Exhibit______(CWK-1T)
(DoD/FEA Exhibit 1)

BEFORE THE WASHINGTON STATE
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of	)	
	)	
QWEST COMMUNICATIONS	)	
INTERNATIONAL, INC. AND	)	DOCKET UT-100820
CENTURYTEL, INC.	)	
	)	
For Approval of Indirect Transfer of	)	
Control of Qwest Corporation, Qwest	)	
Communications Company LLC, and	)	
Qwest LD Corp.	)	
	)	
. . . .	)	

RESPONSIVE TESTIMONY

of

CHARLES W. KING

On Behalf of
THE DEPARTMENT OF DEFENSE
And
ALL OTHER FEDERAL EXECUTIVE AGENCIES

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September 27, 2010

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1 **RESPONSIVE TESTIMONY OF**
2 **CHARLES W. KING**

3 **QUALIFICATIONS**

4 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

5 A. My name is Charles W. King. I am President of the economic consulting firm of
6 Snavely King Majoros & O'Connor, Inc. ("Snavely King"). My business address
7 is 1111 14th Street, N.W., Suite 300, Washington, D.C. 20005.

8 **Q. PLEASE DESCRIBE SNAVELY KING.**

9 A. Snavely King, formerly Snavely, King & Associates, Inc., was founded by the
10 late Carl M. Snavely and myself in 1970 to conduct research on a consulting basis
11 into the rates, revenues, costs and economic performance of regulated firms and
12 industries. The firm has a professional staff of 12 economists, accountants,
13 engineers and cost analysts. Most of its work involves the development,
14 preparation and presentation of expert witness testimony before federal and state
15 regulatory agencies. Over the course of its 40-year history, members of the firm
16 have participated in over 1000 proceedings before almost all of the state
17 commissions and all Federal commissions that regulate telecommunications,
18 utilities or transportation industries.

19 **Q. HAVE YOU PREPARED A SUMMARY OF YOUR QUALIFICATIONS**
20 **AND EXPERIENCE?**

21 A. Yes. Attachment A is a summary of my qualifications and experience.

22 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN**
23 **REGULATORY PROCEEDINGS?**

24 A. Yes. Attachment B is a tabulation of my appearances as an expert witness before
25 state and federal regulatory agencies. It shows that I have testified before the
26 public utility commissions of over 40 states, including Washington, and I have

1 appeared before all federal agencies that regulate telecommunications, utilities,
2 transportation and postal services.

3 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**

4 I am appearing on behalf of the consumer interests of the Department of Defense
5 ("DoD") and all other Federal Executive Agencies ("FEA") in Washington.

6

7 **INTERESTS OF DoD/FEA**

8

9 **Q. WHY HAS DoD/FEA INTERVENED IN THIS CASE?**

10

11 A. The Department of Defense and all other Federal Executive Agencies have a
12 substantial presence in the State of Washington. Several major military
13 installations are located in Washington, including Joint Base Lewis-McChord
14 (formerly Fort Lewis and McChord Air Force Base) and Fairchild Air Force Base,
15 and naval facilities around the Puget Sound area. In addition, the Federal
16 presence also exists as numerous and widespread major facilities such as the
17 General Services Administration Northwest/Arctic Region Office, and the
18 Department of Veterans Affairs medical and outreach facilities, and small-
19 business sized offices such as Armed Forces recruiters, Post Offices, Social
20 Security offices, as well as Fish and Wildlife Service, National Parks, USDA
21 Forest Service and Farm Service/Agricultural agents. Federal employment
22 (Civilian and Active Duty Military) in Washington State exceeds 100,000
23 persons.

24

25 This very substantial presence makes DoD/FEA one of the largest users of
26 telecommunications services in the state of Washington.[1] It is important to
27 DoD/FEA that services in the affected exchanges are provided in an efficient

[1]Although in aggregate DoD/FEA is one of the largest users, it obtains a broad variety of services. Individual customer locations (both urban and rural) cover a wide range of sizes, employing the full panoply of telecommunications services from single-line business service to complex, multimodal and specially designed networks.

1 manner, at reasonable cost, and with the highest service quality and performance.
2 DoD/FEA is concerned that any change in Qwest's corporate governance be
3 seamless and not degrade retail services, and that CenturyLink be willing and able
4 to offer state-of-the-art retail business services of the nature that DoD/FEA
5 operations require.
6
7 Moreover, the DoD/FEA interest goes beyond the locations directly affected by
8 the transition. Where possible, DoD and FEA telecommunications services are
9 procured under contract through competitive bidding. The effectiveness of the
10 competitive procurement process is, of course, dependent upon there being a
11 number of financially strong and technically capable entities that can submit bids.
12 If the proposed transfer is approved, it is important to DoD/FEA that
13 CenturyLink's competitors have the opportunity to access Federal installations on
14 a fair and reasonable basis through CenturyLink facilities and that CenturyLink be
15 able to render service to Federal locations even outside of its service territories.
16 Moreover, CenturyLink itself must be a sophisticated competitive bidder capable
17 of providing the full range of telecommunications services at reasonable costs to
18 the Federal government.
19
20 The merged company will also be a wholesale provider of services and facilities
21 to competitive retail telecommunications providers. The service quality
22 performance, the practices, and the operations of that company must support fair
23 and effective competition among carriers in providing services to business
24 customers and the general public in Washington.
25
26 Unfortunately, the record of recent telecommunications acquisitions has not been
27 encouraging.
28
29

1 **PREVIOUS TELECOMMUNICATIONS ACQUISITIONS**
2
3 **Q. WHAT PREVIOUS TELECOMMUNICATIONS ACQUISITIONS ARE**
4 **YOU REFERRING TO?**
5
6 A. I am referring to the three recent major Verizon landline spin-offs to acquiring
7 companies. The first was the acquisition of Verizon's Hawaiian landline assets
8 by The Carlyle Group ("Carlyle"). The second was the purchase of Verizon's
9 northern New England wireline operations by FairPoint Communications
10 ("FairPoint"). The third and most recent was the acquisition of Verizon's non-
11 metropolitan operations in 14 states by Frontier Communications.
12
13 **Q. PLEASE DESCRIBE THE HAWAIIAN TELEPHONE TRANSACTION.**
14
15 A. The Hawaiian transaction provides a case study of the difficulties that ill-advised
16 telephone company acquisitions can lead to. It was unsuccessful in almost all
17 respects, resulting in severe service degradation to Hawaiians and in the financial
18 failure of the successor company.
19
20 In 2004, Verizon sought approval to sell its Hawaiian assets to Carlyle, a private
21 equity enterprise. Carlyle created a new entity, Hawaiian Telcom, Inc. ("HT"), to
22 provide the local exchange services previously offered by Hawaiian Telephone.
23 The applicants in that case stated that after the transition HT "will have the
24 financial fitness and ability to fund the continuing operations of Verizon Hawaii
25 through the revenue generated from the existing and proposed operations."[2]
26 Likewise, the applicants stated that they ". . . acknowledge the importance of
27 ensuring a seamless transition for customers and have conducted a rigorous
28 process to select a world-class systems integrator to replicate the full functionality
29 of the systems currently provided by Verizon."[3] In 2005, the Hawaii Public

---

[2] Application, Docket No. 04-0140, June 21, 2004, pp. 13-14.
[3] *Id.*, p. 15.

1 Utilities Commission ("HPUC") approved the transfer subject to numerous
2 conditions.[4]
3
4 In its decision approving the sale, the HPUC stated that it would initiate an
5 investigation of HT's service quality approximately six months after HT assumed
6 the back-office operations that Verizon previously provided on a national basis to
7 all of its service territories, including Hawaii. This service quality proceeding,
8 HPUC Docket No. 2006-0400, confirmed that the transition from Verizon was far
9 from seamless or harmless to customers. Although the HPUC has not yet
10 rendered a decision in that proceeding, it is undisputed that for more than a year
11 following the cutover from Verizon's back-office operations, HT was unable to
12 collect data – even manually – as to six service standards for which the HPUC
13 required reports.[5] Thus, the full extent of the problems associated with the
14 transfer could not even be quantified.
15
16 As to the seven service standards for which HT was able to file reports, five dealt
17 with call answering time. HT's ability to answer calls was lacking compared to
18 the experience under Verizon. For example, during the nine months following the
19 cut-over, HT's percent of residential installation and billing office calls answered
20 in 20 seconds ranged from a low of 8.01 percent to a high of 70.37 percent,
21 compared to the objective of 85 percent and Verizon's 2005 percentage of 87.46
22 percent. Likewise, the answering time achieved for business installation and
23 billing office calls following the cut-over ranged from 12.83 percent to 78.82
24 percent compared with the objective of 85 percent and Verizon's achieved rate of
25 88.23 percent. [6] In an effort to repair the damage caused by the non-functioning
26 systems, HT had to replace the contractor working on the transition.[7]
27

[4] Docket No. 04-0140, Decision and Order No. 21696, March 16, 2005.
[5] HT's Post-Hearing Brief, HPUC Docket No. 2006-0400, filed November 9, 2007 at p. 118, fn. 101. The missing reports included crucial data such as the percent of trouble reports cleared within 24 hours, the percent of installation and repair commitments met and customer trouble reports per 100 lines.
[6] HT's February 15, 2007 Statement of Position, HPUC Docket No 2006-0400, pp. 39-41.
[7] *Id.,* pp. 74-77.

1 HT admitted in its pleadings that service suffered as a result of the transition from
2 Verizon and that it created erroneous bills and was unable to handle adequately
3 incoming calls.[8] HT candidly admitted that "… the cutover did unfortunately
4 create some negative impacts on its customers." [9] Finally, HT agreed with the
5 assessment of the Consumer Advocate that its "… retail customers following
6 cutover experienced long waiting times to reach [its] contact center, extremely
7 slow and long transaction processing times, high levels of fall out, long waiting
8 times to repair, missed or delayed installation and repair commitments and billing
9 errors."[10]
10
11 The cutover from Verizon's back-office operations also caused significant
12 problems for HT's wholesale customers. One Competitive Local Exchange
13 Carrier ("CLEC"), Time Warner Telecom of Hawaii, L.P. ("TWTC"),
14 summarized the problems as follows:

15 HT's conversion to its new back office systems was a failure by any
16 measure. Immediately following cutover, virtually none of the
17 wholesale back office systems were functioning. Today, 19 months
18 after cutover, they are still not functioning at the same level as the
19 Verizon systems. Although HT has made significant progress in
20 addressing its issues, those efforts are not complete.
21
22 HT violated the Merger Decision and the Stipulation by failing to
23 provide the same or similar functionality for wholesale service as
24 previously provided by Verizon, and by failing to remain on the
25 Verizon systems until HT's new systems were fully tested and
26 operational. These violations significantly harmed TWTC and HT's
27 other customers. [11]
28
29

[8] *Id.,* pp. 53-57.
[9] HT's August 31, 2007 Final Position Statement, HPUC Docket No. 2006-0400, p. 21.
[10] *Id.,* p. 7.
[11] Time Warner Telecom of Hawaii, L.P., dba Oceanic Communications' Post-hearing Brief, HPUC Docket No. 2006-0400, November 9, 2007, p. 2 (footnote omitted). The text of the brief contains a detailed description of HT's numerous failures in connection with providing wholesale service after acquiring the Verizon exchanges, and the adverse impact that the failures had on Time Warner and its customers. Another CLEC, Pacific LightNet, Inc., filed a Post-hearing Brief asserting that the flawed transfer of operations caused it to incur additional expense to resolve interconnection problems and billing errors.

1 In summary, the applicants in the Hawaii sale promised a seamless transition to
2 HT's back-office systems, but the record in that case – including HT's own
3 pleadings -- shows that both wholesale and retail customers suffered significantly
4 from the failure of automated systems, dropped calls, long call answering and
5 holding times, billing errors and costly manual efforts to correct the deficiencies.
6 HT was not able to track repair and installation times, so that data for these
7 critical service quality metrics could not even be assessed in determining the
8 adverse effects of the transition to HT's systems.
9
10 On December 1, 2008, HT filed for Chapter 11 bankruptcy protection.[12] The
11 public explanation for the bankruptcy was the impending inability to refinance its
12 debt, but the costs and lost customers resulting from HT's poor service quality
13 probably contributed to the Company's inability to service its debt.
14
15 **Q. PLEASE DESCRIBE VERIZON'S SALE OF NEW ENGLAND**
16 **OPERATIONS TO FAIRPOINT.**
17
18 A At the beginning of 2007, FairPoint was an incumbent local exchange
19 telecommunications company with about 330,000 access lines. In that year,
20 Verizon New England, Inc., FairPoint, and affiliated firms announced a planned
21 $2.4 billion transaction, similar in some respects to that proposed in Washington
22 (but smaller in size), under which FairPoint would obtain Verizon's landline
23 businesses in Maine, New Hampshire and Vermont.
24
25 The proposed transaction was controversial and the implementation of the sale
26 was seriously flawed. In Vermont, for example, the Public Service Board initially
27 denied the application. The petitioners submitted a revised proposal in which
28 they improved the transaction from the standpoint of ratepayers in several ways.
29 The revised proposal bettered FairPoint's financial standing after the acquisition

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[12] See Hawaiian Telcom Communications, Inc., Securities and Exchange Commission Form 8-K filed December 1, 2008, and HT's December 1, 2008 Press Release contained in that filing.

by substantially reducing the initial debt and decreasing dividends. In addition, the proposal was revised to include a Performance Enhancement Plan, which was designed to prompt more investment and improve service quality by mandating that FairPoint set aside funds if it failed to meet certain specified service standards. Also, FairPoint agreed to an independent monitor of the transition from Verizon's systems to its own, with the objective of making the transition more seamless and further safeguarding consumers.[13]

The Vermont Public Service Board approved the transfer with additional conditions on February 15, 2008.[14] Following the transaction, there began a series of "cutover" problems that are still not fully resolved. Indeed, service deteriorated to the extent that the Board called for an investigation into whether the Company should be allowed to continue its operations in the state if it cannot overcome its customer service, billing and operational problems.[15]

On October 26, 2009, FairPoint announced that it had filed for Chapter 11 bankruptcy protection. [16]

Q. HAVE THERE BEEN SERVICE PROBLEMS WITH THE SALE OF VERIZON'S EXCHANGES TO FRONTIER COMMUNICATIONS?

A. On May 13, 2009, Frontier Communications and Verizon entered into an Agreement and Plan of Merger (the "Merger Agreement") under which Frontier, through the acquisition of stock, would acquire approximately 4.8 million access lines owned by subsidiaries of Verizon in Arizona, Idaho, Illinois, Indiana, Michigan, Nevada, North Carolina, Ohio, Oregon, South Carolina, Washington, Wisconsin and West Virginia as well as a small number of access lines in California bordering Arizona, Nevada and Oregon. The sale was consummated in

[13] Vermont Public Service Board Docket No. 7270, Order entered February 15, 2008.
[14] *Id.*
[15] Vermont Docket No. 7270 Information Page at http://www.state.vt.us/psb/document/. This testimony has focused on Vermont, but the problems exist in the other states as well. For example, on July 29, 2009, the *Bangor Daily News* reported that the Maine Public Utilities Commission refused to waive the financial penalties that FairPoint had incurred for poor service performance.
[16] FairPoint Form 8-K, filed with the Securities and Exchange Commission, October 26, 2009.

1 the spring of 2010 and is so recent that it cannot yet be determined whether this
2 transition will be more successful than the two previous transactions, but there are
3 already disturbing indications.

4

5 On July 21, 2010, FiberNet, a competitive local exchange carrier, filed a Petition
6 to Reopen the Frontier/Verizon authorization proceeding in West Virginia.
7 FiberNet cited a number of problems it allegedly experienced when attempting to
8 order wholesale services through the Frontier's operational support system (OSS).
9 FiberNet asserted that the various problems have created delays in providing
10 service to FiberNet customers and increased costs for FiberNet. FiberNet
11 requested that the Commission reopen this matter and direct Frontier to provide
12 an OSS that is functionally equivalent to the system previously provided by
13 Verizon. The West Virginia Public Service Commission has established a
14 complaint proceeding to deal with FiberNet's alleged problems.[17] DoD/FEA
15 Exhibit 2 is a copy of the Commission's Order. It remains to be seen whether the
16 difficulties experienced by FiberNet are discrete to that company or are part of a
17 wider deterioration in service.

18

19 Additionally, it appears that the very favorable cost-benefit ratios claimed by
20 Frontier may have begun to unravel. Frontier and Verizon had stated that Frontier
21 expected the fully implemented transaction would yield annual operating expense
22 savings of $500 million.[18] Recently, however, Frontier revealed a significant
23 increase in systems integration costs that cuts into the previously heralded
24 savings:

> 25 While we anticipate that certain expenses will be incurred, such
> 26 expenses are difficult to estimate accurately, and may exceed
> 27 current estimates. For example, our estimate of expected 2010
> 28 capital expenditures related to integration activities has recently

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[17] West Virginia PSC Order of August 16, 2010 in Case No. 09-0871-T-PC.
[18] Verizon Communications Inc. and Frontier Communications Corp. Application to the Federal Communications Commission, *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), p. 3.

1 increased from $75 million to $180 million, attributable in large
2 part to costs to be incurred in connection with third-party software
3 licenses necessary to operate the Spinco business after the closing
4 of the merger. Accordingly, the benefits from the merger may be
5 offset by costs incurred or delays in integrating the companies.[19]
6

7 **Q. WHAT IS THE LESSON FROM THESE PREVIOUS ACQUISITIONS?**

8 A. All of these transactions were described as seamless and of no harm to consumers,
9 much as this transaction in Washington has been described by CenturyLink and
10 Qwest. Events proved otherwise in each case. In view of this history, this
11 Commission must view with great suspicion the Applicants' statements that there
12 will be no impact on customers from the transfer. Indeed, CenturyLink itself
13 acknowledges the very substantial risks associated with this merger. The
14 following is an excerpt from CenturyLink's second quarter 2010 SEC Form 10-Q.

15 We expect to incur substantial expenses in connection with
16 completing the Qwest merger and integrating Qwest's business,
17 operations, networks, systems, technologies, policies and
18 procedures of Qwest with ours. There are a large number of
19 systems that must be integrated, including billing, management
20 information, purchasing, accounting and finance, sales, payroll and
21 benefits, fixed asset, lease administration and regulatory
22 compliance. While we have assumed that a certain level of
23 transaction and integration expenses would be incurred, there are a
24 number of factors beyond our control that could affect the total
25 amount or the timing of our integration expenses. Many of the
26 expenses that will be incurred, by their nature, are difficult to
27 estimate accurately at the present time. Moreover, we expect to
28 commence these integration initiatives before we have completed a
29 similar integration of our business with the business of Embarq,
30 acquired in 2009, which could cause both of these integration
31 initiatives to be delayed or rendered more costly or disruptive than
32 would otherwise be the case. Due to these factors, the transaction
33 and integration expenses associated with the Qwest merger could,
34 particularly in the near term, exceed the savings that we expect to
35 achieve from the elimination of duplicative expenses and the
36 realization of economies of scale and cost savings related to the
37 integration of the businesses following the completion of the
38 merger. As a result of these expenses, we expect to take charges
39 against our earnings before and after the completion of the merger.

[19] Frontier Communications, Inc., Form 10-Q, filed May 16, 2010, p. 56.

> The charges taken after the merger are expected to be significant, although the aggregate amount and timing of such charges are uncertain at present. Following the Qwest merger, the combined company may be unable to integrate successfully our business and Qwest's business and realize the anticipated benefits of the merger.[20]

I have attached the full Form 10-Q discussion of merger risks as DoD/FEA Exhibit 3.

I therefore believe it is important that this Commission establish safeguards to ensure that the difficulties that arose in these previous transactions will not be repeated in Washington.

ASSESSMENT OF THE TRANSACTION

Q. DO YOU OPPOSE THIS TRANSACTION?

A. Not necessarily. Although I have some reservations which I will discuss, there are a number of features of this transaction that are more promising than those of the previous acquisitions. CenturyLink is a much larger, more experienced and financially healthier company than the Carlyle Group, FairPoint or Frontier. Unlike the previous acquisitions, this transaction is a stock transfer that involves no new debt. So far, the record of CenturyLink's acquisitions has been relatively trouble-free. The combined company will display a much stronger balance sheet relative to that of Qwest at the present time. With appropriate conditions, I believe the merger may be in the public interest.

Q. WHAT, THEN, IS YOUR CONCERN IN THIS PROCEEDING?

A. I am concerned that the transition from Qwest to CenturyLink be as seamless as possible and that there be no rate increases, disruptions, or other service quality

[20] CENTURYTEL INC, Form 10-Q, filed August 6, 2010, p. 32. See DoD/FEA Exhibit 3.

losses arising from this transaction. In this testimony, I recommend several conditions that should be imposed on the merged company as part of the approval of the transaction. These conditions relate to two principal areas of concern to DoD/FEA. The first is the financial stress that may be imposed on the merged company's Washington operations. The second is the maintenance of adequate service quality in the Washington exchanges.

FINANCIAL STRESS ON WASHINGTON OPERATIONS

Q. WHY ARE YOU CONCERNED ABOUT THE FINANCIAL HEALTH OF THE WASHINGTON OPERATIONS?

A. CenturyLink asserts that the merger of its company with Qwest will generate annual synergies of $625 million.[21] These synergies are expected to take the form of reduced corporate overheads, network and operational efficiencies, IT support, increased purchasing power, and the combining of the two companies' advertising and marketing programs. As the foregoing excerpt from CenturyLink's Form 10-Q concedes, these synergies are difficult to forecast with precision, and they may not develop as expected.

Whatever the synergies, they come at a substantial cost. The Applicants estimate that there will be one-time operating costs of $650 to $850 million to achieve the planned synergies nationwide. On top of that an additional $150 to $200 million in capital costs will be required.[22] These costs are estimates, and the Company concedes that they could be exceeded, as has happened in all three of the acquisitions discussed earlier in this testimony. Moreover, these costs will be incurred before the benefits of the synergies are felt, so that they represent a net new requirement for funds. Left unstated is where the money for these transition costs will come from.

[21] Direct Testimony of G. Clay Bailey, p.11.
[22] Exhibit GCB-2, p. 13.

It is possible that some of the money might come from new bond and stock issues, but there are downsides to these sources of funds. At present, CenturyLink is rated by S&P at the critical BBB- rating that just qualifies its bonds for "investment grade", meaning that fiduciary funds, such as pension and insurance funds, can buy the bonds. Qwest's BB rating is just below that threshold.[23] The combined company will thus be on the cusp of investment grade bond ratings. Any substantial increase in debt would push the company below that important threshold, eliminating a portion of its potential bond market and possibly increasing its interest costs.[24] Additional stock sales would dilute the value of the existing shares, depriving the stockholders of the full promised benefits of the merger. It is therefore likely that the Company will avoid these financing sources if it can find the needed funds elsewhere.

An important source of funds elsewhere will be the company's customers, and that is the source of my concern. As an alternative to bond or stock sales, CenturyLink may look to its local operations, including those in Washington, to meet the urgent requirement to increase revenue.

Q. WHERE MIGHT THE MERGED COMPANY FIND ADDITIONAL REVENUE IN WASHINGTON?

A. Where the merged company can find additional revenue is dependent on the extent to which competition limits its ability to increase rates unilaterally. This very issue was addressed by the Federal Communications Commission ("FCC") in its rejection of a request from Qwest for "forbearance" from FCC regulation of certain services in four metropolitan areas, including the regional Seattle Metropolitan Statistical Area ("MSA").

[23] Direct Testimony of G. Clay Bailey, p. 22, fn. 28.
[24] CenturyLink has represented to Moody's Investor Services that it is committed to an investment grade rating. *See* Exhibit GCB-4.

1 The FCC's summarized its conclusions regarding competition in these MSAs as
2 follows:

3 We find that Qwest is subject to competition in the four MSAs from both
4 intra- and intermodal competitors. The record indicates that a number of
5 competitive LECs (*i.e.*, intramodal competitors) compete with Qwest for
6 mass market and enterprise customers in certain subsections of the four
7 MSAs. The evidence also shows, however, that, in serving mass market
8 and enterprise customers, these intramodal competitors rely significantly
9 on access to Qwest's last-mile network facilities, including UNEs, and
10 Qwest's other wholesale services in all four MSAs. We also find that, in
11 these four MSAs, Qwest is subject to intermodal competition,
12 particularly from cable operators, primarily for residential services. We
13 do not include providers of "over-the-top" or nomadic voice over
14 Internet Protocol (VoIP) services in our competitive analysis because
15 there are no data in the record that justify finding that these providers
16 offer close substitute services. (footnotes omitted)[25]

17

18 Just last June, the FCC again rejected Qwest's petition for forbearance relating to the
19 Phoenix, AZ MSA on the grounds that competition is inadequate to prevent Qwest from
20 exercising market power. In that decision, it found that cable companies, such as
21 Cox, offer substitute telephone service to residential customers, but that wireless
22 service does not provide price-constraining competition.[26] As in its earlier
23 decision, the FCC found that although there are a number of competitors for
24 "enterprise" services to medium and large commercial customers, those
25 competitors are principally dependent on Qwest facilities to access their
26 customers.[27]

27

28 The FCC's findings provide the basis for evaluating the relative ability of Qwest
29 to extract additional revenue by means of unilateral price increases from its three
30 primary retail markets, residential, small commercial and large "enterprise"
31 commercial.

32

---

[25] *In the Matter of Petitions 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*, Memorandum Opinion and Order, WC Docket No. 07-97 (July 25, 2008), para. 16. (Emphasis supplied.)

[26] *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, released June 22, 2010), para. 57.

[27] *Id.,* paras. 87-91; 99.

If, as the FCC finds, wireless is not a price-constraining competitor, then the only facilities-based competition for residential telephone service must come from the Voice over Internet Protocol ("VoIP") service offered by the cable TV companies.

A cable company offering VoIP will also provide Internet access. That being the case, the incumbent carriers' response is to offer its own "triple play" package of telephone, cable TV and Internet access, or even "quadruple play" with the addition of wireless service from other providers.[28] In light of the fierce competition for these services, it is unlikely that Qwest or CenturyLink could sustain significant rate increases either for its residential wireline service or its residential multi-service bundles.

Small business wireline service is another matter. Businesses require fixed telephone access with publicly available number identification. They may use wireless in addition to wireline, and they may use VoIP for long-distance service, but they are still heavily dependent on the conventional telephone, at least for inbound local access. Cable TV companies that offer telephone services over their facilities do not have the same marketing advantage for business users because businesses are usually not interested in broadcast television capabilities at the workplace. Therefore, while Cable TV companies may market to businesses, they are somewhat less of a competitive threat than in the residential market. In recent years, Competitive Local Exchange Carriers ("CLECs") provided some competition, but that competition is small and declining. In 2009, CLECs served only 14.7 percent of the access lines in Washington, down from 15.8 percent in the previous year.[29] Furthermore, as the FCC has noted, these competitors are significantly dependent on Qwest to access their customers.

[28] Neither Qwest nor CenturyLink directly offers its own wireless service.
[29] Federal Communications Commission, "Local Telephone Competition: Status as of June 30, 2009", Table 8.

1 From these indications, I suspect that the merged company will probably seek
2 additional revenues from the small business market. That additional revenue is
3 likely to take the form of unilateral rate increases.
4
5 The "enterprise" market is the most competitive of the three major segments of
6 wireline telephone market, although the FCC has found that even this market is
7 susceptible to Qwest's control of the "last mile" local loop. Most services in this
8 category are procured through competitive bidding and the prices paid are
9 generally subject to contract and not publicly disclosed. Even if the prices were
10 publicly identified, they would likely not be comparable to tariff services because
11 so much of enterprise service comes in the form of "bundles" of service elements.
12
13 But enterprise service does not exist in a vacuum. The ultimate ceiling on any
14 competitive bid is the price that would be paid if the same services were
15 purchased from the carrier's public tariff. When the published rates increase, that
16 ceiling increases, providing more headroom for the competitors to increase their
17 bids. Thus, even though enterprise customers can solicit competing bids, they still
18 may experience an upward shift in those bids when the listed rates for basic
19 business services increase.
20
21 Based on the foregoing, I believe that basic business services are most susceptible
22 to unilateral rate increases motivated by the need to raise revenue to implement
23 the merger.
24
25 **Q. IS IT IN THE PUBLIC INTEREST FOR THE MERGED COMPANY TO**
26 **EXTRACT UNILATERAL RATE INCREASES IN THE WASHINGTON**
27 **MARKETS TO FUND THE MERGER?**
28
29 A. No. This transaction is in the public interest only if the public is no worse off
30 with the merger than without it. If the merged company increases its rates

unilaterally to fund the merger, then its customers would have been better off if the merger had never taken place.

Q. WHAT IS THE RESOLUTION OF THIS PROBLEM?

A. The resolution is to impose a temporary price cap on Qwest's and CenturyLink's basic business services to be effective until the synergies of the merger begin to be realized. By then, the need for additional revenue to fund the transition, including the direct costs of the merger, will have abated, and the Commission will be able examine the merged company's overall revenue need.

Q. WHAT BASIC BUSINESS SERVICE PRICES SHOULD BE CAPPED?

A. The basic business service rates that should be capped are single and multiple line business rates, PBX and Centrex charges, and the rates for special access services.

Q. HOW LONG SHOULD THIS TEMPORARY PRICE CAP REGIME LAST?

A. CenturyLink anticipates that synergies will only be fully recognized over a three to five year period following closing of the merger.[30] During that period Qwest's present AFOR should be maintained but with its and CenturyLink's basic business rates capped. Once the synergies have been realized, the Commission can then conduct a full review of the merged company's revenue need and adopt a new AFOR, if appropriate.

The duration of the caps is therefore a function of the realization of synergies. For the first three years, the caps should be firm, but if the Qwest AFOR period lasts longer, then in fairness to the Company the price caps should be adjusted to an inflation index such as the Gross Domestic Product ("GDP") deflator.

[30] Direct Testimony of G. Clay Bailey, p. 11.

1 **Q. IS YOUR RECOMMENDATION TO PLACE A LIMITED PRICE CAP ON**
2 **BASIC BUSINESS RATES FOLLOWING THE MERGER A DEPARTURE**
3 **FROM THE COMMISSION'S CURRENT REGULATORY SCHEME FOR**
4 **QWEST?**

5 **A.** The current regulatory scheme for Qwest was established in 2007 when the
6 Commission adopted an Alternative Form of Regulation ("AFOR"). In its
7 decision, Commission granted pricing flexibility to the last of Qwest's business
8 services, although it retained price regulation of basic residential services.[31] My
9 recommendation temporarily suspends these provisions for only a handful of
10 basic business services. This limited suspension, however, is necessary until the
11 pressure to increase rates on business services to cover the merger-related costs
12 passes. Absent such a suspension of pricing flexibility, business customers such
13 as DoD/FEA cannot conclude that they will suffer no harm as a result of the
14 merger. That is because Qwest has the incentive to use its pricing flexibility to
15 recover integration costs from business customers long before they enjoy savings
16 from the alleged synergies. Clearly, the Commission in 2007 could not have
17 envisioned such a major change in Qwest's corporate status and its financial
18 needs. It is unrealistic to ignore this effect of the merger by allowing Qwest to
19 continue to enjoy its current broad pricing flexibility for business services.
20
21 I am not suggesting that all of Qwest's business rates be reregulated. I am only
22 suggesting a condition of approval that will ensure that end-users of the merged
23 company's services will be no worse off for the merger having been
24 consummated. As noted earlier, the absence of harm to the public is a necessary
25 requirement to a finding that the transaction is in the public interest. My proposal
26 is intended to cover the short period during which the pressure for increased
27 revenue will be most forceful.
28

[31] *In the Matter of the Petition of Qwest Corporation for an Alternative Form of Regulation Pursuant to R.C.W.80.36.135,*Order Accepting Settlement and Approving Alternative Form of Regulation, on Conditions, Docket UT-061625, (July 24, 2007).

1 **Q. ARE CENTURYLINK'S BUSINESS SERVICES SIMILARLY**
2 **DEREGULATED?**
3
4 A. No. CenturyLink continues to be subject to rate base/rate-of-return regulation, so
5 a price cap on its business services would not be a departure from the present
6 regulatory scheme. However, CenturyLink has been directed to submit an AFOR
7 plan sometime within the first five years of its merger with Embarq, which means
8 by 2014. That plan should embody the price caps that I am recommended.
9
10 **<u>SERVICE QUALITY CONCERNS</u>**
11
12
13 **Q. HOW DOES THE SERVICE QUALITY PERFORMACE OF THESE TWO**
14 **COMPANIES COMPARE?**
15
16 A. In its "Automated Reporting Management Information System" ("ARMIS")
17 reports, the Federal Communications Commission ("FCC") publishes six different
18 service performance metrics on an annual basis for most of the major telephone
19 companies in the country. The latest data are for the year 2009. DoD/FEA
20 Exhibit 4 attached to this testimony shows the results for Qwest nationally and for
21 Embarq, which merged with CenturyTel during the year (no corresponding data
22 are available for CenturyTel itself). In every case but one, Embarq scores no
23 better or worse than Qwest, suggesting that its standards of service have not been
24 as high as those of Qwest.
25
26 I have also reviewed the Washington Commission's data for a somewhat different
27 set of metrics for the telephone companies within the state. With one exception,
28 the scores of Embarq and the legacy CenturyTel, now both CenturyLink, are
29 generally comparable to those of Qwest. The exception is complaints to the
30 Commission, where Qwest comes up worse than CenturyLink.
31

1 **Q. WHY, THEN, ARE YOU CONCERNED ABOUT THE SERVICE**
2 **QUALITY RESULTING FROM THIS TRANSACTION?**
3
4 A. As noted earlier in my testimony, several recent large wireline acquisitions have
5 resulted in severe service quality degradation. I am concerned that a similar
6 deterioration of service might develop following the transfer of Qwest to
7 CenturyLink ownership, for two reasons.
8
9 The first reason has already been noted: the pressure to finance the
10 implementation of the merger. While revenue enhancement may be one source of
11 the funds for the merger implementation, another source could be cost cutting in
12 the form of reduced resources, including capital investment and manpower
13 devoted to plant maintenance and customer service. Obviously, this kind of cost
14 cutting would lead to a deterioration of service performance.
15
16 The other reason for concern is the incompatibility of the Qwest and CenturyLink
17 operating support systems. To achieve the promised synergies, CenturyLink will
18 have to integrate its protocols and IT systems with those of Qwest. This
19 integration is layered on top of the already complex integration of the Embarq
20 systems with those of CenturyTel. As noted in the earlier quotation from the
21 Company's 10-Q report (pages 10-11), CenturyLink has conceded that this
22 integration could pose severe difficulties. Past experience has demonstrated that
23 these difficulties can result in degraded service performance and excessive costs.
24
25 **Q. THE APPLICANTS STATE THAT QWEST AND CENTURYLINK WILL**
26 **CONTINUE TO OPERATE AS THEY DO NOW, SO WHY ARE YOU**
27 **CONCERNED?**

1 A. The corporate identities of Qwest and CenturyLink may continue.[32] However, as just noted, the Applicants' claimed network and operational synergies can only be realized through the integration of Qwest's management and operations support systems with those of CenturyLink. That means that Qwest or CenturyLink will eventually have to cut all protocols over to a common format. As I have noted, in previous cases this cutover has proved to be difficult, costly and highly disruptive to both retail and wholesale customers.

For these reasons, it is important for the Washington Commission to maintain close surveillance over CenturyLink's service performance. To be a deterrent against service degradation, the Commission should monitor the merged company's service performance and be prepared to react quickly, if need be by imposing sanctions if service quality deteriorates.

Q. DOES THE WASHINGTON COMMISSION CURRENTLY HAVE QUALITY STANDARDS FOR QWEST'S AND CENTURYLINK'S TELECOMMUNICATIONS SERVICES?

A. Yes. WAC 480-120-401 through 480-120-560 contain safety and service quality standards for most categories of local exchange telephone service. For example, WAC 480-120-438 contains the standard for trouble reports. WAC 480-120-440 provides standards for repairs for service interruptions and impairments. WAC 480-120-439 contains the service quality reporting requirements. WAC 480-120-019 allows the Commission to impose administrative penalties for failure to achieve the service quality standards.

Additionally, both Qwest and CenturyLink have "customer service guarantee" plans that were adopted in prior Washington merger orders. The Qwest service guarantee plan was initially required at the time Qwest acquired US WEST, but

[32] Direct Testimony of John Jones, p. 5.

has been continued as part of Qwest's AFOR. It provides for customer credits for out-of-service (no dial tone) conditions on both an individual customer and a wire center basis. Customer credits are also provided when there are excessive trouble reports. Qwest is obliged to submit a report each year to its customers that summarizes eight service quality measures for the prior year and compares them to specified "baseline" values. [33]

CenturyLink's service guarantee plan is inherited from Embarq when it was spun off from Sprint. In the CenturyTel/Embarq merger order, the Commission made that plan applicable to CenturyLink companies until one year following the full integration of the two companies' customer service and billing systems.[34] The plan provides for credits of $15 to residential customers and $25 to business customers for missed installation commitments.

Q. ARE THESE STANDARDS ADEQUATE FOR PURPOSES OF MAINTAINING HIGH SERVICE QUALITY?

A. The standards are adequate, but the service guarantee plans are both scheduled to expire. The Qwest plan will expire when the current AFOR plan expires in 2011. The Embarq/CenturyTel service guarantee plan will expire one year following the full integration of the Embarq systems into those of CenturyLink.

Q. WHAT DO YOU RECOMMEND?

A. The Embarq/CenturyTel service guarantee plan should be extended beyond its expiration date. Because it applies to only one metric, service installations, it is not adequate to protect customers during this transition. For this reason, I recommend that the Qwest service guarantees be expanded to cover the entire

[33] *In the Matter of US WEST and Qwest Communications for an Order Approving Merger*, Ninth Supplemental Order, Docket T-991358 (June 19, 2000), pp. 10-11.
[34] *In the Matter of Embarq Corporation and CenturyTel, Inc. for Approval of Transfer of Control,* Order 05 Final Order Approving and Adopting Settlement Agreement, Docket UT-082119 (May 28, 2009), Appendix 1 - Settlement Agreement, para. 3.

merged company. As I have earlier recommended, Qwest's AFOR should be extended until the merger synergies are realized. The service guarantee portion of the AFOR would, of course, be extended as well.

The AFOR service guarantees, beneficial as they are, provide only for customer bill credits. The Commission should be prepared to impose stronger sanctions if there is a systematic deterioration in service performance such as has occurred with previous mergers. As noted, WAC 480-120-019 allows the Commission to impose administrative penalties for failure to achieve its service quality standards. I therefore recommend that the Commission establish a schedule of direct sanctions and penalties based on the degree to which the company fails to meet the various service metrics in its present rules.

OTHER CONCERNS

Q. DO YOU HAVE ANY OTHER CONCERNS REGARDING THIS MERGER?

A. Yes. I have two. The first deals with the loss of competition, and the second with the ability of the merged company to perform on government contracts.

Q. WHY ARE YOU CONCERNED WITH THE LOSS OF COMPETITION?

A. At present CenturyLink can bid against Qwest for government procurements of telecommunications services. The merger collapses these two potential competitors into one. This issue is particularly relevant in Washington, where, as Qwest witness Mark Reynolds states, "… CenturyLink serves governmental customers within the boundaries of the Qwest Olympia exchange."[35] Thus, in Washington the loss of one competitor for enterprise customers' telecommunications services is a fact, not an academic possibility. Mr. Reynolds'

[35] Direct Testimony of Mark S. Reynolds, p. 16.

1 testimony about the nature of the Qwest and CenturyLink service areas in
2 Washington, which he views as "generally complementary," also suggests that,
3 absent the merger, additional enterprise customers may have been able to select
4 from competitive offerings from both companies. In support of his testimony that
5 the merger will result in economies of scale and scope, Mr. Reynolds states that
6 "In many cases the networks are adjacent or within close proximity to one
7 another, and this will make it easier to implement operating efficiencies and
8 infrastructure improvements."[36] If the networks are in fact adjacent or in close
9 proximity, one would believe that the presence of competition for enterprise
10 customers in Olympia might well be duplicated elsewhere because the necessary
11 staff and infrastructure to provide service in other locations are physically nearby.
12 This loss of competition is thus a downside consideration not only for the
13 government, but for all enterprise service customers.
14
15 **Q. WHAT CAN THE COMMISSION DO ABOUT THIS ISSUE?**
16
17 A. The loss of competition is the inevitable result of merging two
18 telecommunications carriers into one. Other than to disapprove the merger, the
19 Commission cannot prevent this outcome. However, it does mean that the
20 Commission must find that there are significant and identifiable benefits from the
21 merger that offset this downside effect.
22
23 **Q. WHY ARE YOU CONCERNED ABOUT THE MERGED COMPANY'S**
24 **ABILITY TO PERFORM ON GOVERNMENT CONTRACTS?**
25
26 A. My concern relates to the following language in the "risks" section of
27 CenturyLink's second quarter 2010 SEC Form 10-Q:

28 > We may be unable to obtain security clearances necessary to
29 > perform certain Qwest government contracts. Certain Qwest legal
30 > entities and officers have security clearances required for Qwest's
31 > performance of customer contracts with various government

[36] *Id.*, p. 13.

> entities. Following the merger, it may be necessary for us to obtain comparable security clearances. If we or our officers are unable to qualify for such security clearances, we may not be able to continue to perform such contracts.[37]

Q. IS THERE ANYTHING THE COMMISSION CAN DO TO ADDRESS THESE CONCERNS?

A. The issue of security clearances is another negative factor associated with the merger over which the Commission has little control. Possibly the Commission could require that as a condition of approval there be no personnel changes that would jeopardize government contracts until all of the affected personnel have the required clearances.

SUMMARY OF RECOMMENDATIONS

Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

A. In this testimony, I have recommended that, as conditions of approval of the merger:

- The Commission extend Qwest's present AFOR until the synergies from the merger have been realized. At that time, the Commission can examine the merged company's overall revenue needs.
- For the duration of the AFOR, for at least three years, the basic business rates of both CenturyLink and Qwest should be capped. If the cap lasts longer than three years, the caps should be adjusted for inflation.
- The Commission extend the Qwest service guarantee plan to cover the CenturyLink/Qwest merged entity until it is superseded by a new AFOR service guarantee program.
- The Commission develop a schedule of direct sanctions and penalties for failure by the merged company to achieve the service quality standards set forth in the Commission's rules.

[37] CENTURYTEL INC, Form 10-Q, filed August 6, 2010, p. 34. *See* DoD/FEA Exhibit 3.

- The Commission direct CenturyLink to refrain from personnel transfers that may jeopardize the ability of the Company to bid on government contracts.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes. It does, although I should note that there are some aspects of this transaction that I have not addressed. These include such issues as the likelihood of cost savings from the transaction, the quality and extent of the merged company's broadband services, the extent to which past obligations will affect the new entity, and the wholesale market policies and the interfaces between the Company and its CLEC competitors. My silence on such issues does not mean that they are not important to DoD/FEA or that DoD/FEA will not address them later in this proceeding. [38]

[38] I should also note that the discovery process is not completed. It is possible that further responses may require supplemental testimony.