARES AND THE CALCULATION OF THE SHARE**  
2           **PRICE.”<sup>78</sup>**

3    A.     As part of a comprehensive settlement agreement recommending an approval of the  
4           proposed Transaction, CenturyLink could agree to a condition similar to Staff’s proposed  
5           Condition No. 8. CenturyLink will be able to report the share price on the closing date,  
6           but notes that price per share is not material in this Transaction as there is no variability  
7           in the stock-for-stock exchange ratio. Rather, the exchange ratio already has been fixed  
8           as part of the merger agreement—Qwest shareholders will receive 0.1664 shares of  
9           CenturyLink shares (New York Stock Exchange (“NYSE”)—ticker symbol “CTL”) for  
10          each Qwest share (NYSE—ticker symbol “Q”) they hold. Therefore, the share price  
11          information included as part of proposed Condition No. 8 appears to be unnecessary.

13   **Q.     PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO.**  
14   **9 RELATED TO AFFILIATED INTEREST TRANSACTION FILINGS.**

15   A.     Staff proposes that “[f]or all affiliated interest transaction filings under WAC 480-120-  
16          375, CenturyLink ILECs and Qwest must: a. Certify in the cover letter for the filing that  
17          the transaction complies with 47 C.F.R. 32.27 (“Transactions with affiliates”); b.  
18          Determine that the cost of the transaction is reasonable and consistent with the public  
19          interest and, upon request of Staff, CenturyLink, a CenturyLink ILEC, or Qwest, provide  
20          cost support documentation prior to the effective date of the transaction.”<sup>79</sup> CenturyLink  
21          believes that proposed Condition No. 9 is a non-issue, as CenturyLink and Qwest have

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<sup>78</sup> Staff, Vasconi, p. 20, line 32 through p. 21, line 2.

<sup>79</sup> Staff, Vasconi, p. 21, lines 3-11.

1 complied, and will continue to comply, with all statutes and regulations that apply to  
2 reporting affiliated interest transactions. However, it is unclear what is involved in  
3 supplying “cost support documentation” as proposed in this Condition. To the extent this  
4 condition is intended to impose additional affiliate interest reporting and approval  
5 requirements, CenturyLink is opposed to such provisions. A merger approval proceeding  
6 is not the appropriate forum for placing additional requirements beyond the  
7 Commission’s current rules when there has been no demonstration of any potential harm  
8 in this area resulting from the Transaction  
9

10 **Q. PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO.**  
11 **10 REGARDING THE REQUIREMENT TO NOTIFY THE COMMISSION**  
12 **ABOUT ANY MATERIAL CHANGE IN THE TRANSACTION TERMS OR**  
13 **CONDITIONS.**

14 A. As part of a comprehensive settlement agreement recommending an approval of the  
15 proposed Transaction, CenturyLink could agree to a condition similar to Staff’s proposed  
16 Condition No. 10.  
17

18 **Q. PLEASE COMMENT ON STAFF’S PROPOSED FINANCIAL CONDITION NO.**  
19 **11 REGARDING THE REQUIREMENT TO MAINTAIN BOOKS CONCERNING**  
20 **“WASHINGTON-SPECIFIC DATA THAT IS BEING REPORTED CURRENTLY**  
21 **BY CENTURYLINK ILECS AND QWEST.”<sup>80</sup>**

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<sup>80</sup> Staff, Vasconi, p. 21, lines 22-26.

1 A. As part of a comprehensive settlement agreement recommending an approval of the  
2 proposed Transaction, CenturyLink could agree to a condition similar to Staff's proposed  
3 Condition No. 11, if this Condition means that CenturyLink will continue to report data it  
4 has reported up to the present and Qwest will report data it has reported up to the present.

5  
6 **Q. PLEASE COMMENT ON STAFF'S PROPOSED FINANCIAL CONDITION NO.**  
7 **13 REGARDING THE REQUIREMENT THAT THE COMBINED COMPANY'S**  
8 **WASHINGTON OPERATING SUBSIDIARIES PROVIDE AN ANNUAL**  
9 **REPORT DETAILING VARIOUS ASPECTS OF WASHINGTON BUDGETED**  
10 **CAPITAL EXPENDITURES.**<sup>81</sup>

11 A. CenturyLink intends to be responsive to Commission concerns about the quality of the  
12 network. However, the imposition on CenturyLink of costly and burdensome reporting  
13 requirements that are not otherwise also imposed upon CenturyLink's competitors places  
14 CenturyLink at a competitive disadvantage and creates unnecessary reporting costs that  
15 could detract from investments. Given the potential for unnecessary costs associated  
16 with unilateral reporting obligations, Staff's proposed Condition 13 should be rejected.

17  
18 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION NO. 43**  
19 **REGARDING CAPITAL INVESTMENT LEVELS OVER THE THREE YEARS**  
20 **AFTER THE CLOSE OF THE TRANSACTION.**

21 A. As explained in more detail beginning on page 33, CenturyLink objects to this proposed  
22 condition which would result in potentially uneconomic per-line capital expenditures in

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<sup>81</sup> Staff, Vasconi, p. 17, lines 19-30.

1 Washington and would limit the Company's financial flexibility in a way that could  
2 result in harm to the Company's Washington customers.

3  
4 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION NO. 44**  
5 **REGARDING MAINTENANCE INVESTMENT LEVELS OVER THE THREE**  
6 **YEARS AFTER THE CLOSE OF THE TRANSACTION.**

7 A. As explained on page 36, CenturyLink objects to this proposed condition which would  
8 result in potentially uneconomic per-line maintenance expenditures in Washington and  
9 would limit the Company's financial flexibility in a way that could result in harm to the  
10 Company's Washington customers.

11  
12 **Q. PLEASE COMMENT ON STAFF'S PROPOSED CONDITION NO. 45**  
13 **REGARDING THE EXCLUSION FROM PROPOSED STAFF CONDITIONS 43**  
14 **AND 44 OF CAPITAL INVESTMENTS AND MAINTENANCE EXPENDITURES**  
15 **REQUIRED TO MEET THE STAFF'S PROPOSED DSL COMMITMENTS.**

16 A. As explained on page 37, CenturyLink objects to this proposed Condition that would add  
17 an incremental capital investment requirement to already high network investment as  
18 specified in Conditions 43 and 44. CenturyLink believes that such elevated levels of  
19 network investment in Washington would limit the Company's financial flexibility in a  
20 way that could result in harm to the Company's Washington customers.

1 **Q. DO YOU HAVE CONCLUDING REMARKS?**

2 A. Yes. CenturyLink wishes to serve its customers—retail and wholesale—in a manner  
3 consistent with the history of CenturyLink and Qwest, while striving to improve that  
4 service over time. CenturyLink objects to unverified and speculative risks that will lead  
5 to the imposition of costly and inefficient conditions to achieve hypothetical benefits that  
6 appear not to be required under Washington’s standard of review. CenturyLink will  
7 abide by all regulatory and negotiated agreements and terms, and is committed to  
8 providing superior telecommunications services to its customers. CenturyLink could not  
9 find evidence that any of the risks outlined by the Staff or other intervenor witnesses  
10 were likely to result in net harm to Washington or Washington customers as a result of  
11 the Transaction. In fact, the vast majority of the combined company’s Washington  
12 customers—the current Qwest customers—will benefit from the improved operating  
13 performance and financial strength of the post-merger company when compared to Qwest  
14 today. Thus, there will be no net harm to Washington customers, and the Transaction  
15 actually will provide meaningful public interest benefits. Further, I believe that  
16 CenturyLink and Qwest have given the Commission facts that provide assurance that the  
17 merged company will have the resources and capabilities to provide services, that the  
18 Transaction will result in no net harm to customers, and that the proposed Transaction is  
19 in the public interest.

20  
21 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

22 A. Yes.