EXHIBIT___ AHA-1T

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the matter of, 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

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

September 27, 2010

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1 **I. INTRODUCTION**

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

3 A. My name is August H. Ankum. My business address is QSI Consulting, 150
4 Cambridge Street, Suite A603, Cambridge, Massachusetts, 02141.

5 **Q. PLEASE PROVIDE A BRIEF SUMMARY OF YOUR TESTIMONY.**

6 A. My testimony considers the proposed merger of CenturyLink and Qwest in the
7 context of the history and economics of similar mergers, particularly those
8 involving the unique characteristics of incumbent LECs (ILECs). Specifically,
9 my testimony discusses the following:

10 • The economic incentives underlying mergers;
11 • A brief overview of past mergers in the telecommunications industry,
12 demonstrating a troublesome history of mergers and the likelihood of
13 failure;
14 • The potential harm and absence of any demonstrated public benefit
15 from the proposed transaction; and
16 • The need for conditions and commitments to prevent or mitigate the
17 risk of harm to competition resulting from the proposed transaction,
18 and to ensure that the merger is in the public interest.

19 Based upon the serious risks to the public interest inherent in this merger
20 proposal, I recommend that the Commission reject the proposed transaction.
21 However, if the Commission nevertheless decides to approve the transaction, then
22 it should recognize the potential hazards faced by captive CLECs and their end
23 user customers, and adopt a set of stringent conditions and commitments,
24 discussed in my testimony and that of Mr. Gates, in order to safeguard wholesale
25 customers and the competitive marketplace in Washington.

1 **Q. WHAT IS QSI CONSULTING, INC. AND WHAT IS YOUR POSITION**
2 **WITH THE FIRM?**
3 A. QSI Consulting, Inc. ("QSI") is a consulting firm specializing in regulatory and
4 litigation support, economic and financial modeling, and business plan modeling
5 and development. QSI provides consulting services for regulated utilities,
6 competitive providers, government agencies (including public utility
7 commissions, attorneys general and consumer councils) and industry
8 organizations. I am a founding partner and currently serve as Senior Vice
9 President.

10 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**
11 **WORK EXPERIENCE.**
12 A. I received a Ph.D. in Economics from the University of Texas at Austin in 1992,
13 an M.A. in Economics from the University of Texas at Austin in 1987, and a B.A.
14 in Economics from Quincy College, Illinois, in 1982.

15 My professional background covers work experiences in private industry and at
16 state regulatory agencies. As a consultant, I have worked with large companies,
17 such as AT&T, AT&T Wireless, Bell Canada and MCI WorldCom ("MCIW"), as
18 well as with smaller carriers, including a variety of competitive local exchange
19 carriers ("CLECs") and wireless carriers. I have worked on many of the
20 arbitration proceedings between new entrants and incumbent local exchange
21 carriers ("ILECs"). Specifically, I have been involved in arbitrations between
22 new entrants and NYNEX, Bell Atlantic, USWEST, BellSouth, Ameritech, SBC,

1 GTE and Puerto Rico Telephone. Prior to practicing as a telecommunications
2 consultant, I worked for MCI Telecommunications Corporation ("MCI") as a
3 senior economist. At MCI, I provided expert witness testimony and conducted
4 economic analyses for internal purposes. Before I joined MCI in early 1995, I
5 worked for Teleport Communications Group, Inc. ("TCG"), as a Manager in the
6 Regulatory and External Affairs Division. In this capacity, I testified on behalf of
7 TCG in proceedings concerning local exchange competition issues, such as
8 Ameritech's Customer First proceeding in Illinois. From 1986 until early 1994, I
9 was employed as an economist by the Public Utility Commission of Texas
10 ("PUCT") where I worked on a variety of electric power and telecommunications
11 issues. During my last year at the PUCT, I held the position of chief economist.
12 Prior to joining the PUCT, I taught undergraduate courses in economics as an
13 Assistant Instructor at the University of Texas from 1984 to 1986.

14 A list of proceedings in which I have filed testimony is attached hereto as Exhibit
15 AHA-2.

16 **Q. DO YOU HAVE EXPERIENCE WITH THE ISSUES IN THIS**
17 **PROCEEDING?**

18 A. Yes. I have been involved in telecommunications since 1988, and over the course
19 of my career, I have worked and testified on virtually all issues pertaining to the
20 regulation of incumbent local exchange companies, including those governing
21 their wholesale relationship with dependent competitors, such as competitive local
22 exchange carriers ("CLECs"). I have also worked on numerous proceedings

1 involving competitive and market dominance issues, including those pertaining to
2 the FCC's triennial review cases and merger analyses.

3 **Q. ON WHOSE BEHALF ARE YOU FILING THIS RESPONSIVE**
4 **TESTIMONY?**

5 A. My testimony is being filed on behalf of the following CLECs: Integra Telecom
6 of Washington, Inc., Electric Lightwave, Inc., Advanced TelCom, Inc., and
7 United Communications, Inc. d/b/a Unicom (collectively "Integra"); tw telecom
8 of washington, llc; Covad Communications Company; Level 3 Communications,
9 LLC; McLeodUSA Telecommunications Services, Inc., d/b/a PAETEC Business
10 Services; Charter Fiberlink WA-CCVII, LLC; and Cbeyond Communications
11 LLC (collectively referred to in my testimony as "Joint CLECs").

12 **II. PURPOSE AND ORGANIZATION OF TESTIMONY**

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

14 A. The purpose of my testimony is to evaluate whether the proposed merger between
15 CenturyLink[1] and Qwest is in the public interest. Having reviewed the
16 companies' Washington Joint Application,[2] supporting testimony and data request
17 responses, I believe it is not. As discussed herein, and in the testimony of my
18 colleague Mr. Timothy Gates, the information provided by CenturyLink and

1 I will use CenturyLink (as opposed to CenturyTel) to refer to the company seeking to acquire Qwest, unless referring specifically to the legacy CenturyTel company that existed prior to the merger with Embarq. When referring to both CenturyLink and Qwest in the context of the proposed merger, I will use the term "the Companies" or "the Joint Applicants."

2 CenturyTel, Inc. and Qwest Communications International, Inc., Joint Application for Expedited Approval of Indirect Transfer of Control, filed May 13, 2010 ("Washington Joint Application").

1 Qwest is inadequate to demonstrate that the proposed transaction is in the public
2 interest. As I will demonstrate, the proposed transaction should either be rejected
3 *in total* or in the alternative, approved only if and when the Commission has
4 imposed firm, specific, and enforceable conditions on CenturyLink and Qwest
5 (hereafter "the Joint Applicants" or "the Companies") in order to safeguard
6 wholesale customers and the competitive marketplace in Washington.

7 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

8 A. The remainder of my testimony is organized as follows:

9
10
- Section III discusses the standard of review that the Commission should apply when reviewing the Companies' proposed transaction.

11
12
13
- Section IV provides a review of the economics and history of mergers in the telecommunications industry, demonstrating a troublesome history of mergers and the likelihood of failure.

14
15
16
- Section V demonstrates the harms to the public interest that could result from approval of the Companies' proposed merger in the absence of additional safeguards.

17
18
- Section VI demonstrates that the Companies have failed to substantiate the public benefits that they allege their merger would bring about.

19
20
21
22
- Section VII sets forth the Joint CLECs' proposed merger conditions related to wholesale services availability and rate stability, and explains how they would help mitigate the risk of harm to competition resulting from the proposed transaction.

23
24
25
26
- Section VIII describes some additional considerations arising from the merger, such as the relationship between potential cost reductions accruing to the Merged Company from efficiency gains and the cost-based rates required for UNEs and interconnection offered to CLECs.

27
- Section IX provides my Conclusion.

28 **Q. DO YOU HAVE SOME PRELIMINARY OBSERVATIONS REGARDING**
29 **THE PROPOSED TRANSACTION?**

1 A. Yes. Mergers are often seen as a means of expeditiously growing a company, not
2 organically (through competitive success and customer acquisitions with superior
3 product offerings), but by means of a short cut: by buying another company and
4 its products and customers. While proposed mergers are invariably touted by the
5 merging companies as generating significant benefits, through potential synergies,
6 increased economies of scale and scope, etc., in practice, it is very difficult to
7 predict which mergers will be successful and which ones will not. An interesting,
8 in retrospect ironic, example of supposed experts misjudging mergers is found in
9 an issue of the *Harvard Business Review* dedicated to mergers and acquisitions,
10 which published the minutes of a roundtable discussion on the resurgence of
11 mergers and acquisitions in the late nineties as follows:[3]

12 **Moderator:** The announcement in January of the merger between
13 ***America Online*** and ***Time Warner*** marked the convergence of the two
14 most important business trends of the last five years: the rise of the
15 internet and the resurgence of mergers and acquisitions. [...]
16
17 **Moderator:** I'm sure some of you are familiar with the studies
18 suggesting that most mergers and acquisitions do not pan out as well
19 as expected. Has that been your experience...Are mergers and
20 acquisitions worth it?
21
22 **Participant:** I would take issue with the idea that most mergers end up
23 being failures. I know there are studies from the 1970's and '80's that
24 will tell you that. But when I look at many companies today – in
25 particular new economy companies like ***Cisco*** and ***WorldCom*** – I have
26 a hard time dismissing the strategic power of M&A.

27 Rather than illustrate the success of mergers, the examples cited in this discussion
28 show the opposite. Of the three companies mentioned (AOL/Time Warner,

3 Dennis Carey, "Lessons from Master Acquirers: A CEO Roundtable on Making Mergers Succeed," Harvard Business Review on Mergers and Acquisitions, 2001, at pp. 2-3.

1 Cisco, and WorldCom), two were brought down by failed mergers, while the
2 third, Cisco, is still prospering after its mergers, putting the failure rate of mergers
3 at two out of three, which is about where the academic literature puts it.[4]

4 **Q. ARE YOU SAYING THAT MERGERS ARE UNDESIRABLE?**

5 A. No. Mergers and acquisitions may spawn innovative and profitable companies.
6 At issue in this case, however, is the merit of the *instant transaction,* and an
7 examination of past mergers and their failures (discussed below) should alert the
8 Commission to various pitfalls of mergers and underscore the importance of
9 carefully examining the impact of the proposed merger on all affected parties,
10 including competitive carriers and their end-user customers. As discussed below,
11 this merger raises serious public interest concerns that need to be weighed
12 carefully against the backdrop of general merger risks and past merger failures.

13 **Q. DO MERGERS OF ILECS RAISE UNIQUE ISSUES, NOT NECESSARILY**
14 **RELEVANT TO MERGERS BETWEEN OTHER TYPES OF**
15 **COMPANIES?**

16 A. Yes. A merger involving a large ILEC such as Qwest touches on many public
17 interest issues, particularly the public's interest in local exchange competition. To

4 This observation is found in many publications. See for example: Richard Dobbs, Marc Goedhart, and Hannu Suonio, "Are Companies Getting Better at Mergers and Acquisitions," McKinsey Quarterly, December 2006, at p. 1: "McKinsey research shows that as many as two-thirds of all transactions failed to create value for the acquirers"; Cartwright, Sue and Cooper, Cary, Managing Mergers, Acquisitions & Strategic Alliances, Butterworth-Heinemann, reprinted 2001, Section 3, Mergers and Acquisition Performance – a Disappointing History, discusses a number of studies, in line with the McKinsey studies; Pritchett, Price, After the Merger, The Authoritative Guide for Integration Success, McGraw-Hill, 1997, Chapter 1, Section Statistics on Merger Success and Failure, sets the failure rate at between 50% and 60%.

1 appreciate the public interest stake in this merger, it is important to recall the
2 starting points of the ILECs' network investments.

3 Until the early 1990s, ILECs had a government-sanctioned monopoly to provide
4 local services to captive ratepayers. In exchange, ILECs operated in a rate-
5 regulated environment. Rate regulation meant that if an ILEC had increased
6 operating costs, or was required to invest new capital to build out local
7 infrastructure (*e.g.*, middle-mile or last-mile loop facilities), the ILEC had the
8 ability to pass along those increased capital or operating costs by securing a rate
9 increase from the state regulators. Those regulated rates provided for a rate of
10 return that the ILEC was permitted to earn. Of course, ILECs often earned more
11 than their authorized rate of return, and sometimes they earned less (which meant
12 the ILEC was entitled to pursue higher rates). Not only was the ILEC able to
13 secure rate increases when it proved its case to regulators, its monopoly status
14 then assured it that every business and residential customer in its local exchange
15 market would pay those regulated rates to obtain local service. Some states
16 provided an alternative form of regulation, but the bottom line was that the ILEC
17 had certainty that its Commission-approved rates would be paid by all its
18 customers subscribing to local services. Thus, a material portion of the ILEC
19 infrastructure in place today, especially the local loop infrastructure, was built
20 when the ILEC was guaranteed that the cost of its investment would be paid for
21 by captive customers through regulated rates that included an appropriate rate of
22 return. That monopoly environment with its guarantees of an adequate rate of
23 return is in stark contrast to the current competitive environment in which CLECs

1 must compete for every customer. The Telecommunications Act of 1996 resulted
2 in CLEC entry into local exchange markets under provisions allowing them to use
3 portions of the ILECs' networks and services, generally at TELRIC rates. This
4 mandate allowing CLEC access to ILEC networks has created competition where
5 none existed prior to 1996. However, a merger, such as the one proposed in the
6 instant proceeding, could upset the wholesale relationship between ILEC and
7 CLECs, and harm competition in Washington. Without reasonable, reliable and
8 nondiscriminatory access to Qwest's and CenturyLink's networks, CLECs cannot
9 get access to customers. As a result, an ILEC merger like the one between
10 CenturyLink and Qwest in this case has unique and profound public interest
11 implications not present in mergers in other industries or between two CLECs.

12 **Q. DO CLECS DIFFER FROM OTHER AT-RISK STAKEHOLDERS IN THE**
13 **PROPOSED MERGER?**

14 A. Yes. An examination of past telecom mergers teaches us that the risks and gains
15 of a merger are not evenly distributed among all stakeholders. (Indeed, seven
16 Qwest executives stand to gain personally more than $110 million in cash and
17 stock if the merger is consummated.)[5]

18 CenturyLink's and Qwest's shareholders, for example, can sell their shares if they
19 anticipate that things will go awry, or, alternatively, hold on to their shares to reap
20 whatever benefits they may anticipate: it is a risk-return tradeoff each shareholder

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5 The Denver Post has reported that "[s]even top executives at Qwest stand to reap more than ***$110 million in cash and stock*** from the Denver-based company's proposed merger with CenturyLink, according to a new regulatory filing." See, "Windfall for Qwest Top Execs," by Andy Vuong, *The DenverPost,* 7/18/2010, at http://www.denverpost.com/search/ci_15536725 (emphasis added).

1 is free to either assume or walk away from. However, this freedom of choice
2 does not exist for other, captive stakeholders. Specifically, retail customers in
3 captive segments of retail markets have little or no choice and neither do
4 wholesale customers, such as CLECs, who critically depend on CenturyLink and
5 Qwest for loops, transport, collocation and a variety of other wholesale network
6 inputs. That is, captive retail and wholesale customers will not only reap *no gains*
7 if the proposed transaction is successful, they may experience great harm when
8 things go awry (as they have in so many of these ventures). This asymmetry in
9 the risk-return profiles between various stakeholders is profound. Hence, the
10 need for a regulatory review process to determine whether the proposed
11 transaction is in the interest of *all* stakeholders.

12 **Q. IS THERE A DIVERGENCE BETWEEN A PUBLIC INTEREST**
13 **ANALYSIS AND THE PRIVATE RISK-RETURN ANALYSIS GUIDING**
14 **CENTURYLINK AND QWEST?**

15 A. Yes. CenturyLink and Qwest need only consider their private risk-return trade-
16 offs. In contrast, the Commission must consider the broader public interest,
17 including the transaction's potential impact on other stakeholders who will likely
18 not benefit from the proposed transaction, but may be harmed. Naturally, this is a
19 broader analysis, and less likely to result in a finding that the proposed transaction
20 should be permitted to move forward as proposed.

21 **Q. ARE THERE ASPECTS TO THIS MERGER THAT ARE**
22 **PARTICULARLY TROUBLING?**

1 A. Yes. I have already noted that most mergers are not successful, even as measured
2 by the ultimate impact of the merger on shareholders. Yet more troubling in this
3 case is the fact that CenturyTel is seeking to acquire a much larger Bell Operating
4 Company ("BOC") while it is still integrating the recently acquired Embarq, a
5 company that was already about four times larger than the original CenturyTel. If
6 the successful outcome of mergers is generally in question, the outcome of this
7 one is particularly so.

8 What comes to mind is the experience of WorldCom, a one-time darling of Wall
9 Street that in rapid succession acquired a number of firms of increasing size and
10 complexity, culminating in the fateful acquisition of MCI and ultimately the
11 financial collapse of WorldCom. While WorldCom was brought down by a
12 number of missteps, some of them criminal, it is fair to say that its demise
13 stemmed in significant part from the failure to successfully integrate the various
14 acquired companies and the escalating challenges of ever-larger acquisitions.
15 CenturyTel's proposed acquisition of Qwest on the heels of its recent acquisition
16 of Embarq presents some disturbing similarities to the experience of WorldCom
17 and other failed acquisitions.

18 The table below gives the approximate line counts of CenturyTel (as it existed
19 before its Embarq acquisition), Embarq and Qwest, and demonstrates explosive
20 growth.

1

	Year	Access Lines[6]	% of Post-Merger Total
CenturyTel	2009	1,300,000	8%
Embarq	2009	5,700,000	34%
Qwest	2010	10,000,000	59%
Total		**17,000,000**	**100%**

2

3 This exponential growth path raises questions, specifically about the ability of
4 CenturyLink's management to handle the challenges of post-merger integration.
5 Again, organic growth through customer acquisition, as a result of superior
6 product offerings, is different from growth through mergers and acquisitions.
7 With respect to organic growth, management proves its abilities to manage
8 growth on an ongoing basis and exponential growth is a sign that management is
9 doing things right. By contrast, growth by means of acquisitions may signify that
10 management is able to maneuver nimbly in financial markets, but little, if
11 anything, about management's ability to run a much larger organization. It is the
12 latter, however, that the Commission is tasked, among other issues, to evaluate.

13 Furthermore, while CenturyLink may have integrated smaller firms, the
14 company's current attempt to swallow a BOC should give regulators pause. To
15 be sure, the challenge of integrating and running Qwest, with its unique BOC
16 obligations, comparatively enormous customer base, substantial wholesale

6 Line counts are taken from CenturyLink's testimony. The line counts in CenturyLink's testimony appear to be approximate line counts. See Direct Testimony of Todd Schafer on behalf of CenturyLink, Exhibit TS-1T, Washington UTC Docket No. UT-100820, May 21, 2010 ("Schafer Washington Direct (CenturyLink Exhibit TS-1T)") at p. 7 and Exhibit TS-2; and Direct Testimony of G. Clay Bailey on behalf of CenturyLink, Washington UTC Docket No. UT-100820, May 21, 2010 ("Bailey Washington Direct (CenturyLink Exhibit GCB-1T)"), at p. 4.

1 responsibilities, and complex set of operational support systems, is particularly
2 daunting and far beyond anything CenturyLink has faced to date. Indeed,
3 CenturyLink has admitted in its latest SEC Form 10Q report that " The Qwest
4 merger will change the profile of our local exchange markets to include more
5 large urban areas, ***with which we have limited operating experience.***"[7] Whatever
6 may be CenturyLink's proven track record, integrating and managing a BOC is
7 not a part of it.[8]

8 **Q. DOES THE FACT THAT SBC AND VERIZON WERE ABLE TO**
9 **ACQUIRE AND INTEGRATE FELLOW BOCS SUGGEST THAT**
10 **CENTURYLINK WILL BE ABLE TO DO THE SAME WITH QWEST?**

11 A. No. First, SBC and Verizon were large BOCs themselves. Given their common
12 genealogy as Baby Bells, SBC's and Verizon's management knew what they were
13 acquiring and how to run a BOC, with all the attendant regulations and
14 obligations to which it is subject. Further, the BOCs still had a common corporate
15 culture and were mostly working with common engineering practices inherited
16 from Ma Bell. Also, when, for example, SBC acquired Ameritech, SBC was
17 larger than Ameritech – not, as is the case here, smaller by a factor of 10 (using
18 CenturyTel as the base). Nevertheless, regulators imposed substantial conditions
19 as prerequisites to approving those BOC mergers in spite of the advantages

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7 CenturyLink, Inc. SEC Form 10Q, filed August 6, 2010, at p. 40 (emphasis added).

8 Also, as has been suggested in the literature, the integration process is always different. As Cooper and Cartwright note: "Different acquisitions are likely to result in quite different cultural dynamics and potential organizational outcomes. Consequently, acquiring management cannot assume that because they were successful in assimilating one acquisition into their own culture, that same culture and approach to integration will work equally successfully with another acquisition." Garry L. Cooper and Sue Cartwright, Managing Mergers, Acquisitions & Strategic Alliances, Butterworth-Heinemann, 2nd Edition, reprinted 2001, at p. 25.

1 inherent in mergers between BOCs as compared to a non-BOC's acquisition of a
2 BOC such as Qwest.

3 Q. **WHY SHOULD THE COMMISSION BE PARTICULARLY CONCERNED**
4 **ABOUT POTENTIAL ADVERSE IMPACTS ON CLECS AND THEIR**
5 **END USERS?**

6 A. Because CLECs depend on Qwest and CenturyLink for interconnection and
7 critical wholesale network inputs that are essential to their ability to provide
8 competitive local exchange services. CLECs are generally captive customers of
9 Qwest and CenturyLink for these wholesale network inputs. Further, CLECs
10 compete with CenturyLink and Qwest for business and residential customers,
11 which creates a perverse incentive structure in which CenturyLink and Qwest
12 may have disincentives to provide CLECs with quality, reasonably priced,
13 nondiscriminatory wholesale services and network access. In light of this, and the
14 fact that the economic health of CLECs is critical to local exchange competition,
15 it is important for the Commission to ensure that CLECs' interests are considered
16 and protected.

17 Q. **WHAT IS YOUR RECOMMENDATION?**

18 A. I recommend that the Commission reject the proposed transaction. As discussed
19 herein and in the testimony of Mr. Gates, this proposed transaction poses serious
20 risks to the public interest, including the public's interest in robust competition
21 from the many wholesale CLEC customers of Qwest and CenturyLink.
22 However, if the Commission nevertheless decides to approve the transaction, then

1 it should recognize the potential hazards faced by captive CLECs and their end
2 user customers, and impose on CenturyLink and Qwest a set of stringent
3 conditions and commitments, discussed herein and by Mr. Gates, in order to
4 safeguard wholesale customers and competition.

5 **III. STANDARD FOR REVIEW**

6 **Q. WHAT IS THE APPROPRIATE STANDARD FOR THE COMMISSION**
7 **TO USE IN REVIEWING CENTURYLINK'S AND QWEST'S PROPOSED**
8 **REORGANIZATION?**

9 A. I am not a lawyer, but my understanding is that pursuant to RCW 80.12[9] and
10 WAC 480-143-170,[10] the applicable standard for review is that the Commission
11 will reject the Companies' proposed transaction if the Commission determines
12 that it is not consistent with the public interest. As the Commission explained in
13 its recent Order that applied this standard and approved, subject to conditions,
14 Frontier's acquisition of Verizon Northwest Inc., "[t]his is sometimes called the
15 'no harm' standard because the transaction must not harm the public interest in

9 See, RCW 80.12.020 (Order required to sell, merge, etc. — Exemption).

10 See, WAC 480-143-170 ("Application in the public interest: If, upon the examination of any application and accompanying exhibits, or upon a hearing concerning the same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application.").

1 order to be approved."[11] The Commission also applied this standard in its May
2 2009 Order approving, with conditions, CenturyTel's acquisition of Embarq.[12]

3 **Q. HAS THE COMMISSION PREVIOUSLY IDENTIFIED THE KINDS OF**
4 **FACTORS THAT SHOULD BE ADDRESSED WHEN IT APPLIES THIS**
5 **STANDARD TO A PROPOSED TELECOMMUNICATIONS MERGER?**

6 A. Yes. In the *Frontier-Verizon Merger Order*, the Commission observed that "the
7 approach for determining what is in the public interest varies with the form of the
8 transaction and the attending circumstances,"[13] but noted that it had considered
9 the following factors when evaluating previous telecommunications merger
10 proposals:

11
12
13
- The impact on competition at the wholesale and retail level, including whether the transaction might distort or impair the development of competition;

14
15
- Whether the surviving corporation has the technical, managerial and financial capability to operate the operating subsidiary;

16
17
- The potential impact on service quality, including the impact on investment in Washington and neglect and abandonment of facilities;

---

11 *In the Matter of the Joint Application of Verizon Communications, Inc., and Frontier Communications Corporation For an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest, Inc.*, Docket No. UT-090842, Final Order Approving and Adopting, Subject to Conditions, Multiparty Settlement Agreements and Authorizing Transaction, April 16, 2010 ("*Frontier-Verizon Merger Order*"), at ¶ 9 (footnote omitted).

12 *In the Matter of the Joint Application of Embarq Corporation and Centurytel, Inc. For Approval of Transfer of Control of United Telephone Company of the Northwest d/b/a Embarq and Embarq Communications, Inc.*, Docket No. UT-082119, Final Order Approving and Adopting Settlement Agreement; Authorizing Transaction Subject to Conditions; Rescinding Order 03; Approving and Rejecting Side-Agreements; Granting and Denying Pending Requests for Leave to Withdraw; Dismissing Party, May 28, 2009 ("*CenturyTel-Embarq Merger Order*"), at ¶ 24.

13 *Frontier-Verizon Merger Order*, at ¶ 117 (footnote omitted).

1 • How any benefits or synergies would be shared between customers and
2 shareholders;

3 • The financial impacts of the proposed merger on cost of capital, capital
4 structure, and access to financial markets; and

5 • The impact of the merger on rates, terms, and conditions of service.[14]

6 The Commission's review of the Frontier-Verizon transaction encompassed all of
7 these factors, including the mitigation of potential competitive harms, which I
8 discuss specifically later in my testimony (see Section VII below).

9 **Q. CAN THE COMMISSION IMPOSE CONDITIONS ON APPROVAL TO**
10 **HELP ENSURE THAT THE PROPOSED TRANSACTION MEETS THE**
11 **'NO HARM' PUBLIC INTEREST STANDARD?**

12 A. Yes. While I am not offering a legal opinion, my understanding is that the
13 Commission can impose conditions beyond those voluntarily agreed to by the
14 Companies, if necessary in order to satisfy the 'no harm' public interest standard.
15 In fact, the Commission did just that in both the Frontier-Verizon and CenturyTel-
16 Embarq cases I referenced. In the *Frontier-Verizon Merger Order*, the
17 Commission not only accepted multi-party settlement agreements that included
18 conditions and commitments by the applicants, it also prescribed additional
19 conditions in the areas of financial reporting, OSS testing and validation, and
20 broadband deployments in order to ensure that the transaction would meet the 'no
21 harm' public interest standard.[15] The Commission concluded therein that:

14 *Id.*, at ¶ 117 (footnote omitted).

15 *Id.*, at ¶ 213.

> The commitments in the five multiparty Settlement Agreements, as further conditioned by this Order, are sufficient to protect Verizon's customers and the public interest from risks of harm associated with this change of control transaction.[16]

In the *CenturyTel-Embarq Merger Order*, the Commission similarly augmented the conditions and commitments made in a settlement agreement (as well as certain side-agreements) with its own conditions, prior to granting approval.[17] As I shall explain later in my testimony, many of the specific conditions and commitments adopted in these two orders are very similar to conditions that Mr. Gates and I are recommending in the instant case.

Q. ARE THERE OTHER STANDARDS TO CONSIDER IN REVIEWING THE JOINT APPLICATION?

A. Yes. The mandates of the Telecommunications Act of 1996 are also critical in reviewing the proposed merger. Nevertheless, the Washington Joint Application makes only a vague reference to "...the laws governing interconnection."[18] The Washington Joint Application and testimony provide no analysis of the Act's requirements or how they will be met under the proposed merger.[19] This lack of information and commitment is a common theme in all of CenturyLink's and Qwest's applications and testimony I have reviewed in the various states in which

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16 *Id.*, Conclusion of Law No. 4, at ¶ 237.

17 *CenturyTel-Embarq Merger Order*, at ¶¶ 86 and 93. Note especially Conclusion of Law No. 4 at ¶ 93, stating that "The Settlement Agreement commitments, as further conditioned by this Order, are sufficient to protect customers and the public interest from risks of harm associated with this change of control transaction."

18 See, Washington Joint Application at p. 13.

19 See, for example, Direct Testimony of John Jones on behalf of CenturyLink, Washington UTC Docket No. UT-100820, Exhibit JJ-1T, May 21, 2010 ("Jones Washington Direct (CenturyLink Exhibit JJ-1T)"), at p. 6 and p. 15.

1 the Companies are applying for regulatory approval, and should be a source of
2 great concern for the Commission.

3 **IV. ECONOMICS AND REVIEW OF TELECOM MERGERS**

4 ***A. Mergers Seek to Increase Private Shareholder Value which May Cause***
5 ***Them to Be at Odds with the Public Interest***

6 **Q. IN GENERAL TERMS, WHAT MAY CAUSE FIRMS TO MERGE OR**
7 **ACQUIRE OTHER FIRMS?**

8 A. The incentives for mergers and acquisitions are manifold but center around the
9 notion that shareholder value can potentially be increased by merging and
10 streamlining the resources of the pre-merger firms. The benefits from the merger
11 may stem from: the ability to lower costs, through increasing the post-merger
12 firm's economies of scale (*e.g.*, allowing it to achieve lower per unit costs) and
13 scope (*e.g.*, increasing the firm's efficiency by being able to offer a broader array
14 of services at larger volumes); capturing synergies associated with merging and
15 streamlining overhead and operational support systems; and/or improving the
16 Merged Company's overall competitiveness and market share by broadening its
17 product offerings and access to a larger customer base, or otherwise from
18 capitalizing on joint talents and expertise. The notion is that bigger is better.

19 Of course, these are all stock, theoretical considerations raised in mergers, but it is
20 always a question whether or not these benefits will actually materialize.
21 Furthermore, even on a theoretical level, there are serious doubts about whether
22 such alleged benefits are likely to result from a merger between firms such as

1 those in this transaction, or whether benefits could more likely be achieved by the
2 firms individually, through contractual agreements or simply through endogenous
3 growth.[20]

4 **Q. WHAT IS THE DIFFERENCE BETWEEN A HORIZONTAL AND A**
5 **VERTICAL MERGER?**

6 A. A horizontal merger is a merger between two firms that offer a comparable set of
7 services in comparable segments of a market or industry. The objective of a
8 horizontal merger is typically to broaden the reach of the firm and to increase its
9 overall market share.

10 A vertical merger, by contrast, seeks to integrate the operations of an upstream
11 firm with those of a downstream firm to whom it provides, typically, critical
12 inputs. Vertical integration may be motivated, for example, by a desire to leverage
13 the market power the upstream firm has into downstream markets.

14 While these types of mergers differ conceptually, they both allow the acquiring
15 firm to grow and potentially capture certain economies and synergies in addition
16 to other potential benefits.

17 **Q. WHAT SHOULD BE THE ULTIMATE OBJECTIVE OF A MERGER**
18 **FROM THE *COMPANY'S* PERSPECTIVE?**

19 A. While a merger may be motivated by a variety of considerations and objectives,
20 including management's personal ambitions,[21] the ultimate objective of a merger

20 For example, see Joseph Farrell and Carl Shapiro, "Scale Economies and Synergies in Horizontal Mergers," Antitrust Law Journal, Vol. 68, at pp. 67 – 710.

1 from the perspective of the firms' management should be to increase shareholder
2 value – which is also how the management should evaluate its success or failure.[22]

3 **Q. DO MANAGEMENT'S OBJECTIVES TO INCREASE SHAREHOLDER**
4 **VALUE POTENTIALLY CONFLICT WITH THE COMMISSION'S**
5 **OBJECTIVE TO PROTECT THE PUBLIC INTEREST AND FURTHER**
6 **COMPETITION IN WASHINGTON?**

7 A. Yes. Even if we ignore for the moment the possibility that this merger, like many
8 others, may go awry, an ILEC's pursuit of profit and increased shareholder value
9 through the acquisition of another ILEC inherently conflicts in many ways with
10 the Commission's mandate to promote the public interest and competition. For
11 example, the public interest is best served by a vibrant and competitive market for
12 telecommunications services; yet it is in the Companies' interests to strengthen
13 their already dominant market positions in order to realize benefits that justify the
14 merger. Given that CLECs rely on CenturyLink's and Qwest's wholesale
15 services to compete with the Companies, private and public interests diverge. This
16 is why, among other reasons, mergers between ILECs, such as CenturyLink and
17 Qwest, should raise serious concerns about the companies' responsibilities in
18 wholesale markets and the continued viability of retail competition. Specific

21 As I noted earlier in my testimony, seven top executives at Qwest stand to gain more than ***$110 million in cash and stock*** if the merger is consummated.

22 While mergers are at times motivated by other considerations, such as strategic or personal ambitions of the CEO, ultimately, from the firm's perspective, the "numbers" have to work to increase shareholder value. See, for example, Robert G. Eccles, Kersten L. Lanes, and Thomas C. Wilson, "Are You Paying Too Much for that Acquisition," Harvard Business Review on Mergers and Acquisitions, 2001, at pp. 45 - 73.

1 concerns about how this merger may harm the public interest are discussed in a
2 separate section below.

3 **Q. DO THE FEDERAL TRADE COMMISSION (FTC) AND DEPARTMENT**
4 **OF JUSTICE (DOJ) REVISED HORIZONTAL MERGER GUIDELINES**
5 **(2010) (*HMG*) PROVIDE THE COMMISSION WITH GUIDANCE?**

6 A. Yes. While the focus of an FTC or DOJ antitrust review of the proposed merger
7 differs from and is narrower than the Commission's public interest evaluation, the
8 HMG provides useful guidance on how to assess various claims put forth by the
9 merging companies regarding the alleged benefits of the proposed transaction.
10 Specifically, the HMG stresses that "most merger analysis is necessarily
11 predictive, requiring an assessment of what will likely happen if a merger
12 proceeds as compared to what will likely happen if it does not."[23] The HMG then
13 goes on to note that, in a merger analysis, there is no single uniform formula to be
14 applied, but "rather, it is a fact-specific process through which the agencies,
15 guided by their extensive experience, apply a range of analytical tools to the
16 reasonably available and reliable evidence [...]"[24] These observations are
17 important because, as discussed in the testimony of Mr. Gates and herein, the
18 applicants have provided insufficient information to conduct a "fact-specific"
19 investigation of the likely outcome of the proposed merger. (As part of the
20 framework for the Commission's predictive analysis, I discuss below a number of
21 previous mergers that subsequently went awry and show that past applicants made

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23 FTC and DOJ, Horizontal Merger Guidelines For Public Comment, Released on April 20, 2010, at p. 1.

24 *Id.*

claims similar to those made by Qwest and CenturyLink, demonstrating that the mere promise of benefits in no way ensures that benefits will in fact ensue.) For their part, the Companies' near-total absence of factual analysis is disconcerting, given the far reaching implications of the proposed transaction and its potential impact on a broad array of stakeholders, including CLECs, and the fact that the Commission must ultimately make its public interest judgment based on hard facts provided by the applicants.

Q. WOULD THE APPROVAL OF CENTURYLINK'S AND QWEST'S SHAREHOLDERS SIGNIFY THAT THE MERGER IS IN THE PUBLIC INTEREST?

A. No. Shareholders should consider only how shareholder value will be affected, which revolves mostly around the question of whether it will increase future earnings; obviously, shareholder value is but one component of a much broader and more complex evaluation necessary for a public interest finding. In short, the Commission should not succumb to the belief that the "invisible hand" of the market place will safeguard the public interest in this merger.

B. A Cautionary Tale: Brief Review of Mergers that Went Awry

Q. CAN ANYTHING BE LEARNED BY CONSIDERING THE OUTCOMES OF OTHER RECENT MERGERS AND ACQUISITIONS INVOLVING ILEC OPERATIONS?

A. Yes. The old adage that "those who do not heed the lessons of history are doomed to repeat them" readily applies to regulatory review of ILEC mergers and

1 acquisitions. I believe it is crucial that the Commission consider the proposed
2 Qwest-CenturyLink transaction in light of other, recent mergers and acquisitions.
3 As I shall explain, there are several such cases in which the merging companies'
4 initial high expectations and promised public benefits failed to materialize, in
5 some cases instead leading to financial failure, including Chapter 11 bankruptcies.

6 **Q. WHAT ARE POSSIBLY THE TWO MOST PROMINENT MERGERS**
7 **AMONG TELECOMMUNICATIONS COMPANIES TO RESULT IN**
8 **FAILURES?**

9 A. There are two mergers that stand out: the acquisition of MCI by WorldCom in
10 1998 and the acquisition of US WEST, a BOC, by Qwest in 2000.

11 **Q. WHAT HAPPENED IN THE WORLDCOM-MCI MERGER AND WHAT**
12 **WENT WRONG?**

13 WorldCom, which had its genesis in LDDS, experienced precipitous growth in
14 the 1990s, fueled largely by a series of acquisitions,[25] culminating in the $37
15 billion acquisition of MCI in 1998. Following the acquisition, the company had
16 to file for Chapter 11 bankruptcy protection in 2002, after having destroyed much
17 of the shareholder value of both WorldCom and MCI. While the reasons for
18 WorldCom's collapse are many, it can be explained in part by the failure to

25 Among the companies acquired were: Advanced Communications Corp. (1992), Metromedia Communication Corp. (1993), Resurgens Communications Group (1993), IDB Communications Group, Inc (1994), Williams Technology Group, Inc. (1995), and MFS Communications Company (1996).

1 successfully integrate the operations of the acquired companies. As the
2 Bankruptcy Court found:

3 Another challenge for WorldCom involved its integration of acquired
4 assets, operations and related customer services. Rapid acquisitions
5 can frustrate or stall integration efforts. Public reports, and our
6 discussions with WorldCom employees, raise significant questions
7 regarding the extent to which WorldCom effectively integrated
8 acquired businesses and operations.[26]

9 **Q. WHAT HAPPENED IN THE US WEST-QWEST MERGER AND WHAT**
10 **WENT WRONG?**

11 Qwest was founded in 1996 as a largely fiber-based company, installing facilities
12 along lines of the Southern Pacific Railroad to offer mostly high-speed data
13 services. Like WorldCom, Qwest Communications grew aggressively through a
14 series of acquisitions,[27] positioning Qwest not only as a provider of high speed
15 data to corporate customers, but also as a rapidly-growing provider of residential
16 and business long distance services.

17 In 2000, Qwest acquired US WEST. The total value of the transaction at the time
18 was considered approximately $40 billion.[28] About ten years after the merger,
19 Qwest's market capitalization is now approximately $10 billion.[29] This represents
20 a stunning loss in shareholder value.[30]

26 Re: WORLDCOM, INC., et al. Debtors, Chapter 11 Case No. 02-15533 (AJG) Jointly Administered, First Interim Report of Dick Thornburgh, Bankruptcy Court Examiner, November 4, at p. 12.

27 Qwest acquired such companies as Internet service provider SuperNet in 1997, LCI, a long distance carrier in 1998, and Icon CMT, a web hosting provider, also in 1998.

28 Qwest 2000 Annual Report, at p. 1.

29 See Money.cnn.com, Ticker Q.

30 In 2000, Qwest boasted: "Qwest Communications Reports Strong Third Quarter 2000 Financial Results While Successfully Integrating $77 Billion Company." (Emphasis added.) See http://news.qwest.com/index.php?s=43&item=1571

1 **Q. WHAT LESSIONS CAN BE LEARNED FROM THESE TWO MERGERS**
2 **IN EVALUATING THE MERGER AT ISSUE IN THIS CASE?**

3 The lesson to be learned from the WorldCom/MCI and Qwest/US WEST mergers
4 is, among others, that an applicant's ability to put together a merger, get Wall
5 Street's approval and shepherd a proposed transaction through the various steps of
6 an approval process in no way demonstrates an ability to successfully run the
7 post-merger firm. Further, generic claims of "synergies," which, as I will discuss
8 in more detail later in my testimony, invariably accompany all merger proposals,
9 mean little or nothing unless they are adequately substantiated by fact-based
10 analyses – and in the instant Application they surely are not.

11 **Q. ARE THERE MORE RECENT ILEC MERGERS THAT THE**
12 **COMMISSION SHOULD PAY PARTICULAR ATTENTION TO WHEN**
13 **CONSIDERING THE CENTURYLINK-QWEST APPLICATION?**

14 A. Yes. There are three major ILEC transactions within the past five years that I
15 think offer particularly sobering lessons to the Commission as it considers
16 CenturyLink's proposed acquisition of Qwest. In particular, I am referring to:

17
18
19
- **Hawaiian Telcom:** The Carlyle Group's acquisition of Verizon Hawaii (renamed Hawaiian Telcom), followed by Hawaiian Telcom's filing for Chapter 11 bankruptcy protection in 2008;

20
21
22
- **FairPoint:** FairPoint's acquisition of Verizon's operations in northern New England (Maine, New Hampshire, and Vermont), followed by FairPoint's Chapter 11 bankruptcy filing in October 2009; and

23
24
25
- **Frontier:** Frontier Communication's July 2010 acquisition of approximately 4.8 million access lines from Verizon in rural portions of fourteen states, which is giving rise to cut-over problems with back-

1 office and OSS systems reminiscent of the prior two transactions.[31]

2 As I will demonstrate, the track record of these types of mergers is not good. (Mr.
3 Gates discusses a different set of problems associated with these mergers.)

4 **Q. HAVE YOU PREPARED AN EXHIBIT THAT SUMMARIZES THE**
5 **PROMISED BENEFITS AND ACTUAL OUTCOMES OF THESE ILEC**
6 **TRANSACTIONS?**

7 A. Yes. My Exhibit AHA-3, "The Promises vs. Realities of Recent ILEC Mergers
8 and Acquisitions," supplies a summary of the promised benefits and actual
9 outcomes of the Carlyle-Hawaiian Telcom and FairPoint-Verizon transactions. In
10 addition, the Exhibit summarizes the more recent Frontier-Verizon and
11 CenturyTel-Embarq transactions in the same manner, to the extent possible, given
12 that integration activities pursuant to these transactions are still on-going, so that
13 their full impacts and outcomes have yet to be realized.

14 In each case, at the time the transaction was first proposed, the companies
15 involved made numerous claims and assurances concerning the anticipated
16 benefits of their transactions, in their FCC applications, public press releases, and
17 testimony to state PUCs. My Exhibit summarizes those claimed benefits and
18 compares them to the actual outcomes realized to date, in the areas of (1)
19 deployment of broadband and other new services, (2) service quality, both retail
20 and wholesale, (3) job creation, and (4) the financial stability and performance of

31 Frontier Communications, Fact Sheet dated 5/19/2009, "Frontier Communications to Acquire Verizon Assets, Creating Nation's Largest Pure Rural Communications Services provider," downloaded from Frontier's Investor Relations webpage, http://phx.corporate-ir.net/phoenix.zhtml?c=66508&p=irol-irhome

1 the company post-transaction.

2 **Q. WHAT DOES EXHIBIT AHA-3 SHOW?**

3 A. Exhibit AHA-3 shows the enormous gulf between the anticipated benefits claimed
4 by company management in these types of ILEC transactions, and the ensuing
5 realities. In all cases, company management claimed their proposed transactions
6 would spur accelerated deployment of broadband and other new services, create
7 jobs,[32] improve service quality and/or be seamless to customers, including CLECs
8 relying on wholesale services obtained via Operations Support System ("OSS"),
9 and improve the post-transaction company's financial stability and performance.
10 Unfortunately, as the Exhibit vividly shows, the reality has been far different,
11 particularly for the two earlier transactions (Hawaiian Telcom and FairPoint).
12 Their outcomes included:

13 - <u>Little or no demonstrated progress in broadband deployment</u>:
14 15   - After its acquisition by Carlyle, Hawaiian Telcom added only 3,247 net retail broadband lines from 2006 through 3Q 2008;[33]
16 17 18 19 20 21   - FairPoint's Chapter 11 reorganization plan includes delays/cut-backs to its broadband deployment commitments, and eliminates a cap on DSL rates so that customers may face higher rates; one Commissioner in Maine charged that "FairPoint has used the bankruptcy proceeding as an opportunity to renege on its promises to Maine consumers especially in the area of broadband build out."[34]
22 - <u>Severe declines in retail and wholesale service quality</u>:

32 In the instant proceeding, I am not aware of any claims of job creation made with respect to the CenturyTel-Embarq merger, and in fact as noted in the Exhibit, CenturyLink had cut approximately 1,000 jobs (out of a base of 20,000) by early 2010.

33 The 3,247 value is the difference between Hawaiian Telcom's total retail broadband lines, as of 9/30/2008, 93,567, and, as of 12/31/2006, 90,320 (source: Hawaiian Telcom, 3Q2008 Form 10-Q at p. 23 and 2007 Form 10-K, at p. 50), respectively.

34 Dissent of Commissioner Viafades, Maine PUC Order issued 7/6/10.

1 ➢ For Hawaiian Telephone, "very significant slow-downs in call answer and
2 handling times in its customer contact centers and errors in its
3 billing...;"[35]

4 ➢ For FairPoint, triggering the maximum payment under Vermont's Retail
5 Service Quality Plan in 2009, and widespread disruptions to wholesale
6 customers due to OSS systems failures, order fall-outs, and manual
7 processing work-arounds;

8 • Net job losses rather than gains:

9 ➢ Hawaiian Telephone's employment level had fallen to approximately 1450
10 by March 2010, a 15% decline from its pre-sale level of 1700
11 employees;[36]

12 ➢ FairPoint's Chapter 11 reorganization plan defers previously-negotiated
13 raises in union contracts, and creates a task force to cut operating expenses
14 by millions of dollars.[37]

15 • Financial weakness and instability:

16 ➢ Hawaiian Telcom: Chapter 11 bankruptcy filing, December 2008; reported
17 annual rate of return as of June 2009: –29.3%;

18 ➢ FairPoint: Chapter 11 bankruptcy filing, October 2009; VT Public Service
19 Board, "FairPoint's actual performance throughout 2008 and 2009 turned
20 out to be worse than the Board's most pessimistic assumptions."[38]

21 **Q. WHAT KIND OF OUTCOMES DO THE FRONTIER-VERIZON AND**
22 **CENTURYTEL-EMBARQ TRANSACTIONS APPEAR TO BE HAVING?**

23 A. The Frontier-Verizon and CenturyTel-Embarq outcomes are largely pending
24 because those transactions are so recent, but the preliminary indications are also
25 troubling. As noted in my Exhibit AHA-3, Frontier's integration of the former
26 Verizon exchanges has been marred by recent wholesale OSS failures, ordering
27 delays, under-staffed Access Order centers, and trouble report backlogs. These

35 Hawaii PUC Annual Report 2008-2009, at p. 58.

36 See Hawaiian Telcom Holdco, Inc. Form 10-A, filed 5/26/10, at p. 12 and Honolulu Star-Bulletin, "Hawaiian Telcom Gets CEO." 10/14/04.

37 Nashua Telegraph 2/9/10.

38 VT PSB Order 6/28/10 at p. 58.

1 problems are documented in detail in the testimony of Mr. Gates. Already, they
2 appear to belie Frontier's pledge that "this transaction will be seamless for retail
3 and wholesale customers."[39]

4 For its part, CenturyLink portrays its ongoing integration of Embarq's ILEC
5 operations in 18 states as "highly successful"[40] and "on track"[41] or even "ahead of
6 schedule"[42] relative to some systems integration activities, but here again there are
7 signs of strain.

8 As Mr. Gates shows in his Responsive Testimony, the CLECs tw telecom and
9 Socket Telecom have been dealing with EASE (OSS) system failures in the
10 legacy Embarq territories since late 2009.

11 **Q. ARE CENTURYLINK AND QWEST NOW MAKING THE SAME SORTS**
12 **OF CLAIMS CONCERNING THE FUTURE BENEFITS FROM THE**
13 **PROPOSED TRANSACTION AS THESE OTHER COMPANIES DID?**

14 A. Yes. When I consider the proposed CenturyLink-Qwest merger in this context,
15 what is particularly troubling to me is that so many of the promises and
16 assurances that CenturyLink and Qwest are making now to secure their merger
17 are highly similar to those made to regulators by the prior companies, before their
18 transactions' failures. Compare for example, the following claims:

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39 Frontier-Verizon FCC Application, Exhibit 1 (description of the Transaction and Public Interest Statement.), at p. 4.

40 FCC WC Docket No. 10-110, Reply Comments of CenturyLink, Inc. and Qwest Communications International, Inc., filed July 27, 2010, at p. 10.

41 Id, at p. 9.

42 FCC WC Docket No. 10-110, Reply Comments of CenturyLink, Inc. and Qwest Communications International, Inc., filed July 27, 2010, Exhibit (Declaration of William E. Cheek), at ¶ 2.

1 • <u>Claims of a strong track record of successful telecommunications acquisitions</u>:

2 ➢ Carlyle Group: "Carlyle has a track record of successful
3 telecommunications investments..."

4 ➢ FairPoint: "FairPoint has long-term experience in the telecommunications
5 industry. In fact, FairPoint has been acquiring telecommunications
6 companies since 1993..."[43]

7 ➢ Frontier: "Frontier has a strong record of successfully integrating
8 acquisitions..."

9 ***<u>CenturyLink-Qwest:</u>*** *"CenturyLink's management team has some of the*
10 *longest and most successful tenure in the industry with a proven track*
11 *record of successful mergers and acquisitions."*[44]

12 • <u>Claims that proposed transaction will accelerate broadband deployment</u>:

13 ➢ Hawaiian Telcom: "In short order we will offer new services to our
14 customers, including expanded broadband..."[45]

15 ➢ "FairPoint plans to increase broadband availability from current levels in
16 Maine, New Hampshire, and Vermont within twelve months after the
17 completion of the merger..."[46]

18 ➢ "Frontier believes that... it can dramatically accelerate broadband
19 penetration in these new markets over time."[47]

20 ***<u>CenturyLink-Qwest:</u>*** *"the transaction will help to accelerate deployment*
21 *of broadband services in unserved and underserved areas for both*
22 *residential and business customers."*[48]

23 • <u>Claims that transaction will be seamless and non-disruptive to customers</u>:

24 ➢ FairPoint: "...will enhance service quality and promote competition..."[49]

25 ➢ Frontier: "this transaction will be seamless for retail and wholesale

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43 FairPoint-Verizon FCC Application, at p. 17.

44 CenturyLink-Qwest's FCC Application, "Application For Consent To Transfer Control," filed May 10, 2010, at p. 10 ("CenturyLink-Qwest FCC Application").

45 Carlyle Press Rel. 5/21/04

46 FairPoint-Verizon FCC Application, at p. 18.

47 Frontier-Verizon FCC Application, Exhibit 1 (Description of the Transaction and Public Interest Statement), at p. 3.

48 CenturyLink-Qwest FCC Application, at p. 2.

49 FairPoint-Verizon FCC Application, at p. 18.

1 customers"[50]

2 ***CenturyLink-Qwest:*** *"The merger will not disrupt service to any retail or*
3 *wholesale customers..."*[51]

4 • Claims that transaction will improve financial strength and stability:

5 ➢ FairPoint: "the proposed transaction will ... improv[e] its overall financial
6 flexibility and stability"[52]

7 ➢ Frontier: "the transaction will transform Frontier by strengthening its
8 balance sheet."[53]

9 ***CenturyLink-Qwest:*** *"the transaction will... create a service provider*
10 *with improved financial strength and the financial flexibility to weather*
11 *the impacts of changing marketplace dynamics..."*[54]

12 **Q. CENTURYLINK PROJECTS THAT IT WILL REAP $625 MILLION IN**
13 **ANNUAL OPERATING EXPENSE AND CAPITAL COST SYNERGIES**
14 **FROM 3-5 YEARS AFTER THE MERGER CLOSES. WERE HAWAIIAN**
15 **TELCOM AND FAIRPOINT ABLE TO ACHIEVE THE SYNERGIES**
16 **THEY ORIGINALLY PROJECTED IN CONNECTION WITH THEIR**
17 **MERGER/ACQUISITION TRANSACTIONS?**

18 A. No, they were not. In the Hawaiian Telcom case, I am not aware of any specific
19 quantification of transaction synergies made by the parties at the time of their
20 application for regulatory approvals. However, Carlyle did tell the Hawaii PUC
21 that it expected to realize operational efficiencies by creating new back office

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50 Frontier-Verizon FCC Application, Exhibit 1 (Description of the Transaction and Public Interest Statement), at p. 4.

51 CenturyLink-Qwest FCC Application, at p. 37.

52 FairPoint-Verizon FCC Application, at p. 19.

53 Frontier-Verizon FCC Application, Exhibit 1 (Description of the Transaction and Public Interest Statement), at p. 4

54 CenturyLink-Qwest FCC Application, at p. 2.

1 systems located in Hawaii, to replace Verizon's centralized, legacy systems. As
2 the Hawaii PUC stated at the time the transaction was approved:

> 3 In re-establishing these functions, Carlyle plans to replace Verizon's
> 4 numerous legacy systems with updated and flexible application
> 5 systems. Carlyle specifically represents that it will achieve increased
> 6 economies of scale and improved operating efficiencies from replacing
> 7 multiple and duplicative systems with a single application.[55]

8 As Mr. Gates describes in depth in his Responsive Testimony, the build-out of
9 these new systems went seriously awry, and contributed to the financial downfall
10 of the company. Instead of producing synergistic operating efficiencies and cost
11 reductions, development delays and failures in the new systems caused Hawaiian
12 Telcom to incur millions of dollars of additional, unanticipated operating
13 expenses. The company's Form 10-Q SEC filing for the third quarter of 2006
14 documents over $33 million in such incremental expenses for just the first nine
15 months of 2006, including $22.3 million paid to Verizon to continue using its
16 systems after the planned cutover date, and another $11.3 million for "[t]hird-
17 party provider services and other services required as a result of the lack of full
18 functionality of back-office and IT systems."[56] The Form 10-Q filing explains
19 that:

> 20 Because BearingPoint was unable to deliver the expected full system
> 21 functionality by the April 1, 2006 cutover date and has continued to be
> 22 unable to deliver full functionality, it has been necessary for us to
> 23 incur significant incremental expenses to retain third-party service
> 24 providers to provide call center services and other manual processing
> 25 services in order to operate our business. To help remediate

55 *In the Matter of the Application of Paradise Mergersub, Inc., GTE Corporation, Verizon Hawaii Inc. Bell Atlantic Communications, Inc. and Verizon Select Services Inc. for Approval of a Merger Transaction and Related Matters*, Hawaii PUC Docket No. 04-0140, Decision and Order No. 21696, March 16, 2005, at p. 48.

56 Hawaiian Telcom Communications, Inc. Form 10-Q, filed November 14, 2006, at p. 26.

> deficiencies we engaged the services of an international strategic partner with expertise in general computer controls and change management as well as specific expertise with information technology process controls. In addition to the costs of third-party service providers, we also incurred additional internal labor costs, in the form of diversion from other efforts as well as overtime pay.[57]

The filing goes on to say that the company expected to continue to incur significant incremental systems-related costs through the last quarter of 2006 and on into fiscal year 2007.[58]

Q. DID FAIRPOINT MANAGE TO ACHIEVE ITS CLAIMED TRANSACTION SYNERGIES?

A. No. Like Hawaiian Telcom, FairPoint also fell far short of its initial synergy projections for the Verizon transaction, which were largely driven by expected efficiency improvements in back-office and OSS systems. In an April 2007 filing with the SEC, FairPoint stated that "FairPoint estimates that within six months following the end of this transition period, which is expected to occur in 2008, the combined company will realize net costs savings on an annual basis of between $60 and $75 million from internalizing these functions or obtaining these services from third-party providers."[59] In reality, FairPoint experienced severe operational difficulties and cost over-runs during its post-transaction efforts to integrate the legacy Verizon exchanges into its back-office and OSS systems, as Mr. Gates documents in his Responsive Testimony. By the time the company filed its Form

57 Id., at p. 26.

58 Id. at p. 26. Note that the company's Form 10-K filing for year 2007 does not provide a similar quantification of systems-related incremental expenses, and the SEC's "EDGAR" filings database does not list a year 2008 Form 10-K for the company, presumably because of its Chapter 11 bankruptcy that year.

59 FairPoint Communications, Inc., Form S-4, filed April 3, 2007, at p. 14.

1 10-K for 2009, it was forced to admit that:

2-7 Because of these Cutover issues, during the year ended December 31, 2009, we incurred $28.8 million of incremental expenses in order to operate our business, including third-party contractor costs and internal labor costs in the form of overtime pay. The Cutover issues also required significant staff and senior management attention, diverting their focus from other efforts.[60]

8 Once again, as in the Hawaiian Telcom case, the fact that forecasted operating
9 efficiencies and synergies failed to materialize, and instead were replaced by
10 substantial, unanticipated expense increases, contributed heavily to FairPoint's
11 financial distress and subsequent filing for Chapter 11 bankruptcy protection.

12 **Q. DOES FRONTIER APPEAR TO BE ON TRACK TO REALIZE THE**
13 **SYNERGIES IT CLAIMED WILL BE PRODUCED BY ITS RECENT**
14 **ACQUISITION OF VERIZON EXCHANGES?**

15 A. No, it does not, judging from the most recently-available public information that I
16 have been able to review. In their joint Application to the FCC, Frontier and
17 Verizon stated "When fully implemented, Frontier expects to yield annual
18 operating expense savings of $500 million" from the transaction.[61] However,
19 Frontier's Form 10-Q filed May 16, 2010, already admits to a major unanticipated
20 cost increase with respect to systems integration that detracts from those savings:

21-25 While we anticipate that certain expenses will be incurred, such expenses are difficult to estimate accurately, and may exceed current estimates. For example, our estimate of expected 2010 capital expenditures related to integration activities has recently increased from $75 million to $180 million, attributable in large part to costs to

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60 FairPoint Communications, Inc., Form 10-K, filed May 27, 2010, at p. 16.

61 Verizon Communications Inc. and Frontier Communications Corp., Consolidated Application for Transfer of Control and Assignment of International and Domestic Section 214 Authority, May 28, 2009, Exhibit 1 (Description of the Transaction and Public Interest Statement), at p. 3.

1 be incurred in connection with third-party software licenses necessary
2 to operate the Spinco business after the closing of the merger.
3 Accordingly, the benefits from the merger may be offset by costs
4 incurred or delays in integrating the companies.[62]

5 **Q. WHAT CONCLUSIONS DO YOU REACH BASED ON YOUR**
6 **ASSESSMENT OF THESE PRIOR ILEC MERGER AND ACQUISITION**
7 **EXPERIENCES?**

8 A. Based on my overall assessment of the prior ILEC merger and acquisition
9 experiences set forth above, my conclusions are as follows:

10 • Mergers and acquisitions involving the transfer and integration of ILEC
11 local telephone operations carry a high degree of risk of failure, even
12 when implemented by highly-experienced management teams and well-
13 financed companies;

14 • When pursuing these types of transactions, company management tends to
15 overstate the anticipated benefits and understate the risks and
16 uncertainties;

17 • The integration of a Bell Operating Company's ILEC operations, in
18 particular, can prove to be extremely expensive and difficult, and
19 integration failures can be so costly as to not only eliminate the forecasted
20 transaction cost savings and other synergies, but to place the post-
21 transaction company under severe financial pressure.

22 Taken as a whole, I believe that these experiences demonstrate that regulators
23 must be extremely skeptical of management's pre-transaction claims and
24 assurances, and cognizant that such transactions involve significant
25 uncertainties and risks. From a public interest standpoint, those risks simply
26 may not be worth accepting, particularly because, as discussed previously, the
27 risks and gains are unevenly divided between shareholders and the broader

62 Frontier Communications, Inc., Form 10-Q, filed May 16, 2010, at p. 56

1 public interest, including captive customers such as CLECs. The economic
2 viability of CLECs may be threatened if things go awry, but unlike
3 shareholders, CLECs stand to gain little, if anything, if the merger is successful
4 from a shareholder standpoint. At a minimum, this asymmetric division of risks
5 must be mitigated by establishing concrete conditions, with meaningful
6 consequences for nonperformance, prior to the transaction's regulatory
7 approval.

8 V. A CENTURYLINK/QWEST MERGER IS LIKELY TO HARM
9 THE PUBLIC INTEREST

10 *A. Overview*

11 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE PROPOSED**
12 **MERGER BETWEEN CENTURYLINK AND QWEST?**

13 A. In this proceeding, CenturyLink, formerly CenturyTel, seeks approval for the
14 acquisition of Qwest Communications. The merger entails a stock swap of $10.6
15 billion. CenturyLink will also assume approximately $12 billion in Qwest debt.
16 The overall value of the merger is about $22 billion. The Merged Company will
17 operate in 37 states, and serve some 5 million broadband customers and 17
18 million phone lines.

19 **Q. DOES THIS REPRESENT AN EXTRAORDINARY GROWTH FOR**
20 **CENTURYTEL?**

21 A. Yes. If the proposed transaction is consummated, CenturyTel will have grown
22 from a small rural company with about 1.3 million lines to a nationwide company

1 of about 17 million lines – over the course of a mere three years. The table
2 below, presented previously in the introduction, summarizes its growth:

	Year	Access Lines[63]	% of Post-Merger Total
CenturyTel	2009	1,300,000	8%
Embarq	2009	5,700,000	34%
Qwest	2010	10,000,000	59%
Total		**17,000,000**	**100%**

3

4 As discussed previously, it is important to note that this growth is not the result of
5 superior product offerings and customer growth, but rather achieved through
6 putting together a number of companies that were struggling[64] to hold their own
7 in rapidly changing telecom retail markets.[65]

8 Q. **DOES THE PROPOSED MERGER ENTAIL ANY SIGNIFICANT**
9 **BENEFITS OF VERTICAL INTEGRATION?**

10 A. For the most part, this is a horizontal merger. As noted, the proposed merger
11 seeks to integrate the operations of CenturyLink and Qwest. An evaluation of this
12 merger is further complicated by CenturyLink's ongoing and, as of yet,
13 incomplete efforts to integrate the recently acquired Embarq. Therefore,
14 assessing the synergies claimed with respect to CenturyLink's acquisition of

63 Line counts are taken from CenturyLink's testimony. The line counts in CenturyLink's testimony appear to be approximate line counts. See Schafer Washington Direct (CenturyLink Exhibit TS-1T), at p. 7 and Exhibit TS-2; and Bailey Washington Direct (CenturyLink Exhibit GCB-1T), at p. 4.

64 Both companies, for example, continue to experience access line losses. For CenturyLink see http://ir.centurylink.com/phoenix.zhtml?c=112635&p=irol-newsArticle_Print&ID=1422603&highlight; for Qwest, see, 2010 Quarterly Earnings at http://investor.qwest.com/qtrly earnings

65 This does not mean that the companies are not dominant in wholesale markets and continue to control the wholesale relationship with CLECs that require access to the Join Applicant's network.

1 Qwest involves considerations of integrating the operations of three incumbent
2 LECs. That is, in essence, this case concerns a predominantly *horizontal* merger
3 across the geographically separate serving areas of three incumbent LECs,
4 CenturyTel, Embarq and Qwest, all three of which are generally in the same line
5 of business in different service areas.

6 Q. **DOES THE FACT THAT CENTURYLINK IS SEEKING TO PUT**
7 **TOGETHER THE OPERATIONS OF THREE ILECS LIMIT THE**
8 **EXTENT TO WHICH SYNERGIES CAN BE REALIZED?**

9 A. Yes. Because the proposed transaction would involve the integration of three
10 ILECs operating in different service areas, the benefits from the potential merger
11 are necessarily limited, which may explain why CenturyLink and Qwest refer to
12 the alleged benefits in vague terms, like "capitalizing on," "leveraging,"
13 "extending," and so forth. Those vague assertions leave one wondering why,
14 under the right management, such benefits could not be achieved by each of the
15 firms individually.

16 While mergers often fail to enhance shareholder value, there are types of mergers
17 and acquisitions that tend to expand a company's abilities and service offerings.
18 For example, when Microsoft acquired Forethought, which had developed a
19 presentation program, it allowed Microsoft to expand its suite of software
20 programs to include Microsoft PowerPoint, and to eventually market a powerful
21 bundle of programs, Microsoft Office, to students and business users. Similarly,
22 Microsoft's acquisition of Visio Corporation allowed it to further expand its

1 product line by integrating Microsoft Visio. I am not asserting that all of
2 Microsoft's dozens of acquisitions have been successes; rather, I am illustrating
3 an essential difference between these acquisitions by Microsoft and
4 CenturyLink's acquisition of Qwest. While the Microsoft acquisitions are a clear
5 example of how an acquisition can add to a company skills and products that were
6 not previously present, the CenturyLink-Qwest merger is an example, for the
7 most part, of adding more of the same in the hope that something better will
8 emerge, under the motto "Bigger is Better."

9 It is unclear how putting together three ILECs, with a shrinking landline base, is
10 going to result in a sustained turnaround, let alone substantial merger benefits.
11 CenturyLink's claims of merger benefits notwithstanding, there is little inherently
12 new or novel in the proposed combination of these ILECs, with largely
13 overlapping business models.

14 Q. **DOES THE MERGER APPEAR TO ENHANCE THE FINANCIAL**
15 **POSITION OF THE FIRMS?**

16 A. No, not really. Looking at how financial markets seem to be responding to the
17 proposed merger, there hardly seems to be a flurry of excitement; in fact, rating
18 agencies have recognized the increased riskiness of the post-merger firm.[66] Also,
19 using a traditional measure of the weighted average cost of capital ("WACC"), it

66 See the April 2010 ratings reports for CenturyLink issued by Morgan Stanley, Moody's, and Standard and Poor's, which were reproduced as the three exhibits to Mr. Bailey's direct testimony, Exhibits GCB-3, GCB-4, and GCB-5, respectively.

1 is not clear how the Merged Company is better positioned to attract capital.[67] In
2 fact, given that the Merged Company would be no less risky and that CenturyLink
3 would be assuming Qwest's massive debt load, there is reason to conclude that
4 financial markets will be less (rather than more) forthcoming in financing
5 CenturyLink's future network expansions.

6 ***B. Vertical Effects***

7 **Q. YOU NOTED THAT THE PROPOSED MERGER DOES NOT, ON ITS**
8 **FACE, REVEAL COMPLEMENTARY SKILLS AND PRODUCTS. DOES**
9 **THIS SUGGEST THAT THE DRIVE TO ACHIEVE MERGER BENEFITS**
10 **AND SYNERGIES WOULD INVARIABLY PIT CENTURYLINK**
11 **AGAINST ITS WHOLESALE CLIENTS, SUCH AS CLECS?**

12 A. Yes. To justify the merger and the associated costs of integration, CenturyLink is
13 promising regulators and shareholders merger benefits estimated at about $625
14 million over a period of three to five years.[68] As noted, the premerger companies
15 are struggling to hold their own in changing telecom retail markets and it is not
16 clear that the merger will soon, if ever, generate revenues and profits to recoup the
17 upfront costs of integration. This raises concerns about cost cutting measures that
18 may negatively impact wholesale services.

19 Trimming wholesale costs not only saves money on services that are not subject
20 to significant competition, it does so without the likelihood of revenue

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67 See CenturyLink's and Qwest's Response to Staff Data Request No. 3, Oregon Docket No. UM 1484, showing an increase in the post-merger weighted average cost of capital.

68 See Bailey Washington Direct (CenturyLink Exhibit GCB-1T), at p. 4.

1 repercussions: *i.e.*, the cost savings directly improve the bottom line. That is,
2 there are added incentives to cut costs in segments of the companies' operations
3 that are not subject to competitive pressures: most notably, the wholesale business
4 charged with meeting the Section 251 and Section 271 obligations under the
5 Telecommunications Act of 1996. In sum, this dynamic places post-merger
6 CenturyLink at odds with captive CLEC wholesale customers.

7 **Q. SHOULD THE COMMISSION CONSIDER THE IMPACT OF THE**
8 **MERGER ON CLECS AND COMPETITION?**

9 A. Yes. As discussed previously, a public interest review requires consideration of
10 how the merger is likely to impact competition and CLECs, and in turn, CLEC
11 end user customers . In fact, the Commission has recognized this as a key
12 consideration. The public interest would be harmed if the competitive landscape
13 becomes distorted by significant cost cutting that causes a deterioration in
14 wholesale service provisioning. Showing that these concerns are not idle, Mr.
15 Gates discusses in more detail the potentially harmful impact of the merger on the
16 Merged Company's provisioning and how it could seriously impair – *as mergers*
17 *have elsewhere* – the viability of competitors.

18 **Q. HAS THE FCC NOTED THE IMPORTANCE OF CONSIDERING THE**
19 **IMPACT ON WHOLESALE SERVICES AND COMPETITORS?**

20 A. Yes. Part of the FCC's analytical framework in reviewing mergers is to look not
21 only at the horizontal effects of a merger but also the vertical effects, related to

1 the post-merger impact on wholesale markets. Recognizing the potential harm a
2 merger may cause to competitors and competition itself, the FCC notes:

> 3 [w]e need to consider the vertical effects of the merger – specifically,
> 4 whether the merged entity will have an *increased incentive* or *ability*
> 5 to injure competitors by raising the cost of, or discriminating in the
> 6 provision of, inputs sold to competitors.[69] (Emphasis added.)

7 As discussed above, it appears that CenturyLink may have an increased incentive
8 as well as an increased ability to negatively impact its competitors due to the
9 larger scope of its operations.

10 Q. **DOES THIS RAISE CONCERNS NOT JUST WITH RESPECT TO UNES**
11 **BUT ALSO SPECIAL ACCESS SERVICES?**

12 A. Yes. Local competition remains critically dependent on the availability of UNEs,
13 interconnection and special access services at reasonable rates and terms. The
14 proposed merger may negatively impact the provision of special access services,
15 which are already being provisioned at unreasonably high rates and on terms and
16 conditions that are hampering competitors.[70] In fact, in view of these concerns,
17 the FCC has recently decided to revisit its regulations of special access services.[71]
18 This merger may further unsettle special access markets.

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69 In the Matter of A&T Inc. and BellSouth Corporation Application for Transfer of Control, Memorandum Opinion and Order, WC Docket No. 06-74, at ¶ 23.

70 See for example, United States Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, Telecommunications: FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services, November 2006. ("GAO Report").

71 *In the Matter of Special Access Rates for Price Cap Local Exchange Carriers AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25, RM-10593. The FCC conducted a workshop on revising special access pricing on July 19, 2010.

1 **Q. ARE THESE CONCERNS ESPECIALLY IMPORTANT GIVEN THE**
2 **SUBSTANTIAL AMOUNT OF DEBT CENTURYLINK WILL BE**
3 **ASSUMING BY ABSORBING QWEST?**

4 A. Yes. CenturyLink is taking on an enormous amount of debt and other risks, so
5 much so, that it is negatively impacting its credit rating[72] This draws into question
6 the claim that the Merged Company would be a financially stronger entity.
7 Moreover, to deal with this debt, and to placate shareholders and financial
8 markets, CenturyLink has stated that it will use its free cash flow to pay down this
9 debt.[73] Given the dearth of information CenturyLink and Qwest have provided to
10 support the alleged merger savings, CenturyLink's stated intentions to pay off its
11 debt raises still more questions about its ability to provide and maintain quality
12 wholesale services and OSS to CLECs, not just for its own pre-merger operations
13 but especially for Qwest's, which are subject to Section 271 obligations. Again,
14 when asked to provide details supporting its projected merger savings,
15 CenturyLink and Qwest respond that those savings have not been calculated at a
16 detailed level or have not yet been developed.[74] Circular answers like "[t]he

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72 See the April 2010 ratings reports for CenturyLink published by Morgan Stanley, Moody's, and Standard and Poor's, which were reproduced as the three exhibits to Mr. Bailey's direct testimony, Exhibits GCB-3, GCB-4, and GCB-5, respectively. As Moody's notes in its report (p. 1):

> The negative rating outlook for CenturyTel reflects the considerable execution risks in integrating a sizeable company so soon after another large acquisition (Embarq in July 2009) while confronting the challenges of a secular decline in the wireline industry. The negative outlook also considers the possibility that the Company may not realize planned synergies in a timely manner, especially if competitive intensity increases.

73 See, for example, Bailey Washington Direct (CenturyLink Exhibit GCB-1T), at p. 20-21.

74 See my Exhibit AHA-5 at p. 7; see also, e.g., CenturyLink's Response to Integra's First Set of Information Requests, #53 ("CenturyLink has not estimated synergy savings or one-time merger costs by state"); and Iowa Utilities Board Docket No. SPU-2010-0006, CenturyLink's June 16, 2010 Response to OCA Set 1, #13F ("Synergies were estimated at the total enterprise level only and not by

1 combined companies regulated entities will benefit from synergies post merger in
2 the form of lower costs to the extent synergies are achieved,"[75] are not reassuring,
3 much less credible evidence on which the Commission can base findings that the
4 transaction is in the public interest. The absence of, and refusal to provide,
5 anything approaching a detailed analysis of the Companies' projected merger
6 savings leaves unaddressed the required comparison with the profound risks
7 posed by this transaction.

8 In sum, a major concern is that, under the pressure of its debt load, the promises
9 of merger savings to shareholders and regulators, and significant integration costs,
10 CenturyLink will be forced to cut costs when integrating the two companies,
11 leading to a degradation of services to wholesale customers and harm to
12 competition. Worse, of course, is the possibility that this merger could fail as so
13 many have, causing upheaval in wholesale markets and impairing retail
14 competition just when consumers need the benefits of competition most.

15 **Q. DOES MR. GATES DISCUSS A NUMBER OF MERGER CONDITIONS**
16 **THAT COULD SERVE TO ADDRESS CONCERNS ABOUT VERTICAL**
17 **EFFECTS?**

18 A. Yes. As the FCC noted in previous mergers, economically efficient access by
19 CLECs to the ILECs' network elements serves to constrain the ILECs' ability to
20 exploit market power in wholesale markets to the detriment of competition in

entity or by state"); and June 29, 2010 Updated Response to OCA Set 1, #13F ("No estimate of synergies by Post Merger entity has been conducted.").

75 CenturyLink Response to Integra's First Set of Information Requests, #141.

1 downstream, retail markets.[76] In view of this, it is of paramount importance that
2 the Commission take action to ensure reliable, nondiscriminatory access to the
3 post-merger ILEC's wholesale network elements and services, including action
4 that safeguards the wholesale ordering and provisioning processes currently in
5 place. Mr. Gates discusses conditions that serve this important purpose.

6 ### *C. Horizontal Effects*

7 Q. **IN ADDITION TO THE POTENTIAL HARM FROM VERTICAL**
8 **EFFECTS, IS THE MERGER LIKELY TO CAUSE HARM DUE TO**
9 **HORIZONTAL EFFECTS?**

10 A. Yes. A merger of CenturyLink and Qwest reduces competition in areas and for
11 services in which the companies compete. While, for the most part, the
12 companies operate in their own separate service areas, there are some instances in
13 which they do compete. Clearly, a merger would eliminate this competition, and
14 in doing so harm the public interest.

15 For example, as is evident from CenturyLink's own testimony, the companies
16 serve large numbers of exchanges that are adjacent. As is increasingly common,
17 ILECs often set up CLEC subsidiaries through which they compete in adjacent
18 exchanges. For example, CenturyLink operates as a CLEC in Minneapolis in
19 competition with Qwest.[77] CenturyLink also provides Ethernet services to certain

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76 For example, see *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, Memorandum Opinion and Order, December 31, 2006, at ¶ 60.

77 Http://www.centurylink.com/Pages/AboutUs/CompanyInformation/Regulatory/tariff Library.js; sessionid=055C224C462B5CB0FDF05EF67BB97A646E4E4AE78F.dotcomprd19

1 customers (presumably business and/or government customers) in the Olympia,
2 Tumwater and Spokane markets in Qwest's Washington state territory.[78] The
3 merger will eliminate any incentives for this type of competition between the two
4 companies. The harm may, in fact, be larger than meets the eye in the sense that
5 it eliminates not just actual instances of such competition but also *potential*
6 competition as well.

7 Q. **IS THE ELIMINATION OF SUCH COMPETITION AND POTENTIAL**
8 **COMPETITION IN LOCAL MARKETS TROUBLING IN LIGHT OF**
9 **THE FACT THAT LARGE SEGMENTS OF LOCAL EXCHANGE**
10 **MARKETS STILL LACK SIGNIFICANT COMPETITION?**

11 A. Yes. The areas in which CenturyLink and Qwest are potential competitors are
12 often largely rural and populated by captive ratepayers with few alternative
13 providers of local exchange service. Elimination of potential competition in those
14 areas is therefore especially troubling.

15 ***D. Uncertainty and Harm Will Result If the Merger Is Approved As Filed***

16 Q. **HAS CENTURYLINK SUBSTANTIATED ITS CLAIMS ABOUT THE**
17 **TRANSACTION CAUSING NO HARM?**

78 See CenturyLink's Response to Integra's First Set of Information Requests, #10, and Direct Testimony of Mark Reynolds on behalf of Qwest Corporation, Exhibit MSR-1T, Washington UTC Docket No. UT-100820, May 21, 2010 ("Reynolds Washington Direct (Qwest Exhibit MSR-1T)"), at p. 16.

1 A. No. The basis for CenturyLink's claim that the proposed transaction will do no
2 harm is its repeated statements that there will be no "immediate" changes made
3 following the merger. For instance, CenturyLink states:

4 "***Immediately*** upon completion of the Transaction, end-user and
5 wholesale customers will continue to receive service from the
6 same carrier, at the same rates, terms and conditions and under the
7 same tariffs, price plans, interconnection agreements, and other
8 regulatory obligations as ***immediately*** prior to the Transaction; as
9 such, the Transaction will be seamless to the customers."[79]

10 What is important is what this statement does ***not*** include. Specifically, it does
11 not state how long customers will continue to receive service under the same
12 rates, terms and conditions. Indeed, the footnote that follows the above statement
13 is very disconcerting:

14 In view of the current rapidly changing communications market,
15 any provider, including post-Transaction CenturyLink, must
16 constantly review its pricing strategy and product mix to respond
17 to marketplace and consumer demands. While rates, terms and
18 conditions will be the same immediately after the Transaction as
19 immediately before the Transaction, ***prices and product mixes***
20 ***necessarily will change over time as marketplace, technology,***
21 ***and business demands dictate.*** The affected entities will make
22 such changes only following full compliance with all applicable
23 rules and laws.[80]

24 A fair reading of the Washington Joint Application and the companies' supporting
25 testimony indicates that changes will indeed take place and yet there are no
26 specifics about what those changes might be or how and when they might be
27 made.

79 Washington Joint Application, at p. 5 (emphasis added). See also, Jones Washington Direct (CenturyLink Exhibit JJ-1T), at p. 6.

80 Washington Joint Application, at p. 5, fn. 8 (emphasis added).

1 **Q. DO THE COMPANIES' REPRESENTATIONS REGARDING**
2 **TRANSPARENCY SATISFY THE PUBLIC INTEREST STANDARD?**

3 A. No. The companies' vague and limited representations are meaningless, and
4 certainly fail to demonstrate that the public interest will be protected. Obviously,
5 CenturyLink could implement changes within months, weeks, or even days after
6 closing the transaction and still purport to have made no "immediate" changes.
7 For example, shortly after the transaction closes, the Merged Company could
8 implement layoffs[81] or require that CLECs re-negotiate all "evergreen" ICAs
9 using CenturyLink's template ICA or attempt to change Qwest's OSS. As I
10 discussed earlier in my testimony, the Commission's merger approval authority
11 under Washington law is intended to ensure that mergers are in the public interest.
12 This important authority certainly does not contemplate approval of a merger
13 based on the vague, limited assurances offered by the Companies. The bottom
14 line (and the reason why the proposed transaction is of such concern to CLECs) is
15 that the proposed merger provides absolutely no certainty for wholesale (or retail)
16 customers and the Companies have provided no meaningful assurance that the
17 transaction will not harm wholesale customers in the Qwest or CenturyLink
18 territories.

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81 According to the Associated Press, Qwest already made significant job cuts last year on a territory-wide basis, "decreasing its work force by 8.5 percent last year, or roughly 2,800 positions." See "Qwest Q4 profit falls 39 percent", February 16, 2010 at http://www.oregonlive.com/ business/ index.ssf/2010/02/qwest_q4_profit_falls_39_perce.html ; also, according to Timothy Donovan, president of Local 7200 of the Communications Workers of America, based in Minneapolis, about 6,000 workers are likely to lose their jobs. See, "CenturyTel-Qwest deal is a rural double-down," Star Tribune, April 22, 2010 at http://www.startribune.com/business/91876019.html.

1 **Q. GIVEN CENTURYLINK'S CLAIM OF *BUSINESS AS USUAL*
2 "IMMEDIATELY" FOLLOWING THE TRANSACTION, WHY DO YOU
3 BELIEVE THAT CHANGES WILL BE MADE?**

4 A. Because CenturyLink has stated that changes are coming. For example, in
5 response to discovery, CenturyLink states:

> 6 Upon merger closing, there will be no immediate changes to
> 7 Qwest's or CenturyLink's Provisioning Systems. CenturyLink has
> 8 not evaluated its processes and compared them to Qwest's
> 9 processes at this time. Integration planning is in the early stages
> 10 and decisions have not been made at this time. However, because
> 11 the transaction results in the entirety of Qwest, including
> 12 operations and systems, merging into and operating as a subsidiary
> 13 of CenturyLink, it will allow a disciplined approach to systems and
> 14 practices and allow integration decisions to proceed in an orderly
> 15 manner. The merger is intended to bring about improved
> 16 efficiencies and practices in all parts of the combined company, ***so***
> 17 ***changes could be expected over time.*** To the extent any changes
> 18 are made, CenturyLink will comply with all applicable state and
> 19 federal laws and rules, as well as the provisions of any applicable
> 20 interconnection agreements and tariffs, in the same manners as
> 21 they would apply notwithstanding the merger. In addition, any
> 22 changes will occur only after a thorough and ***methodical review of***
> 23 ***both companies' systems and processes to determine the best***
> 24 ***system to be used*** on a go-forward basis from ***both a combined***
> 25 ***company and a wholesale customer perspective.***[82]

26 Though CenturyLink has put CLECs on notice to expect changes, CenturyLink
27 has provided no detail about what will change, when it will change or how
28 CenturyLink will determine which is the "best system"[83] to use. This is

82 CenturyLink Response to Integra's First Set of Information Requests, #35(h) (emphasis added). See also, CenturyLink SEC Form S-4/A, filed July 16, 2010, at p. 16 ("There are a large number of systems that must be integrated, including, billing, management information, purchasing, accounting and finance, sales, payroll and benefits, fixed asset, lease administration and regulatory compliance.")

83 To my knowledge, CenturyLink has not provided any substantive details about the "methodical review" or what it means to perform the review from "both a combined company and a wholesale customer perspective." When asked about this in discovery, CenturyLink provided little additional detail, other than to say that "[i]t has not been determined whether third-party testing will be included

1 particularly problematic when it comes to OSS because only Qwest's existing
2 systems (*i.e.*, not CenturyLink's existing OSS) have been tested under a Section
3 271 review.

4 **Q. CENTURYLINK GOES EVEN FURTHER AND CLAIMS THAT THERE**
5 **ARE NO "POTENTIAL HARMS THAT COULD RESULT FROM THE**
6 **MERGER."[84] IS THIS TRUE?**

7 A. No. As discussed previously, this merger poses a substantial risk of harm to
8 CLECs and competition based on (1) the nature and history of mergers such as
9 this; (2) the prospect of cuts aimed at achieving the enormous synergies claimed
10 by the Companies; and (3) the inherent competitive disincentive to providing
11 quality wholesale services to carriers with whom the Merged Company will
12 compete. The potential for substantial harm is further illustrated by the
13 bankruptcies and system meltdowns that have transpired in the wake of recent
14 mergers. Contrary to CenturyLink's claim, there ***are*** unquestionably "potential
15 harms that could result from the merger."

16 For instance, despite CenturyLink's best efforts, if it attempts to integrate any
17 OSS or other systems from the CenturyLink region to Qwest's region and such an
18 attempt fails (as in the case of FairPoint), CLECs would likely suffer substantial

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in the assessment process." CenturyLink's Response to Integra's First Set of Information Requests, #49(a). In a nutshell, CenturyLink's response is that it will evaluate the different systems and processes, take input from interested CLECs, and then base its decision on "operational efficiencies for the company [CenturyLink], in general." Centurylink's Response to Integra's First Set of Information Requests, #49(b). If CenturyLink is truly concerned about the "wholesale customer perspective," then CenturyLink will not replace Qwest's existing OSS post-transaction. As evidenced by the CLEC proposed conditions, it is clearly the CLECs' perspective that Qwest's existing OSS is preferable to existing CenturyLink OSS.

84 Jones Washington Direct (CenturyLink Exhibit JJ-1T), at p. 15, lines 2-4 (emphasis added).

1 harm. As another example, the Companies' projected synergies and one-time
2 integration costs pose a serious threat to the public interest in at least two respects.
3 First, the pressure to achieve their estimated $625 million in synergies may drive
4 cuts or inattention to the provision of quality wholesale services, including OSS
5 used to support those services. Second, failure to achieve its estimated synergies
6 or higher than expected integration costs could seriously impede the Merged
7 Company's ability to pay down its debt, attract capital and make the investments
8 necessary to ensure adequate service. The free cash flow that CenturyLink claims
9 it will use to reduce debt and invest in its network is based on its estimated $625
10 million in operating and capital synergies, along with its estimated $650-$800
11 million in one-time operating costs and $150-$200 million in one-time capital
12 costs.[85] However, if CenturyLink fails to achieve those synergies or if its
13 integration costs significantly exceed the estimates (despite CenturyLink's best
14 efforts to achieve these targets), its ability to pay down debt will be diminished,
15 thereby leaving the merged company highly leveraged and potentially unable to
16 make the needed investments to maintain service quality or the dividends to
17 satisfy shareholders.

18 **Q. HAS CENTURYLINK ACKNOWLEDGED THE POTENTIAL FOR**
19 **HARM RELATED TO FAILING TO ACHIEVE ESTIMATED SYNERGY**
20 **SAVINGS?**

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85 See e.g., Bailey Washington Direct (CenturyLink Exhibit GCB-1T), at pp. 4-5 and p.4, fn. 5.

1 A. Yes. CenturyLink made this very point to the SEC and its shareholders when it
2 stated that the inability to successfully integrate Qwest and CenturyLink could
3 prevent CenturyLink from:

4 achiev[ing] the cost savings anticipated to result from the merger,
5 which would result in the anticipated benefits of the merger not being
6 realized in the time frame currently anticipated or at all.[86]
7
8 CenturyLink also acknowledges the potential harms or "integration-related risks"
9 associated with beginning the integration of Qwest before the integration of
10 Embarq is complete.[87]

11 **Q. HAS THE FCC PREVIOUSLY REJECTED CLAIMS THAT THERE ARE**
12 **NO POTENTIAL HARMS RESULTING FROM A MERGER OF THIS**
13 **TYPE?**

14 A. Yes. When evaluating the SBC/Ameritech merger – a merger involving two
15 ILECs – the FCC found harm resulting from the transaction in three areas:

16 • It removes one of the most significant potential participants in each of the
17 applicant's local markets, for mass market and enterprise customers
18 • It substantially reduces the ability of regulators to implement and oversee
19 the market-opening provisions of the 1996 Act because the ability to

86 CenturyLink SEC Form S-4A, filed July 16, 2010, at p. 17.

87 See, e.g., Bailey Direct(CenturyLink Exhibit GCB-1T), at p. 18, lines 5-8 ("Q. Does the merger with Qwest include incremental financial risks because the Embarq transaction was only consummated at the end of June, 2009? A. CenturyLink believes that the integration-related risks are manageable for several reasons. ..."). See also, the "Risk Factors" discussion found in CenturyLink's SEC Form S-4A, filed July 16, 2010, identifying, among others, the following as merger-related risks: (1) "substantial expenses in connection with completing the merger and integrating the business, operations, networks, systems, technologies, policies and procedures of Qwest with those of CenturyLink"; (2) "CenturyLink expects to commence these integration initiatives before it has completed a similar integration of its business with the business of Embarq, acquires in 2009, which could cause both of these integration initiatives to be delayed or rendered more costly or disruptive than would otherwise be the case"; (3) "the inability to successfully combine the businesses of CenturyLink and Qwest in a manner that permits the combined company to achieve the cost savings anticipated to result from the merger, which would result in the anticipated benefits of the merger not being realized in the time frame currently anticipated or at all." S-4A, at pp. 16-17.

compare the practices of BOCs and ILECs is diminished, which increases the incumbent's market power

- It increases the incentive and ability of the Merged Company to discriminate against its competitors, particularly with respect to the provision of advanced services.

The FCC found that these harms would have been fatal to the merger application but for the extensive list of conditions that were placed on the merger to offset the harm.[88] The harms identified by the FCC apply to the proposed transaction.

Q. ARE THERE OTHER REASONS TO TAKE ISSUE WITH CENTURYLINK'S AND QWEST'S CLAIM OF "NO HARM"?

A. Yes. The uncertainty surrounding the potential merger and what may take place afterward is causing significant uncertainty for CLECs, which, in and of itself, causes harm. CLECs need certainty to plan their businesses and make prudent investments, and the proposed transaction results in uncertainty in virtually every aspect of the CLECs' relationship with the Merged Company.

E. Harm Due to a Lack of Certainty (Business Planning)

Q. IS THERE A GENERAL NEED FOR CERTAINTY IN BUSINESS RELATIONSHIPS?

A. Yes. In a general sense, when a business relies upon another business for services or parts, it is critical to have a contract in place that is specific and

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88 In re Applications of AMERITECH CORP., Transferor, and SBC COMMUNICATIONS INC., Transferee, For Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules, CC Docket No. 98-141, Memorandum Opinion and Order, ¶¶ 348-349.

1 unambiguous. For instance, if Ford is purchasing tires for its vehicles from
2 Firestone, it is very important for Ford to know and understand what type, size,
3 quality and quantity of tires will be delivered to each manufacturing plant and
4 when. Not surprisingly, the cost of the tires is also important for Ford in setting
5 the prices for vehicles. If Firestone announced that it was being acquired by
6 Tires, Inc. (a fictional company) on December 31, 2010, Ford would likely ask
7 Firestone a litany of questions about what Ford could expect in 2011 – *e.g.*,
8 whether Firestone will deliver the same type and size of tires Ford needs, whether
9 the quality of the tires will be the same, whether the tires will be delivered to the
10 manufacturing plant in a timely manner, etc. If Firestone came back to Ford and
11 said "we don't know and won't know until 2011", Ford would (a) start looking to
12 another tire supplier that can provide more certainty, (b) ask Firestone to provide
13 commitments that can be relied upon in 2011, or (c) both. The point is that Ford
14 would demand certainty so that it could continue to produce vehicles and deliver
15 them to the showroom. Likewise, CLECs – who rely on ILEC-provided services
16 – need certainty in order to deliver their services to the local market place.

17 **Q. DO CLECS HAVE THE SAME OPTIONS WITH REGARD TO**
18 **SUPPLIERS AS FORD DID IN YOUR PREVIOUS ANALOGY?**

19 A. No. Unlike Ford, the CLECs cannot shop elsewhere for the critical wholesale
20 services they purchase from the ILECs in the Companies' territories. That means
21 that certainty in relation to the services CLECs purchase from ILECs is even more
22 important.

1 **Q. HAS CENTURYLINK ACKNOWLEDGED THE HARM THAT RESULTS**
2 **FROM UNCERTAINTY RELATING TO THE PROPOSED**
3 **TRANSACTION?**

4 A. Yes. In its Form S-4A filing (at page 16) CenturyLink states:

> 5 In connection with the pending merger, some customers or vendors
> 6 of each of CenturyLink and Qwest may delay or defer decisions,
> 7 which could negatively impact the revenues, earnings, cash flows
> 8 and expenses of CenturyLink and Qwest, regardless of whether the
> 9 merger is completed.

10 CLECs are wholesale customers of Qwest and CenturyLink, and CenturyLink is
11 correct that the pending merger can result in delayed or deferred decisions from
12 these wholesale customers. And while CenturyLink focuses on the potential
13 negative impacts on revenues, earnings, cash flows and expenses of Qwest and
14 CenturyLink resulting from this uncertainty, CenturyLink ignores that this
15 uncertainty also could cause negative impacts on CLEC revenues, earnings, cash
16 flows and expenses. Likewise, in its recent Reply Comments to the FCC,
17 CenturyLink states that, "the transaction will bring much-needed stability to the
18 incumbent local exchange carrier ('ILEC') sector",[89] but ignores that CLECs also
19 need stability and that the proposed transaction causes severe *un*certainty for
20 CLECs. Because the Merged Company will be pursuing merger-related synergy
21 savings for a three-to-five year period after the merger, the uncertainty for the
22 Merged Company's CLEC wholesale customers will continue well beyond the
23 date of merger approval.

89 FCC WC Docket No. 10-110, Reply Comments of CenturyLink, Inc. and Qwest Communications International, Inc., filed July 27, 2010, at p. 9.

1 **Q. HAS THE COMMISSION SEEN REPRESENTATIONS SIMILAR TO**
2 **THE COMPANIES' THAT CERTAIN DECISIONS WILL NOT BE MADE**
3 **UNTIL AFTER THE MERGER CLOSES BEFORE?**

4 A. Yes. In regard to dozens of issues in this proceeding, the Companies have stated
5 in initial testimony and in discovery that the relevant decisions have not been
6 made yet and will not be made until after the merger. That has been the
7 Companies' response on almost everything – from which OSS will be used in
8 Washington to the staffing levels and potential headcount reductions that may
9 occur post-merger in the wholesale services support centers for Washington and
10 other legacy Qwest territories.

11 **Q. HAVE YOU PREPARED AN EXHIBIT TO DEMONSTRATE THE**
12 **SIGNIFICANT UNCERTAINTY FACING CLECS DUE TO THE**
13 **PROPOSED MERGER?**

14 A. Yes. Attached as Exhibit AHA-4 is a table which lists many of the important and
15 customer-impacting issues that should be examined in determining whether the
16 proposed transaction will cause "no harm" (*e.g.*, systems integration, operations
17 integration, performance assurance plans, wholesale rates, etc.) and matches that
18 list to what the Companies have said about those issues in discovery responses.
19 This exhibit shows complete uncertainty post-transaction for important issues
20 such as OSS integration, billing systems integration, E911 systems, provisioning
21 intervals, wholesale customer service, change management process, network
22 investment, just to name a few. In each area, the Companies were unable or
23 unwilling to provide any plans or describe any changes that will take place – other

1 than to say, *we'll let you know after the merger has been approved.*
2 Unfortunately, that is too late. The Companies must demonstrate now that the
3 proposed transaction will do "no harm" and they have failed to demonstrate that,
4 as evidenced by this exhibit.

5 **VI. FAILURE TO PROVE BENEFITS RESULTING FROM MERGER**

6 **Q. CAN THE COMMISSION VALIDATE CENTURYLINK'S CLAIMS OF**
7 **BENEFITS RESULTING FROM THE MERGER?**

8 A. No. Although CenturyLink has identified numerous alleged benefits from the
9 proposed transaction, it has substantiated none of them. In discovery in
10 Washington and other states undertaking merger reviews, various parties
11 including CLECs, commission staffs and consumer advocates asked the
12 Companies about their plans regarding the alleged benefits, and in every instance,
13 the Companies have stated that they have no plans and/or that plans cannot be
14 developed until after the transaction is approved. Again, *we'll let you know after*
15 *the merger has been approved.* To demonstrate this point, I developed Exhibit
16 AHA-5 which is a table that lists the alleged benefits resulting from the merger
17 claimed by the Companies and matches that list to what the Companies have said
18 about those alleged benefits in discovery responses. In each instance, there is no
19 substance supporting the alleged benefit. By way of example, despite repeated
20 claims about benefits related to broadband and IPTV deployment as a result of the

1 merger,[90] when asked about its post-merger plans, CenturyLink was unable to
2 provide any details (*i.e.*, no plans for rollout, no projection, no timeline) and, in
3 fact, CenturyLink explained that it does not even know whether the Qwest
4 network is currently capable of supporting the advanced services deployment that
5 CenturyLink has identified as a benefit of the merger.[91] Obviously, if the Qwest
6 network is not capable of providing the advanced services that CenturyLink touts,
7 then the alleged benefit of IPTV/advanced services deployment will not be
8 realized post-transaction (or will be delayed indefinitely while the necessary
9 upgrades can be made – a likely scenario given that the Merged Company will be
10 focused on integration efforts and debt reduction post-merger). My Exhibit AHA-
11 5 shows the same results for other alleged benefits, including network investment,
12 free cash flow, debt repayment, synergies, improved access to capital,
13 implementation of CenturyLink's go-to-market model, and others. I was unable
14 to locate a single alleged benefit that CenturyLink could substantiate with facts.

15 **Q. WHAT WOULD THE COMPANIES NEED TO SHOW TO**
16 **SUBSTANTIATE THESE BENEFITS?**

17 A. The FCC has applied the following criteria for determining whether a claimed
18 benefit is cognizable:

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90 See, e.g., Washington Joint Application at pp. 2, 10, and 12, and Bailey Washington Direct (CenturyLink Exhibit GCB-1T) at pp. 13-14 and 23.

91 See my Exhibit AHA-5 at pp. 1-4, and CenturyLink Response to OR UTC Staff Data Request #33, CenturyLink Response to IA OCA Data Request #004A, and CenturyLink response to WA UTC Staff Data Request #52 ("Once the transaction closes, a review of the marketplace will be done to determine needs of the [Oregon, Iowa, Washington] market. This process also includes an assessment of the capabilities of existing Qwest infrastructure necessary to support advanced communications, data, and potentially entertainment services the combined company may chose to rollout in the future…").

1. "the claimed benefit must be transaction or merger specific (i.e., the claimed benefit 'must be likely to be accomplished as a result of the merger but unlikely to be realized by other means that entail fewer anticompetitive effects')."
2. "the claimed benefit must be verifiable," which requires Applicants to "provide sufficient evidence supporting each claimed benefit..." and allows discounting of "benefits that are to occur only in the distant future...because...predictions about the more distant future are inherently more speculative than predictions about events that are expected to occur closer to the present" and
3. "marginal cost reductions [are more cognizable] than reductions in fixed cost" because "reductions in marginal cost are more likely to result in lower prices for consumers."[92]

Q. DO THE COMPANIES' ALLEGED BENEFITS MEET THESE CRITERIA?

A. No. None of the alleged benefits is "verifiable" because no evidence was provided to support the benefits; rather, the Companies make unsupported predictions about what may transpire in the distant future. To the contrary, the available evidence casts doubt on whether the alleged benefits will actually be realized. The alleged benefits also fail to satisfy the FCC's three-part criteria for other reasons. For example, the alleged benefit of broadband deployment does not meet the first prong (merger specific). Legacy Qwest has deployed broadband to 86% of its customers.[93] To expand this deployment, Qwest filed an application in March, 2010, for a federal stimulus grant from the Broadband Initiatives Program (BIP) "to extend broadband at speeds of 12 to 40 Mbps to rural communities throughout its local service region." Qwest has stated that "[t]he

92 *In the Matter of Applications Filed for the Transfer of Control of Embarq Corporation to CenturyTel, Inc.*, WC Docket No. 08-238, Memorandum Opinion and Order, released June 25, 2009 ("*CenturyTel/Embarq Merger Order*"), at ¶ 35.

93 Integra, et al., Comments, WC Docket No. 10-110, at p. 67, citing Joint Applicants' FCC Application at 13.

1 Transaction will not have any impact on this request."[94] What this means is that
2 advanced deployment in Qwest's legacy territory is not merger-specific: Qwest is
3 pursuing it independent of the merger. The Communications Workers for
4 America (CWA) agreed with this assessment in their comments to the FCC on the
5 proposed transaction:

> 6 Although the Applicants claim that the proposed merger will result
> 7 in accelerated broadband deployment and increased bandwidth,
> 8 they provide no concrete, verifiable broadband commitments. The
> 9 Applicants do not indicate the number of new households, small
> 10 businesses, or anchor institutions that will have access to
> 11 broadband; the upgraded capacity that will be delivered; nor the
> 12 new markets that will be served with IPTV expansion.[95]

13 When CenturyLink was asked specifically about the third prong – *i.e.*, to identify
14 the marginal cost reductions resulting from the merger, CenturyLink responded:
15 "Those cost savings are not broken out between fixed or marginal cost."[96] As
16 such, it is impossible to tell what portion, if any, of the estimated synergies would
17 result in lower prices for consumers, and in turn, impossible for the Companies to
18 substantiate benefits under the third prong. If the Companies cannot provide
19 reasonable verification that their alleged benefits satisfy the FCC's test, the
20 merger should not be approved.

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94 See, e.g., Reynolds Washington Direct (Qwest Exhibit MSR-1T), at p. 10. Qwest described its grant application in more detail in response to Montana Consumer Counsel Data Request 58 in Montana PSC Docket No. D2010.5.55: "Qwest Corporation's project proposes deployment of High Speed Access within its current 14-state ILEC footprint. Over 500,000 living units (LUs) in [the 14 states] will be served with speeds ranging up to 40 Mbps downstream. About 90% of the LUs proposed for new or upgraded broadband service are in rural areas…And, if funded, the project's $467 M investment will create more than 23,000 jobs for local economies in the 14 states…" Again, this project is being pursued independently of the proposed transaction.

95 Comments of Communications Workers of America, FCC WC Docket No. 10-110, July 12, 2010, at p. 13.

96 CenturyLink's Response to Integra's First Set of Information Requests, #55(a).

1 **Q. HAVE THE COMPANIES IDENTIFIED ANY BENEFITS THAT WOULD**
2 **ACCRUE TO CLECS FROM THE MERGER?**
3 A. No. The Companies have not identified a single direct benefit that would accrue
4 to CLECs. The Washington Joint Application makes a sweeping statement that it
5 is seeking expedited approval so that "consumer, business, and wholesale
6 customers and shareholders" will all benefit sooner from "the combined firm['s]
7 greater financial strength and flexibility to compete" and "significant economies
8 of scale and scope" it claims the transaction would create – but in no sense does it
9 explain how CLECs would benefit from these alleged changes.[97] To my
10 knowledge, the only place in the instant proceeding where a CenturyLink or
11 Qwest witness even discusses benefits to wholesale customers is in the following
12 Q&A from Qwest's witness Mr. Reynolds:

13 **Q PLEASE SUMMARIZE HOW WHOLESALE CUSTOMERS**
14 **WILL BENEFIT FROM THE MERGER TRANSACTION.**
15 A. The additional financial resources, combined network capacity and
16 geographic reach afforded by the merger will allow the combined
17 company to continue to serve the wholesale customers by
18 providing a much broader footprint than either company can
19 currently do independently. For example, as the demand for
20 broadband wireless services has mushroomed, the need for
21 additional fiber capacity to serve cellular tower sites (often referred
22 to as wireless backhaul) has increased dramatically. As noted
23 above, Qwest is already committing significant resources to serve
24 the increased demand from wireless carriers in its region, and the
25 combined entity will possess the resources to continue this
26 investment.[98]

97 Washington Joint Application at p. 18.

98 Reynolds Washington Direct (Qwest Exhibit MSR-1T), at p. 25, lines 1-11. The Washington Joint Application also makes a passing reference to "deploy additional fiber-to-the-cell-tower capabilities…" at p. 10.

1 The first sentence of the answer does not identify any benefit. First, it simply
2 says that the Merged Company will "continue to serve the wholesale market" –
3 something that would occur independently of the proposed transaction. Second,
4 the reference to the size of the Merged Company's footprint ("geographic
5 reach") does not translate to benefits to wholesale customers unless the
6 efficiencies that come along with that larger footprint are realized by the local
7 market as well – such as lower transaction costs across the footprint. The
8 remainder of the answer applies to fiber to cell towers – a claim that, even if
9 substantiated, relates to financial benefits that would accrue largely, if not solely,
10 to the Merged Company, and not to CLECs.

11 **Q. HAVE CLECS RECEIVED ASSURANCE THAT THEY WILL SHARE IN**
12 **ANY MERGER RELATED SAVINGS?**

13 A. No. Take the larger footprint discussed above as an example. Due to this larger
14 footprint, and associated alleged economies, the Merged Company is expecting
15 $575 million in annual operating cost savings (from such sources as corporate
16 overhead, network and operational efficiencies, IT support, increased purchasing
17 power) and $50 million in annual capital expenditure savings.[99] As a result of
18 these synergies (the realization of which is speculative) the cost-structure of the
19 combined company would decline. This should, in turn, result in lower rates for
20 network elements and interconnection leased by CLECs because these cost-based
21 rates should reflect the reductions in forward-looking costs resulting from the

99 Bailey Washington Direct (CenturyLink Exhibit GCB-1T), at p. 11, Reynolds Washington Direct (Qwest Exhibit MSR-1T), at p. 13.

1 merger-related synergy savings. However, when asked if the Merged Company
2 would adjust its cost-based wholesale rates to reflect these cost savings,
3 CenturyLink replied: "CenturyLink has not evaluated or reached any conclusions
4 concerning this issue at this time..."[100] And without a concrete commitment that
5 allows CLECs to rightfully share in the cost-savings the combined company
6 achieves, this will undoubtedly be very low on CenturyLink's priority list post-
7 transaction. The end result is that the Merged Company will enjoy a cost
8 advantage over its competitors, which is the antithesis of the federal pricing
9 standards for network elements and interconnection.

10 Another example is transaction costs. As the Merged Company integrates its
11 business across its 37 state serving territory, transaction costs for the Merged
12 Company should decrease as its service offerings, practices, systems, etc. become
13 increasingly uniform. By way of example, whereas before the transaction both
14 Qwest and CenturyLink would have negotiated (and potentially arbitrated)
15 interconnection agreements with a CLEC like tw telecom separately, after the
16 transaction, the combined company could negotiate with the CLEC in a unified
17 fashion (similar to how CenturyLink currently negotiates and arbitrates
18 agreements for its separate rural and non-rural affiliates). This lowers the
19 combined company's wholesale transaction costs, and unless this benefit is shared
20 by CLECs, it will create a competitive advantage for the combined company
21 which already enjoys substantially more bargaining power than the CLEC in ICA
22 negotiations.

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100 CenturyLink's Response to Integra's First Set of Information Requests, #55(b).

1 **VII. RECOMMENDATIONS AND CONDITIONS**

2 **Q. WHAT IS YOUR RECOMMENDATION WITH RESPECT TO THE**
3 **PROPOSED TRANSACTION?**

4 A. I recommend that the Commission deny the merger as proposed. The Companies
5 have not met the "no harm" public interest standard under Washington law and
6 have failed to materially substantiate the alleged benefits from the merger.
7 However, if the Commission nevertheless approves the merger, it should do so
8 only if the transaction is subject to robust, enforceable conditions to ensure that
9 the proposed transaction ultimately serves the public interest.

10 In addition to the conditions discussed by Mr. Gates, I recommend that the
11 Commission impose the conditions discussed below. (A full set of conditions is
12 provided as Exhibit TJG-9 to Mr. Gates testimony.) Many of these conditions
13 will be familiar to the Commission, as they were included in the Multiparty
14 Settlement reached between Frontier, Verizon, and the "Joint CLECs" (and
15 360networks (USA) Inc.) that was approved and incorporated into the
16 Commission's *Frontier-Verizon Merger Order*.[101] In that Order, the Commission
17 specifically found the wholesale and interconnection conditions established by the
18 Multiparty Settlement to be in the public interest, stating that:

19 > We place considerable weight on the fact the competitors were able to
20 > reach agreement with Joint Applicants on a wide variety of wholesale
21 > and interconnection matters and believe the various commitments in

101 See, *Frontier-Verizon Merger Order*, Appendix C (Multiparty Settlement), Attachment 1 (Settlement Conditions).

1 the settlements will prevent harm to competitive circumstances within
2 Verizon NW's service area.[102]

3 Similarly, adopting the conditions that I set forth below would go a long way
4 towards mitigating competitive harm and ensuring that the proposed
5 CenturyLink-Qwest transaction would meet the 'no harm' public interest
6 standard.

7 ***A. Wholesale Service Availability***

8 **Q. PLEASE IDENTIFY THE PROPOSED CONDITIONS RELATING TO**
9 **WHOLESALE SERVICE AVAILABILITY.**

10 A. There are nine conditions in this category – conditions 1, 6, 8, 9, 10, 12, 14 and 28
11 (the numbers correspond to the full list of conditions found in Exhibit TJG-9):

12 • Condition 1 provides that the Merged Company will make available and not
13 discontinue for the Defined Time Period any wholesale service offered to a
14 CLEC at any time between the merger filing date and the closing date (except
15 as approved by the Commission).

16 • Condition 6 provides that the Merged Company will assume or take
17 assignment of all obligations under Qwest's "Assumed Agreements"[103]
18 (which includes Qwest's interconnection agreements, Commercial
19 agreements[104] and tariffs) and AFOR plans without requiring the wholesale
20 customer to execute any documents to effectuate the assumption or
21 assignment. Further, this condition also states that the Merged Company shall
22 offer and not terminate or change the rates, terms and conditions under the
23 Assumed Agreements for at least the Defined Time Period (or until the
24 expiration date, whichever is longer) unless requested by the wholesale
25 customer or required by change of law. Finally, this condition also states that

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102 *Id.*, at p. 87.

103 All obligations under Qwest's interconnection agreements, interstate tariffs (including the Annual Incentive contract tariff), and intrastate tariffs, Commercial agreements, and other existing arrangements with wholesale customers ("Assumed Agreements").

104 Commercial" agreements include but are not limited to wholesale metro Ethernet agreements, OCN (SONET) agreements, Local Services Platform (e.g., QLSP) agreements, Dark Fiber agreements, Broadband for Resale agreements, and line sharing agreements.

the Merged Company will offer Commercial Agreements in CenturyLink legacy ILEC territory at prices no higher and time periods no shorter than those offered in the legacy Qwest territory.

- Condition 8 states that the Merged Company will allow extensions of existing interconnection agreements for at least the Defined Time Period (or expiration date whichever is later).
- Condition 9 states that the Merged Company will allow requesting carriers to use its pre-existing ICA as basis for negotiating a new ICA. For ongoing negotiations, this condition states that the existing negotiations draft will continue to be used for negotiations and that CenturyLink will not substitute negotiations proposals made prior to the closing date with CenturyLink's negotiations template interconnection agreement.
- Condition 10 states that in the CenturyLink ILEC territory, the Merged Company will allow a requesting carrier to opt into any ICA to which Qwest is a party in the same state. In situations in which there is no Qwest ILEC in the state, the condition allows the carrier to opt into any ICA to which Qwest is a party in any state in which it is an ILEC. This condition permits the state Commission to modify the ICA if the Merged Company demonstrates technical infeasibility or that the prices are inconsistent with the TELRIC-based prices in the state in question. This condition also carves out CenturyLink territories that currently operate under a rural exemption, but does not preclude a regulatory body from finding that the rural exemption should cease to exist, and in those instances, the merger condition would apply to those areas.
- Condition 12 states that the Merged Company will not seek to avoid obligations under Assumed Agreements on the grounds that it is not an ILEC. This condition also states that the Merged Company will waive its right to seek rural exemptions.
- Condition 14 states that for the Defined Time Period the Merged Company will not seek to reclassify wire centers or file new forbearance petitions in relation to its obligations under Sections 251 or 271 of the Act.
- Condition 28 states that, at the CLEC's option, the Merged Company will interconnect with CLEC at a single point of interconnection per LATA, regardless of whether the merged entity operates in that LATA via multiple operating affiliate companies or a single operating company.

Q. WHY ARE THESE CONDITIONS NECESSARY?

A. The concern underlying these conditions is that the availability of wholesale services should be stable over the foreseeable future to offset the substantial

1 uncertainty and risks of degraded wholesale services associated with the proposed
2 merger, including the risks that stem from the Merged Company's efforts to
3 achieve synergy savings post-merger. These conditions help ensure that the
4 Merged Company does not direct its integration efforts to the detriment of
5 wholesale customers by withdrawing services or significantly changing the
6 offerings Qwest currently makes available.

7 These conditions also recognize that the Merged Company will be a larger carrier
8 with a bigger footprint, possibly resulting in economies and efficiencies, as the
9 Companies claim. To serve the public interest, any such economies and
10 efficiencies should accrue in part to the benefit of captive wholesale customers
11 and the general public as well as the merged company; otherwise, the Merged
12 Company will enjoy an unreasonable cost advantage over its captive
13 customers/competitors. As a result, if the Companies' claims of merger savings
14 are accurate, those savings should decrease the costs associated with providing
15 wholesale services and interconnection to CLECs. Allowing the Merged
16 Company to be the sole beneficiary of the economies and efficiencies resulting
17 from the merger would have an anti-competitive and discriminatory impact on the
18 merged company's captive wholesale customers, who depend on wholesale
19 services from, and interconnection with, the ILEC to compete. Such a result
20 would be inconsistent with the pro-competitive mandate of the Act, FCC orders,
21 and state law, and contrary to the public interest.

1 **Q. THESE CONDITIONS INVOLVE THE MERGED COMPANY**
2 **CONTINUING TO MAKE AVAILABLE WHOLESALE SERVICES THAT**
3 **QWEST CURRENTLY PROVIDES FOR THE DEFINED TIME PERIOD.**
4 **WHY IS THIS WARRANTED?**

5 A. Again, wholesale customers need certainty with regard to the elements and
6 services they purchase from Qwest (or the Merged Company) for business
7 planning purposes, and based on the transaction as filed, there is no such
8 certainty. CLECs cannot simply go elsewhere for the wholesale services they
9 need from Qwest and CenturyLink both now and post-merger, so certainty in this
10 area is absolutely essential.

11 **Q. REGARDING CONDITION 1, WHY IS IT IMPORTANT THAT THE**
12 **MERGED COMPANY CONTINUE TO PROVIDE WHOLESALE**
13 **SERVICES THAT IT PROVIDED ANYTIME BETWEEN THE MERGER**
14 **FILING DATE AND CLOSING DATE?**[105]

15 A. The withdrawal of wholesale services after the Filing Date would signal a move
16 toward the Merged Company impeding competition, and in turn, result in a
17 merger-related harm. Even if a condition requires the Merged Company to
18 maintain the wholesale services available at the Closing Date for a period of time,
19 it would not cover the wholesale services that were eliminated between the Filing
20 Date and Closing Date. This concern is based on past experience. One historical

105 "Merger Filing Date" when used in the list of conditions, "refers to May 10, 2010, which is the date on which Qwest and CenturyLink made their merger filing with the FCC." "Closing Date" when used in the list of conditions, "refers to the closing date of the transaction for which the Applicants have sought approval from the Federal Communications Commission (FCC) and state commissions (the 'transaction')."

1 example is when Qwest (f/k/a US WEST) attempted to withdraw Centrex (also
2 known as CENTRON in Minnesota) almost simultaneously with the passage of
3 the Telecommunications Act of 1996. The Act was signed into law on February
4 8, 1996. On February 5, 1996, Qwest filed a notice to grandparent and ultimately
5 terminate CENTRON services. After the Minnesota Commission rejected that
6 termination request; Qwest then followed up with a second request to terminate
7 CENTRON on April 30, 1996.[106] Qwest made these filings to withdraw
8 CENTRON despite that Commission's previous finding that "resale of
9 CENTRON under certain conditions is in the public interest..."[107] Yet, in the
10 relatively brief time between passage of the Act in February 2006 and issuance of
11 the FCC's Local Competition Order to implement the local competition
12 provisions of the Act in August 8, 1996, Qwest attempted to withdraw a
13 wholesale service that was found to be in the public interest. Though Qwest was
14 ultimately unsuccessful in Minnesota,[108] competitors were still required to expend
15 substantial time and money combating Qwest's anti-competitive conduct.

16 **Q. WHAT ARE THE KEY COMPONENTS OF CONDITION 6?**

17 A. There are two important aspects that I will discuss. First, Condition 6 (exclusive
18 of its subparts) commits the Merged Company to take assignment of the Assumed
19 Agreements, without requiring wholesale customers to execute any documents to

106 *In the Matter of the Request of US WEST Communications, Inc.to Grandparent CENTRON Services With Future Discontinuance of CENTRON, CENTREX and Group Use Exchange Services*, Order Denying Petition, Minnesota PUC Docket No. P-421/EM-96-471, February 20, 1997 ("*Minnesota CENTRON Order*"), at pp. 1-2.

107 *Id.* at p. 8.

108 *Id.* at p. 13.

1 effectuate the assumption. Second, subpart A. of this Condition requires the
2 Merged Company to continue offering the terms and conditions of any Assumed
3 Agreement, including any assumed commercial agreements, for a reasonable
4 period of time after the merger, which should be at least as long as the period of
5 synergy savings projected by the Joint Applicants.

6 **Q. WHY SHOULD THE MERGED COMPANY BE PROHIBITED FROM**
7 **REQUIRING WHOLESALE CUSTOMERS TO EXECUTE ANY**
8 **DOCUMENTS IN ORDER FOR THE MERGED COMPANY TO TAKE**
9 **RESPONSIBILITY FOR QWEST'S EXISTING ICAS, TARIFFS AND**
10 **AFOR PLANS (CONDITION 6)?**

11 A. First, when asked whether CenturyLink would assume or take assignment of
12 Qwest's obligations under ICAs, tariffs, etc., CenturyLink replied:

> 13 Qwest Corporation does not cease to exist as a result of the parent-
> 14 level Transaction but remains an ILEC, subject to the same terms
> 15 and obligations of its interconnection agreements, tariffs,
> 16 commercial agreements, line sharing agreements, and other
> 17 existing arrangements with wholesale customers immediately after
> 18 the merger as immediately prior to the merger.[109]

19 Since Qwest does not cease to exist as a result of the transaction, there should be
20 no reason for wholesale customers to have to execute additional documents in
21 order for the Merged Company to assume the obligations under the existing
22 wholesale agreements (*e.g.*, ICAs) and tariffs. Second, the transfer of control
23 should be as smooth and seamless as possible, and requiring wholesale customers
24 to receive, review, negotiate and execute documents for this purpose could result

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109 CenturyLink's Response to Integra's First Set of Information Requests, #113(a).

1 in disruption or delay during the transfer of control. And that disruption and
2 delay would be exacerbated if wholesale customers disagree with the terms
3 included in the documents the Merged Company wants wholesale customers to
4 execute, resulting in parties seeking resolution of those disputes before this
5 Commission.[110]

6 **Q. CAN YOU PROVIDE A REAL-WORLD EXAMPLE OF WHY**
7 **CONDITION 6 IS A NECESSARY PROTECTION IF THE MERGER IS**
8 **APPROVED?**

9 A. Yes. While it may appear self-evident that, if an obligation continues or is
10 assumed, the ILEC will not request further document execution, that was not the
11 result in the case of the Frontier's acquisition of Verizon Northwest. Despite a
12 merger condition that Frontier assume wholesale agreements and not terminate or
13 change their terms, [111] on January 21, 2010, Frontier and Verizon sent a joint letter
14 and Adoption Agreement which effectively attempted to impose amendment of
15 the wholesale agreement to reflect certain Frontier processes.[112]

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110 This is not a theoretical concern. For example, in Iowa, the Companies and PAETEC had difficulty agreeing to the terms of the proprietary agreement that would govern the access and use of confidential information in the merger case in that state. Although PAETEC suggested that the parties use a proprietary agreement that had previously been used between Qwest and PAETEC, the Companies insisted on different terms. This caused significant delay in accessing the proprietary information associated with the Companies' discovery responses in Iowa. This delay was particularly burdensome in this instance because the Companies have requested expedited approval of the merger.

111 In Washington, this was Condition 5 of the Multiparty Settlement between Frontier, Verizon, and multiple CLECs, including Integra. That Settlement was incorporated into the Commission's Order approving the Frontier-Verizon merger, see *Frontier-Verizon Merger Order*, at ¶ 242 and Appendix C. Note that Condition 5 therein made no suggestion that the post-merger company would require wholesale customers to execute further documents to effectuate the assumption or assignment of existing obligations, but it did not expressly prohibit it, as Joint CLEC Condition 6 would do.

112 See Integra's May 13, 2010 Ex Parte filing in FCC WC Dkt. No. 09-95, provided in my Exhibit AHA-7. The Frontier-Verizon letter is discussed at p. 2 therein and reproduced in Attachment A.

1 Condition 6 will help avoid such a situation with respect to the CenturyLink-
2 Qwest merger and eliminate any associated uncertainty, delays and litigation. I
3 see no legitimate reason why the Companies would not voluntarily submit to this
4 condition.

5 **Q. WHY SHOULD THE MERGED COMPANY BE REQUIRED, AS IT**
6 **WOULD BE BY CONDITION 6, SUBPART A, TO CONTINUE MAKING**
7 **QWEST'S COMMERCIAL AGREEMENTS AVAILABLE FOR THE**
8 **DEFINED TIME PERIOD FOLLOWING THE MERGER?**

9 A. As discussed above, this aspect of Condition 6 is essential to provides certainty
10 and protection for wholesale customers and competition in the face of the
11 uncertainty and risks associated with this proposed merger. Many CLECs have
12 existing Commercial Agreements with Qwest, including agreements for the
13 provision of dark fiber, line sharing or the combined switch platform that used to
14 be known as UNE-P. Those CLECs have built their business plans significantly
15 around the availability of the products provided under those commercial
16 agreements and the specific terms set forth in those agreements. Retail customers
17 in turn receive competitive services based on CLEC access to these wholesale
18 services from Qwest under these commercial agreements. Importantly, these
19 CLECs generally have no alternative to Qwest for the products or services, such
20 as dark fiber or line sharing, provided under these commercial agreements.
21 Condition 6 would provide an assurance to the retail and wholesale customers

1 currently relying on services provided under these commercial agreements that
2 those services will remain available following the merger.

3 CenturyLink does not currently make similar products available under
4 commercial agreements (*e.g.,* dark fiber, line sharing), although it may offer them
5 through grandparented contracts that are not commercially available to other
6 CLECs. CenturyLink is the acquiring company in this merger. The fact that
7 CenturyLink does not currently make these products commercially available
8 further increases the risk to CLECs that these products will be withdrawn or the
9 terms of their availability materially changed as a result of the merger. Based on
10 the post-merger risks and incentives discussed throughout my testimony, I believe
11 there is a great risk that, without Condition 6, CenturyLink (as the acquiring
12 company) will not assume the obligations of Qwest's Commercial Agreements or
13 will materially change them in a way that would be detrimental to CLECs and
14 competition. This would result in extensive disruption to CLECs who rely on
15 those products. Those CLECs would, in turn, lose their existing customers who
16 purchase the CLEC services that rely on these wholesale products purchased from
17 Qwest. Condition 6 at least minimizes the uncertainty and risk associated with
18 the merger for a defined period.

19 **Q. WILL CONDITION 6 RESULT IN OTHER PUBLIC INTEREST**
20 **BENEFITS?**

21 A. Yes. Condition 6 would result in the Merged Company offering the same
22 commercial agreements at the same rates in CenturyLink's legacy territory as

1 Qwest provides in its legacy territory. The Companies have boasted of the
2 national breadth[113] and local depth of the Merged Company[114] as "key" benefits
3 of the proposed merger. These benefits (or economies) should not accrue only to
4 the Merged Company, however, or else the transaction will further entrench the
5 Merged Company's position of market power. One way to allow those
6 economies to accrue to the benefit of competition is for the Merged Company to
7 offer the same commercial agreements in legacy CenturyLink territory as it does
8 in legacy Qwest territory.

9 CenturyLink's service territory includes 10 of the 14 states in which Qwest
10 operates as a BOC, with more than two hundred adjacent exchanges[115] and more
11 exchanges in close proximity. Once the companies merge, all of these exchanges
12 will be under a single umbrella and there is no reason why commercial
13 agreements from the Merged Company in one exchange should not also be
14 available in the adjacent or neighboring exchange. This would provide
15 consistency across the Merged Company's territory for those carriers who
16 currently operate in both Qwest and CenturyLink territories and may encourage
17 new competitors to enter the legacy territories of CenturyLink or Qwest.

113 Washington Joint Application at p. 11 ("national telecommunications company"); Reynolds Washington Direct (Qwest Exhibit MSR-1T), at pp. 14-15 and 24.

114 Jones Washington Direct (CenturyLink Exhibit JJ-1T), at p. 9, lines 8-9 ("A key benefit will come from leveraging each company's operational and network strengths, resulting in a company with an impressive national presence and local depth.").

115 CenturyLink's and Qwest's FCC Application, Exhibit 5, cited at Comments of Joint Commenters, WC Docket No. 10-110, July 12, 2010, at p. 18.

1 **Q. CONDITION 8 WOULD EXTEND EXISTING INTERCONNECTION**
2 **AGREEMENTS (INCLUDING ICAS IN "EVERGREEN" STATUS) FOR**
3 **AT LEAST THE DEFINED TIME PERIOD (OR DATE OF EXPIRATION**
4 **WHICHEVER IS LATER). HAVE OTHER ILECS AGREED TO A**
5 **SIMILAR COMMITMENT TO SECURE MERGER APPROVAL?**

6 A. Yes. A similar provision was offered as a voluntary commitment to the FCC by
7 AT&T and BellSouth.[116] Likewise, a similar condition was adopted by the Illinois
8 Commerce Commission,[117] Public Utilities Commission of Ohio,[118] and Oregon
9 PUC[119] as a condition of the Frontier/Verizon merger. While the time period for
10 extension in previous decisions has ranged between 2.5 years and 3 years, the
11 Defined Time Period is tied to the facts of this case.[120]

12 **Q. WHY IS IT IMPORTANT TO REFERENCE "EVERGREEN" ICAS IN**
13 **THIS CONDITION?**

14 A. The reference to "evergreen" ICAs (or ICAs that continue in renewal status past
15 their expiration date) is particularly important in this instance because Qwest
16 currently operates under evergreen ICAs with numerous carriers and has for
17 several years. For example, PAETEC operates under evergreen ICAs with Qwest
18 in all 14 Qwest BOC states. The Qwest/PAETEC ICAs in Minnesota and Iowa
19 have been in place since the 1997-1998 timeframe, and ICAs in other states have

116 *AT&T/BellSouth FCC Merger Order*, Appendix F, "UNEs" commitment #4.
117 ICC Order No. 09-0268, Conditions Appendix, Condition 5.
118 2010 Ohio PUC Lexis 142, *17.
119 2010 Ore. PUC LEXIS 64, *141.
120 Mr. Gates discusses the "Defined Time Period" in his Responsive Testimony.

1 been in place since the 1999-2002 timeframe.[121] This means that terms and
2 conditions under these "evergreen" ICAs have been acceptable to both companies
3 for an extended period, and each carrier's respective network configuration
4 (trunking, collocation arrangements, points of interconnection, traffic exchange,
5 etc.) are based on those terms and conditions. Requesting carriers should not be
6 required to endure the disruption and expense to renegotiate and (potentially)
7 arbitrate the terms under which they have operated with Qwest for, in some cases,
8 more than a decade – particularly given that the Merged Company will have its
9 hands full post-merger as it tries to deliver on its synergy savings estimates and
10 integrate the two companies.

11 **Q. WHAT IS THE CONCERN BEING ADDRESSED BY CONDITION 9?**

12 A. First, a number of CLECs are in the process of negotiating a replacement ICA
13 with Qwest, and have expended considerable time and effort doing so. Those
14 ongoing negotiations should not be disrupted mid-stream with new ILEC
15 proposals from the Merged Company that replace those previously offered by
16 Qwest in negotiations. Accordingly, the Merged Company should continue to
17 honor Qwest's negotiations draft in these ongoing negotiations and not replace it
18 with CenturyLink's new positions. Otherwise, the proposed transaction will
19 directly result in increased costs to CLECs as they may have to negotiate new
20 issues or re-negotiate issues currently closed.

121 See also, Opening Comments of Leap Wireless International, Inc., WC Docket No. 10-110, July 12, 2010, at p. 5 ("Leap's agreements with Qwest have been in this 'evergreen' status for several years, which reflects both parties' satisfaction with the existing ICAs."). My understanding is that these ICAs have typically been amended on multiple occasions over the years (e.g., to reflect changes in law).

1 Condition 9 also states that the Merged Company will allow a requesting carrier
2 to use its pre-existing ICA, including ICAs entered into with Qwest, as the basis
3 for negotiating a replacement ICA. The existing ICAs between CLECs and
4 Qwest have been approved by state commissions as compliant with federal and
5 state law, sometimes after lengthy and contentious arbitration cases in which
6 considerable amounts of scarce CLEC resources are expended. The CLECs
7 should not have to start this process all over again by negotiating agreements from
8 scratch, particularly because doing so would signal a reluctance on the Merged
9 Company's part to make available the same wholesale offerings Qwest has
10 provided for years. Further, the negotiations template proposal that CenturyLink
11 may introduce is a complete mystery at this point,[122] and CLECs should not be
12 forced to negotiate from scratch all over again based on what CenturyLink may
13 come up with as its new ICA, going-in negotiations proposal. The same condition
14 was adopted by the Oregon PUC as a condition of the Frontier/Verizon merger.[123]

15 **Q. IS THERE ANOTHER REASON WHY CLECS SHOULD BE ABLE TO**
16 **USE THEIR PRE-EXISTING ICAS WITH QWEST FOR THE BASIS OF**
17 **NEGOTIATING A REPLACEMENT ICA?**

122 See, e.g., CenturyLink's Response to Integra's First Set of Information Requests, #114 ("Currently, CenturyLink has separate template agreements for legacy CenturyTel and legacy Embarq companies but is in the process of finalizing a single CenturyLink template for interconnection agreements.") At this point, there is no indication as to what CenturyLink's template agreement may look like once it is finalized.

123 2010 Ore. PUC LEXIS 64, 124.

1 A. Yes. As Mr. Gates explains, Qwest's Statement of Generally Available Terms
2 (SGATS) was reviewed during the 271 approval process.[124] These "generally
3 available terms" were incorporated into CLEC ICAs, many of which are part of
4 currently-effective ICAs. For example, the framework, general numbering
5 scheme, and many sections of the current Qwest-Integra interconnection
6 agreement in Minnesota are substantially similar to Qwest's Minnesota SGAT
7 terms.[125] In addition, CLECs have used Qwest's SGAT "as a key source to help
8 frame interconnection agreement ('ICA') negotiation positions"; "as a resource
9 for attempting to resolve disputes with Qwest such as in billing, carrier relations,
10 and Change Management Process ('CMP') contexts"; and "as an internal
11 resource" to, among other things, confirm state commission-approved terms and
12 filed requirements.[126] By contrast, CenturyLink's interconnection agreement
13 terms were not reviewed under a 271 approval process, but instead, are currently
14 in the process of being developed.[127]

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124 See, e.g., Colorado PUC Evaluation at 26 ("This retelling of bringing Qwest's SGAT into compliance with the 14-point competitive checklist only begins to touch on the volume and breath of issues that arose in Colorado's six SGAT workshops.... After evaluating these six staff workshop reports and the enormous record behind these reports, the [Colorado PUC] concluded Qwest's SGAT complies with the 14-point checklist."); see also Idaho PUC Consultation, Exhibit A, at 3 ("The checklist items were addressed in the context of Qwest's SGAT, and so the focus of the workshops was the SGAT terms required to comply with the checklist items. Qwest accordingly has filed the SGAT with the reports showing the terms as they were developed through the workshops and subsequent reports.").

125 Compare Arbitrated Agreement for Terms and Conditions for Interconnection, Unbundled Network Elements, Ancillary Services, and Resale of Telecommunications Services Provided by Qwest Corp. for Eschelon Telecom of Minnesota, Inc. in the State of Minnesota, Minnesota PUC Docket No. IC-06-768 (10/6/08) with Minnesota SGAT Third Revision, Section 12 (3/17/03).

126 Joint CLEC responses to Staff's First Set of Data Requests, ACC Docket No. T-01051B-08-0613, at 2 (2/18/09).

127 PAETEC has proposed a condition to the FCC requiring the Merged Company to offer a multistate ICA that extends the Qwest terms and conditions into the CenturyLink ILEC region. See, Comments of Joint Commenters, WC Docket No. 10-110, July 12, 2010, at p. 56. PAETEC made this recommendation to the FCC to reduce the transaction costs associated with Section 252 ICAs with the

1 **Q. CONDITION 10 ALLOWS CARRIERS IN CENTURYLINK'S LEGACY**
2 **TERRITORY TO OPT INTO QWEST ICAS IN THE SAME STATE.[128]**
3 **WHAT IS THE RATIONALE FOR THIS CONDITION?**

4 A. The same rationale that applies for Condition 6 applies here. The FCC previously
5 adopted a similar condition in conjunction with the AT&T/BellSouth merger,
6 which required AT&T/BellSouth to make available to any CLEC any ICA
7 (negotiated or arbitrated) to which a AT&T/BellSouth ILEC is a party in any state
8 within the AT&T 22-state footprint, subject to state-specific pricing and technical
9 feasibility. Notably, the CLEC-proposed condition permits the state commission
10 to modify the ICA before opt in if the Merged Company demonstrates technical
11 infeasibility or if the TELRIC-based prices in the ICA are inconsistent with the
12 TELRIC-based prices in the state in question.

13 **Q. WOULD THIS OPT-IN CONDITION ALLOW CARRIERS TO**
14 **"CHERRY-PICK THE BEST ICA TERMS"[129]?**

15 A. No. This condition does not allow a carrier to pick-and-choose ICA terms.

16 **Q. PLEASE EXPLAIN THE BUSINESS NEED FOR CONDITION 12.**

Merged Company, similar to how the FCC addressed this issue in the GTE/Bell Atlantic Merger. See, In re Application of GTE Corporation and Bell Atlantic Corporation For Consent to Transfer Control of Domestic and International Sections 214 and 310 Authorizations and Application to Transfer Control of a Submarine Cable Landing License, Memorandum Opinion and Order, CC Docket No. 98-184, FCC-00-221, June 16, 2000 ("FCC GTE/Bell Atlantic Merger Order"), Condition X. This issue is of particular concern regarding the proposed transaction because of the way the Qwest multistate ICA has evolved and the fact that legacy CenturyLink's multistate ICA is still in development (and likely will continue to be under development during the integration process).

128 CenturyLink's service territory overlaps 10 of the 14 states in which Qwest operates as an ILEC. Under this condition, if there is no Qwest ILEC in the state, the carrier may opt into any ICA in which Qwest is an ILEC in any state.

129 CenturyLink's and Qwest's Reply Comments, WC Docket No. 10-110, July 27, 2010, at p. 32.

1 A. There is a material risk that the Merged Company will seek to avoid its
2 obligations as an incumbent LEC under Section 251(c) of the Act post-merger.
3 While CenturyLink has entered into interconnection agreements with requesting
4 carriers, CenturyLink has also expressly reserved the right to invoke the
5 protections of Sections 251 (f)(1) and 251(f)(2) of the Act and thereby avoid its
6 obligations as an incumbent LEC under Section 251(c). For example, in a recent
7 Order approving two CenturyLink interconnection agreements, the Idaho Public
8 Utilities Commission summarized CenturyLink's position as follows:

> 9 [CenturyLink's] Application states that CenturyLink is a "rural
> 10 telephone company," as that term is defined in the Act, 47 U.S.C. §
> 11 153. CenturyLink goes on to state that, pursuant to Section
> 12 251(f)(1) of the Act, it is exempt from Section 251(c) of the Act.
> 13 Notwithstanding that exemption, the companies have agreed and
> 14 entered into this Agreement for purposes of exchanging local
> 15 traffic. The Company also states that "execution of the Agreement
> 16 does not in any way constitute a waiver of limitation of
> 17 CenturyLink's rights under Section 251(f)(1) or 251 (f)(2) of the
> 18 Act." The Company "expressly reserves the right to assert its right
> 19 to an exemption or waiver and modification of Section 251 (c) of
> 20 the Act, in response to other requests for interconnection by CLEC
> 21 or any other carriers."[130]

22 Condition 12 will ensure that the Merged Company does not pull the rug out from
23 underneath wholesale customers in their relationships with the Merged Company.

24 **Q. PLEASE EXPLAIN THE BUSINESS NEED FOR CONDITION 14.**

25 A. Condition 14 states that the Merged Company will not reclassify as "non-
26 impaired" any wire centers or file any new forbearance petitions related to
27 obligations under sections 251 or 271 of the Act for the Defined Time Period.

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130 *In re Application of CenturyTel of Idaho, Inc. d/b/a CenturyLink for Approval of its Interconnection Agreement with Bullseye Telecom, Inc. Pursuant to 47 U.S. C. § 252(e)*, Order No. 31095, Idaho PUC Case Nos. CEN-T-10-01 & CGS-T-10-01, paragraph 1 (adopted May 28, 2010).

1 This condition is needed to provide critical certainty for wholesale customers
2 related to the bottleneck inputs they purchase from the Merged Company, while
3 the Merged Company integrates the two companies and pursues synergy
4 savings.[131] As discussed above, this merger poses a substantial risk to CLECs as
5 the post-merger ILEC's effort to achieve enormous projected synergy savings
6 intersects with the ILEC's inherent disincentive to provide competing CLECs
7 with reliable, reasonably priced access to wholesale services. Further, to the
8 extent the merger results in any cost savings through economies of scope and
9 scale, those benefits will accrue to the merging companies and not their captive
10 CLEC customers. The proposed temporary moratorium on non-impairment
11 reclassifications and forbearance will help mitigate the risk this merger poses to
12 the public's interest in competition and provide some measure of public interest
13 benefit to captive wholesale customers and competition. To adequately protect
14 the public's interest in competition, it is essential to provide CLECs with a period
15 of certainty during which the terms and conditions of access to the wholesale
16 inputs they need to provide competitive local exchange services continue.

17 **Q. DOES THE FCC'S RECENT DECISION REJECTING QWEST'S**
18 **FORBEARANCE PETITION IN THE PHOENIX MSA SHOW WHY**
19 **CONDITION 14 IS NEEDED?**

131 Qwest recently withdrew its four pending forbearance petitions relating to the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas, see In the Matter of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas -- WC Docket 07-97, Letter from Hirisha J. Bastiampillai, Senior Attorney, Qwest Corporation, to Marlene H. Dortch, Secretary, FCC, August 18, 2010. While this is a step in the right direction, it does not in itself eliminate the need for Condition 14.

1 A. Yes, in three distinct respects. First, the FCC's June 2010 decision on Qwest's
2 forbearance petition in the Phoenix, Arizona MSA applies a new analytical
3 framework for the evaluation of BOC forbearance petitions, which replaces the
4 approach that the FCC developed in its 2005 decision granting Qwest forbearance
5 in the Omaha MSA, and has applied in subsequent reviews of BOC petitions
6 seeking similar relief.[132] While that new framework appears to be a substantial
7 improvement, its introduction alone will tend to heighten the uncertainty
8 surrounding future forbearance petitions to the FCC, given that the BOCs
9 vigorously pursued previous FCC rejections of their forbearance decisions in the
10 courts,[133] and may well test the new framework in the same way. Adopting
11 Condition 14 for the Defined Time Period would avoid the uncertainty created by
12 these events during that interim period.

13 Second, in the *Phoenix Forbearance Order*, the FCC explains the anti-
14 competitive opportunities that would be created for a dominant ILEC – such as
15 the Merged Company – if Sections 251 and/or 271 obligations were to be
16 eliminated prematurely:

> 17 …the Commission has long recognized that a vertically integrated
> 18 firm with market power in one market – here upstream wholesale
> 19 markets where…Qwest remains dominant – may have the
> 20 incentive and ability to discriminate against rivals in downstream
> 21 retail markets or raise rivals' costs…assuming that Qwest is profit-
> 22 maximizing, we would expect it to exploit its monopoly position as
> 23 a wholesaler and charge supracompetitive rates, especially given

132 *In the Matter of Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. §160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Docket No. 09-135, Memorandum Opinion and Order, FCC 10-113, (rel. June 22, 2010) ("*Phoenix Forbearance Order*"), at ¶¶ 16-24.

133 See, e.g., *id.* at ¶ 19, describing the D.C. Circuit Court's remands of the FCC's Verizon 6 MSA Forbearance Order and Qwest 4 MSA Forbearance Order in 2009.

1 that (absent regulation) Qwest may have the incentive to foreclose
2 competitors from the market altogether.[134]

3 Given that the merger will enhance the Merged Company's incentive and ability
4 to discriminate against rivals in downstream retail markets and/or raise rivals'
5 costs, Condition 14 is needed to ensure that the Merged Company does not act on
6 these anti-competitive incentives, and to avoid the uncertainty (and costs)
7 imposed on wholesale customers when a petition for forbearance is filed.

8 And third, the justification invoked by the FCC for moving to its new analytical
9 framework shows why Condition 14's temporary moratorium on forbearance
10 petitions is essential to preserve competition during the post-merger transition
11 period. In the *Phoenix Forbearance Order*, the FCC all but declares that the grant
12 of forbearance to Qwest in the Omaha MSA was a mistake, finding that in the
13 *Omaha Forbearance Order* "the Commission eliminated all unbundled loop and
14 transport obligations based largely on predictive judgments…" that were not
15 borne out in the marketplace.[135] In hindsight, the Commission found that the
16 analytical framework applied in the *Omaha Forbearance Order* was seriously
17 flawed in that it was "not supported by current economic theory,"[136]
18 "inappropriately assumed that a duopoly always constitutes effective
19 competition,"[137] and "appears inconsistent with Congress' imposition of
20 unbundling obligations as a tool to open local telephone markets to competition in

134 *Phoenix Forbearance Order*, ¶ 34.
135 *Id.*, ¶ 26.
136 *Id.*, ¶ 28.
137 *Id.*, ¶ 29.

1 the 1996 Act."[138] The FCC ultimately concluded that the outcome of that
2 forbearance has been a substantial reduction in competitive activity in the Omaha
3 MSA, as "the record indicates that McLeodUSA has removed most of its
4 employees from the Omaha marketplace, has limited its operations primarily to
5 serving its existing customer base, and has ceased sales of residential and nearly
6 all business services in Omaha;" while Integra abandoned its plans to enter the
7 Omaha market after the Commission released the *Omaha Forbearance Order.*[139]

8 **Q. HAVE CLECS SOUGHT TO REVERSE THE FCC'S GRANT OF**
9 **FORBEARANCE IN THE OMAHA MSA IN THE CONTEXT OF THE**
10 **FCC'S CENTURYLINK-QWEST MERGER REVIEW PROCEEDING?**

11 A. Yes. For example, a group of CLECs including Access Point, Inc., Covad
12 Communications Company, and McLeodUSA Telecommunications Services Inc.
13 (among others) has proposed the following condition in their initial comments in
14 the FCC's on-going proceeding to review the CenturyLink-Qwest merger
15 transaction, which were filed jointly with several other CLECs:

> 16 Applicants shall voluntarily stipulate that McLeodUSA's Petition
> 17 for Modification be granted and thereby, relinquish forbearance
> 18 relief obtained in Omaha in WC Docket No. 04-223 and comply
> 19 with Section 251(c)(3) UNE obligations throughout the Omaha
> 20 MSA.[140]

21 Taking this step as a voluntary commitment would be the most efficient way to
22 redress the Omaha situation. While the Commission need not take any action

138 *Id.*, ¶ 32.

139 *Id.*, ¶ 34.

140 Access Point, Inc., Covad Communications Company et al., Comments of Joint Commenters, July 12, 2010, WC Docket No. 10-110, at p. 67.

1 with respect to those CLECs' proposal to the FCC, adoption of Condition 14 by
2 the Commission in the instant case would be compatible with and complementary
3 to that proposal.

4 Q. **PLEASE EXPLAIN THE BUSINESS NEED FOR CONDITION 28.**

5 A. As Mr. Gates explains, increased efficiencies can be gained by establishing a
6 single POI per LATA with the Merged Company. Because those efficiencies will
7 be enjoyed by the Merged Company in part because of its network footprint, the
8 same benefits should flow through to CLECs interconnecting with the Merged
9 Company. Just as the purported financial benefits of the merger should be shared
10 by captive CLECs, as discussed above, any operational benefits of accruing to the
11 Companies should also flow to the CLECs. This would also lower barriers to
12 entry for competitors who would be permitted to capitalize on the increased scale
13 and efficiencies of the Merged Company

14 ***B. Wholesale Rate Stability***

15 Q. **PLEASE IDENTIFY THE PROPOSED CONDITIONS RELATING TO**
16 **WHOLESALE RATE STABILITY.**

17 A. There are three conditions in this category – conditions 2, 3, and 7:

18 • Condition 2 states that the Merged Company will not recover or seek to
19 recover through fees paid by CLECs (and hold CLECs harmless from) one-
20 time transfer, branding, or any other transaction-related costs.

21 • Condition 3 states that the Merged Company will not recover or seek to
22 recover through fees paid by CLECs (and hold CLECs harmless from) any
23 increases in overall management costs that result from the transaction.

24 • Condition 7 states that the Merged Company shall not increase prices for
25 wholesale services above the level at merger announcement, or create new

1 rate elements for functions that are currently recovered in existing rates, for
2 the Defined Term Period. This condition also states that the Merged
3 Company will continue to offer any term and volume discount plan offered at
4 merger announcement (without change) for at least the Defined Time Period,
5 and will honor existing contracts on individualized term pricing plan
6 arrangements for the duration of the term. This condition also states that in
7 the legacy CenturyLink territory the Merged Company will comply with its
8 obligation to provide transit in ICAs and at rates no higher than the cost-based
9 rates approved for Qwest (or the current tandem transit rate, whichever is
10 lower).

11 **Q. WHY ARE THESE CONDITIONS NECESSARY?**

12 A. Just as certainty and consistency for wholesale service availability is critical to
13 offset the uncertainty resulting from the merger, so is stability for wholesale
14 service rates. Wholesale rates should, if anything, decrease after the merger.
15 Because the Merged Company's overall cost structure should decrease to the
16 extent synergy savings are achieved post-merger, wholesale rates – which would
17 be based on the cost structure of the Merged Company – should decrease as well.
18 However, at this point, CLECs are not seeking rate reductions, but instead taking
19 the conservative position that rates should not increase for at least the Defined
20 Time Period (Condition 7). This provides a degree of protection for captive
21 wholesale customers that the Merged Company will not seek to increase their
22 rates (or create new rate elements) during the Merged Company's pursuit of
23 synergies and revenue enhancements.

24 These conditions would also hold wholesale rates harmless from the one-time
25 transaction related costs associated with marrying the two companies – costs that
26 have traditionally not been recovered through wholesale rates. Finally, Condition
27 24 is necessary to prevent the Merged Company from adopting as a "best

1 practice" in Qwest's territory anti-competitive charges assessed in legacy
2 CenturyLink ILEC territory, which are discussed in detail in Mr. Gates'
3 testimony.

4 **Q. REGARDING CONDITIONS 2 AND 3, HAS CENTURYLINK AGREED**
5 **TO HOLD WHOLESALE CUSTOMERS HARMLESS FROM ONE-TIME**
6 **MERGER RELATED COSTS AND INCREASES IN OVERALL**
7 **MANAGEMENT COSTS RESULTING FROM THE MERGER?**

8 A. No. When asked whether CenturyLink would seek to recover through wholesale
9 rates or fees paid by CLECs "any one-time transfer, branding or any other
10 merger-related costs" or "overall management costs," CenturyLink did not
11 provide a straightforward answer. Instead, CenturyLink stated that it would
12 record costs according to FCC Part 32 and would use forward-looking cost studies
13 to develop UNE rates – rates that would include the Merged Company's
14 management cost structure post-merger.[141] CenturyLink's response ignores the
15 issue – *i.e.*, that wholesale customers should not have to pay for any of the costs
16 of the merger and CenturyLink's merging of the two companies. This is
17 especially true since CenturyLink claims there will be almost $700 million in
18 savings associated with the merger. These principles have been recognized in

141 CenturyLink Responses to Integra Minnesota Data Request Set 2, #97 and #98. To make matters worse, there is uncertainty surrounding what cost models the Merged Company will use post-merger. This, too, is concerning because (a) the market participants in Qwest's region (including my firm QSI Consulting and my CLEC clients) have spent many hours reviewing and understanding Qwest's cost models for wholesale services (which are mostly consistent across Qwest's 14-state region) – work that would be undermined by a decision of the Merged Company to import legacy CenturyLink cost models into Qwest' region post-merger; and (b) I personally reviewed some of CenturyLink legacy cost studies in my prior work for cable CLECs and can say with first-hand knowledge that the sophistication, transparency and auditability of CenturyLink's cost studies is inferior to Qwest's legacy cost studies.

1 numerous previous mergers[142] and the same principle has been applied to retail
2 service rates.[143]

3 **Q. CONDITION 7(A) STATES THAT THE MERGED COMPANY WILL**
4 **CONTINUE TO OFFER ANY TERM AND VOLUME DISCOUNT PLANS**
5 **OFFERED AS OF THE MERGER ANNOUNCEMENT DATE FOR AT**
6 **LEAST THE DEFINED TIME PERIOD. IS THERE AN EXAMPLE**
7 **DEMONSTRATING THE NEED FOR THIS CONDITION?**

8 A. Yes. On April 30, 2010 (after the Merger Announcement Date[144]), Qwest filed a
9 "Product Notification"[145] (with an effective date of June 1, 2010) "to change its
10 Regional Commitment Program (RCP) from a unit based plan to a revenue based
11 plan and raise the commitment level from 90% to 95% of the total Company-
12 provided in-service DS1 and DS3 Revenue."[146] This change was made to the
13 entire 14-state Qwest ILEC territories covered by its Tariff F.C.C. No. 1
14 (interstate access tariff). A RCP is a pricing plan that allows DS1 and/or DS3
15 customers to receive price reductions for committing to a minimum volume on
16 DS1 and/or DS3 circuits for a certain period of time.[147] As of May 31, 2010 (the
17 day before the effective date of Qwest's Product Notification), the former RCP
18 provisions were no longer available to wholesale customers, and the new, less

142 Conditions substantially similar to proposed conditions 2 and 3 were adopted by the Oregon PUC in the Verizon/Frontier merger proceeding.

143 See, ICC order in Verizon/Frontier merger, and Oregon PUC order in Embarq/CenturyTel merger.

144 The Merger Announcement Date, when used in this list of conditions, refers to April 21, 2010, which is the date on which Qwest and CenturyLink entered into their merger agreement.

145 PROD.RESL.04.30.10.F.07809.DS1_DS3_Services

146 Product Notification: PROD.RESL.04.30.10.F.07809.DS1_DS3_Services, filed April 30, 2010.

147 Qwest Corporation, Tariff F.C.C. No. 1, 3rd revised page 7-100.

1 favorable terms are required going forward.[148] As Integra informed Qwest, these
2 RCP changes "greatly diminish the value of the RCP" by "increasing the risk
3 associated with the plan" and were put in place shortly before "some of these
4 plans are about to expire."[149] I have attached Qwest's Product Notification and
5 Integra's correspondence with Qwest on this issue as Exhibit AHA-6. The point
6 here is that Qwest is taking steps after the Merger Announcement Date and before
7 the Closing Date to raise barriers to entry and enhance its revenues at the expense
8 of wholesale customers, either in terms of degraded services or higher rates.
9 While this is one example, there can be no question that the Companies are geared
10 towards improving the combined company's financial condition, and because it is
11 most profitable for them to boost revenues at the expense of their competitors,
12 there are (and/or will be) likely other similar examples. CenturyLink has stated
13 that "[o]ne of the Transaction's key benefits is the resulting financial condition of
14 the combined company" and a "financially stronger company can...compete
15 against cable telephony providers, wireless carriers, VoIP offerings, and
16 CLECs..."[150] I do not object to robust competition with the Merged Company so
17 long as the competition is fair, but what I do object to in this instance (and what
18 this example shows) is the Companies' attempting to hinder the CLECs' ability to
19 compete with the Merged Company before the proposed transaction is even
20 approved. That is why it is important to provide protections for the time period

148 Qwest Corporation, Tariff F.C.C. No. 1, 3rd revised page 7-100.

149 See Exhibit AHA-6. It is my understanding that Integra's current RCP expires in the fall 2011. At that time, the new, less favorable RCP terms put in place by Qwest after the Merger Announcement Date will be the only RCP terms available.

150 Washington Joint Application at p. 15; for similar statements from Qwest, see Reynolds Washington Direct (Qwest Exhibit MSR-1T), at p. 23.

1 between the Merger Announcement Date and Closing Date as well as for the
2 Defined Time Period.

3 **VIII. ADDITIONAL CONSIDERATIONS**

4 ***A. If the Merger Leads to Lower Costs, Wholesale Prices Should Come***
5 ***Down Commensurably with Costs***

6 **Q. IF THE MERGER IS APPROVED, SHOULD WHOLESALE**
7 **CUSTOMERS SHARE THE BENEFITS?**

8 A. Yes. As discussed, mergers are driven by the objective to increase shareholder
9 value, which, if it actually happens, is a good thing, since it balances for
10 shareholders the potential risks and rewards for owning the company. In the
11 telecommunications industry, however, retail competition relies critically on
12 access to the ILECs' wholesale services, as provided for in the
13 Telecommunications Act of 1996. This means that in the telecommunications
14 industry there are other significant stakeholders likely to be impacted by the
15 merger: CLECs and their customers. Given that in this merger CLECs are being
16 subjected to significant risks, standard economic theory suggests that they
17 likewise should be allowed to reap potential benefits. Specifically, to the extent
18 that the merger may generate benefits in terms of lower overall network and
19 overhead costs (due to realized efficiencies), cost reductions should flow through
20 to CLECs in the form of, for example, lower transaction costs in relation to
21 dealing with the Merged Company.

1 **Q. ARE ANY ADDITIONAL SAFEGUARDS APPROPRIATE TO ENSURE**
2 **THAT MERGER-DRIVEN COST REDUCTIONS WOULD FLOW**
3 **THROUGH ON A NON-DISCRIMINATORY BASIS TO ALL**
4 **WHOLESALE CUSTOMERS, RATHER THAN JUST AFFILIATES OF**
5 **THE MERGED COMPANY?**
6 A. Yes. To the extent that UNEs and interconnection are required to be priced at
7 TELRIC, forward-looking cost savings should be reflected in lower UNE and
8 interconnection rates as a matter of law. Similarly, with respect to the pricing of
9 other wholesale products, such as special access services, the Merged Companies
10 should be expected to pass through merger-related cost savings at least in part to
11 their wholesale customers in a nondiscriminatory manner.

12 ***B. A Post-Merger CenturyLink Should Waive Future Claims of Rural***
13 ***Exemptions***

14 **Q. WHAT IS THE RURAL EXEMPTION?**
15 A. The Federal Telecommunications Act of 1996 generally requires all ILECs to
16 interconnect their networks and exchange traffic with other telecommunications
17 carriers (Section 251, Section 252). Section 251(f), however, provisionally
18 exempts rural ILECs from the obligations under Section 251(c) until they receive
19 a bona fide request for interconnection from a telecommunications carrier. Once
20 such a request is made, the exemption may be terminated by a state commission,
21 if the commission finds that certain conditions are satisfied. Specifically, Section
22 251(f)(1) generally states that the state commission shall terminate the rural
23 exemption from the 251(c) obligations if the request: (1) is not unduly

burdensome; (2) is technically feasible; and (3) is consistent with universal service policies detailed in section 254 (other than subsections (b)(7) and (c)(1)(D).)

Many rural carriers have been hiding behind the rural exemption to avoid competition at the expense of rate payers and the public interest at large. In fact, the FCC has taken note and stated that it will clarify the rural exemption so as to prevent abuse:

> There is evidence that some rural incumbent carriers are resisting interconnection with competitive telecommunications carriers, claiming that they have no basic obligation to negotiate interconnection agreements. [...] Without interconnection for voice service, a broadband provider, which may partner with a competitive telecommunications carrier to offer a voice-video-Internet bundle, is unable to capture voice revenues that may be necessary to make broadband entry economically viable. Accordingly, to prevent the spread of this anticompetitive interpretation of the Act and eliminate a barrier to broadband deployment, the FCC should clarify rights and obligations regarding interconnection to remove any regulatory uncertainty. In particular, the FCC should confirm that all telecommunications carriers, including rural carriers, have a duty to interconnect their networks. [151]

Q. SHOULD THE MERGED COMPANY WAIVE ITS RIGHT TO SEEK ANY FURTHER RURAL EXEMPTIONS UNDER SECTION 251(F)(1) OR SUSPENSIONS AND MODIFICATIONS UNDER SECTION 251(F)(2)?

A. Yes. The rural exemption is intended for small rural carriers whose economic viability may be threatened if they were obligated to incur costs to implement all the unbundling and resale provisions of the Telecommunications Act of 1996,

151 FCC's Connecting America, the National Broadband Plan, at p. 49. (Available from http://www.broadband.gov/download-plan/).

1 such as the costs associated with the development of sophisticated OSS. These
2 considerations are not relevant with respect to a post-merger CenturyLink because
3 it will provide service (through its affiliates) in 37 states, thus becoming the third
4 largest ILEC in the country, behind AT&T and Verizon. Surely Congress did not
5 intend to exempt the largest incumbent service providers in the nation from their
6 statutory obligations under Section 251. Hence, I recommend that the Merged
7 Company commit to waive its right to seek the exemption for rural telephone
8 companies under Section 251(f)(1) and its right to seek suspensions and
9 modifications for rural carriers under Section 251(f)(2) of the Communications
10 Act.

11 **Q. THE STATUTE ESTABLISHES A SEPARATE PROCESS FOR STATE**
12 **COMMISSIONS TO TERMINATE A RURAL EXEMPTION. DOES**
13 **YOUR RECOMMENDATION INTERFERE WITH THAT PROCESS?**

14 A. No. The imposition of a condition to waive the rural exemption would not
15 interfere with the existing statutory process for terminating an exemption. That
16 process would remain available for competitors to utilize in individual cases. But
17 note that those cases can substantially increase competitors' cost of obtaining
18 interconnection with companies like CenturyLink. Given the circumstances of
19 this transaction, and the fact that CenturyLink will become the third largest ILEC
20 in the nation, it is appropriate to predicate approval of the transaction on
21 Condition 12.

1 **Q. ARE YOU AWARE OF ANY CIRCUMSTANCES IN WHICH A**
2 **COMPANY HAS WAIVED ITS RURAL EXEMPTION, AS YOU HAVE**
3 **RECOMMENDED?**

4 A. Yes. In fact, CenturyLink has recently waived, at least partially, certain
5 protections from the rural exemption in Oregon in order to negotiate a formal
6 interconnection agreement with another carrier. The Oregon PUC determined
7 that federal law, including the statutory process for terminating an exemption,
8 does not preclude a carrier's ability to waive the rural exemption.[152] The Oregon
9 PUC cited state commission decisions in Washington and North Carolina as
10 support for its findings.[153] Notably, the Oregon PUC also cited as support for its
11 conclusion that waivers are permissible the fact that transaction costs associated
12 with a rural exemption termination proceeding can be quite burdensome on the
13 parties, and the state commission. The order explains: "The administrative
14 burden on a state commission and the parties involved in a section 251(f)(1)(B)
15 proceeding relieved by a voluntary waiver is significant and should not be
16 ignored."[154]

17 **IX. <u>CONCLUSION</u>**

18 **Q. DR. ANKUM, PLEASE STATE YOUR CONCLUSIONS.**

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152 See *In the Matter of Western Radio Services Company Request for Interconnection Agreement of CenturyTel of Eastern Oregon, Inc.*, Order Answering Certified Questions, ARB 864, 2009 Ore. PUC LEXIS 421 at **18-23, (Ore. PUC Dec. 14, 2009).

153 *Id.* at 19.

154 *Id.* at 19-20.

1 A. In this testimony, I have discussed the troublesome history of mergers and
2 demonstrated that the Commission should prepare for the possibility that this
3 merger, like many others, could fail or otherwise create havoc for the industry.
4 Based upon the serious risks to the public interest inherent in this merger
5 proposal, I recommend that the Commission reject the proposed transaction. In
6 the event that the Commission nevertheless decides to approve it, I recommend
7 that the Commission require the Companies to agree to certain conditions and
8 commitments necessary to protect CLECs and the competitive process. To that
9 purpose, I have identified and discussed specific conditions and commitments that
10 should be required of CenturyLink and Qwest as prerequisites for the merger
11 approval. (A complete list is provided by Mr. Gates in his testimony.)

12 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

13 A. Yes, it does.