STATE OF IOWA
DEPARTMENT OF COMMERCE
IOWA UTILITIES BOARD

IN RE: QWEST COMMUNICATIONS INT'L, INC. AND CENTURYTEL, INC.	DOCKET NO. SPU-2010-0006

DIRECT TESTIMONY

OF

AUGUST H. ANKUM, PH.D.

ON BEHALF OF

MCLEODUSA TELECOMMUNICATIONS SERVICES, INC.

d/b/a PAETEC BUSINESS SERVICES

August 16, 2010

TABLE OF CONTENTS

Exhibits

Exhibit AHA-1: *Curriculum Vitae* of August H. Ankum, Ph.D.

Exhibit AHA-2: The Promises vs. Realities of Recent ILEC Mergers and Acquisitions

Exhibit AHA-3: Discovery Responses Demonstrating the Significant Uncertainty Resulting from the Proposed Transaction

Exhibit AHA-4: Applicants Claims' About Alleged Benefits Resulting From the Merger Compared to Their Discovery Responses

Exhibit AHA-5: Re: Qwest Tariff F.C.C. No. 1 (interstate access tariff) – Qwest's Product Notification and Integra's correspondence with Qwest

I. PROFESSIONAL QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. WHAT IS QSI CONSULTING, INC. AND WHAT IS YOUR POSITION WITH THE FIRM?

A. QSI Consulting, Inc. ("QSI") is a consulting firm specializing in regulatory and litigation support, economic and financial modeling, and business plan modeling and development. QSI provides consulting services for regulated utilities, competitive providers, government agencies (including public utility commissions, attorneys general and consumer councils) and industry organizations. I am a founding partner and currently serve as Senior Vice President.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I received a Ph.D. in Economics from the University of Texas at Austin in 1992, an M.A. in Economics from the University of Texas at Austin in 1987, and a B.A. in Economics from Quincy College, Illinois, in 1982.

My professional background covers work experiences in private industry and at state regulatory agencies. As a consultant, I have worked with large companies, such as AT&T, AT&T Wireless, Bell Canada and MCI WorldCom ("MCIW"), as well as with smaller carriers, including a variety of competitive local exchange carriers ("CLECs") and wireless carriers. I have worked on many of the arbitration proceedings between new entrants and incumbent local exchange carriers ("ILECs"). Specifically, I have been involved in arbitrations between new entrants and NYNEX, Bell Atlantic, USWEST, BellSouth, Ameritech, SBC, GTE and Puerto Rico Telephone. Prior to practicing as a telecommunications consultant, I worked for MCI Telecommunications Corporation ("MCI") as a senior economist. At MCI, I provided expert witness testimony and conducted economic analyses for internal purposes. Before I joined MCI in early 1995, I worked for Teleport Communications Group, Inc. ("TCG"), as a Manager in the Regulatory and External Affairs Division. In this capacity, I testified on behalf of TCG in proceedings concerning local exchange competition issues, such as Ameritech's Customer First proceeding in Illinois. From 1986 until early 1994, I was employed as an economist by the Public Utility Commission of Texas ("PUCT") where I worked on a variety of electric power and telecommunications issues. During my last year at the PUCT, I held the position of chief economist. Prior to joining the PUCT, I taught undergraduate courses in economics as an Assistant Instructor at the University of Texas from 1984 to 1986.

A list of proceedings in which I have filed testimony is attached hereto as Exhibit AHA-1.

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

A. Yes. I have been involved in telecommunications since 1988, and over the course of my career, I have worked and testified on virtually all issues pertaining to the regulation of incumbent local exchange companies, including those governing their wholesale relationship with dependent competitors, such as competitive local exchange carriers ("CLECs"). I have also worked on numerous proceedings involving competitive and market dominance issues, including those pertaining to the FCC's triennial review cases and merger analyses.

Q. ON WHOSE BEHALF ARE YOU FILING THIS DIRECT TESTIMONY?

A. My testimony is being filed on behalf of McLeodUSA Telecommunications Services, Inc. d/b/a PAETEC Business Services (hereafter "PAETEC").

II. PURPOSE AND SUMMARY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AND SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.

A. The purpose of my testimony is to evaluate whether the proposed merger between CenturyLink[1] and Qwest is in the public interest.

Having reviewed the application, supporting testimony and data request responses, I believe it is not. As I will demonstrate, the proposed transaction should either be rejected *in total* or in the alternative, approved only if and when the Board has obtained firm, specific, enforceable commitments from (or placed conditions on) CenturyLink and Qwest (hereafter collectively referred to as "Joint Applicants") in order to safeguard the state of competition and wholesale customers.

---

[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.

As discussed herein, and in the testimony of my colleague Mr. Timothy Gates, the information provided by the Joint Applicants is not only inadequate to demonstrate that the proposed transaction is in the public interest but also strongly suggests that wholesale customers, such as CLECs, may be at risk when the Joint Applicants seek to integrate their two companies post-merger; indeed, all indications are that the proposed transaction will potentially jeopardize not only the viability of CLECs but the competitive process itself.

Specifically, my testimony will discuss the following:

- The economic incentives underlying mergers.
- A brief overview of past mergers in the telecommunications industry, demonstrating a troublesome history of mergers and the likelihood of failure.
- There is no reason to believe there is a public benefit (or that any other state-specific standard has been met) from the proposed transaction.
- Why commitments to ensure benefits for consumer welfare and the industry given the incentives in a post-merger environment are necessary.
- Some specific commitments and/or conditions that should be required of Joint Applicants as prerequisites for the merger to be approved. (A complete list is provided by Mr. Gates.)

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

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

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

Their enthusiasm was misguided, and their judgment flawed: of the three mergers mentioned in this brief exchange (AOL/TW, Cisco, and WorldCom), two were colossal failures, putting the failure rate for these three mergers at two out three, which is about where the academic literature puts it.[3]

---

2 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.

3 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*,

Q. ARE YOU SAYING THAT MERGERS ARE BAD?

A. No, to the contrary: there is no doubt that mergers and acquisitions may spawn innovative and profitable companies and contribute to the vibrancy of free markets. At issue is the merit of the *instant transaction*, and an examination of past mergers and their failures (discussed below) not only serves to alert the Board to various pitfalls but also underscores how important it is that the Board consider all stakeholders.

Q. DO MERGERS OF ILECS RAISE UNIQUE ISSUES, NOT RELEVANT TO MERGERS IN OTHER SECTORS OF THE UNITED STATES ECONOMY?

A. Yes. A merger involving a large ILEC touches on many public interest issues, not least of which is the relationship between the ILEC and its wholesale clients, CLECs, critical to local exchange competition. To appreciate the public's and the CLECs' stake in this merger, it is important to recall the starting points of the ILECs' network investments.

Until the early 1990, ILECs had a government sanctioned monopoly to provide local services to captive ratepayers. In exchange, ILECs operated in a rate regulated environment. Rate regulation meant that if an ILEC had increased operating costs, or was required to invest new capital to build out local infrastructure (*e.g.*, middle mile or last mile loop facilities), the ILEC had the ability to pass along those increased capital or operating costs by securing a rate increase from the state regulators. Those regulated rates provided for a rate of

McGraw-Hill, 1997, Chapter 1, Section Statistics on Merger Success and Failure, sets the failure rate at between 50% and 60%.

return that the ILEC was sanctioned to earn. Of course, ILECs often earned more than their authorized rate of return, and sometimes they earned less (which meant the ILEC was entitled to pursue higher rates). Not only were the ILECs able to secure rate increases when it proved its case to regulators, its monopoly status then assured it that that every business and residential customer in its local exchange market would pay those regulated rates to secure local service. Thus, a material portion of the ILEC infrastructure in place today, especially the local loop infrastructure, was built when the ILEC was guaranteed that the cost of its investment would be paid for by captive customers through regulated rates that included a guaranteed rate of return. That monopoly environment with its guaranteed rate of return is in stark contrast to the competitive environment that CLECs created by their local market entry in which CLECs have to compete for every customer. The Telecommunications Act of 1996 invited CLECs into the market under provisions that allowed them to use certain of the ILECs' networks and services and obviated the need for CLECs to build their own local access loops to all end user premises. This construction has worked reasonably well and created competition where none existed prior to 1996; however, a merger, such as the one proposed in the instant proceeding, could upset the wholesale relationship between ILEC and CLECs, and harm the competitive process. This why the Board should in this merger consider, among other issues, the access to the ILEC's local network and loop infrastructure as it critically impacts local competitors, competition and thus the public interest at large. It is also why mergers involving large ILECs are unique.

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

A. Yes. An examination of past telecom mergers teaches us that the risks and gains of a merger are not evenly distributed among all stakeholders.

The Joint Applicants' shareholders, for example, can sell their shares if they anticipate that things will go awry, or, alternatively, go along for the ride to reap whatever benefits they may anticipate: it is a risk-return tradeoff each shareholder is free to either assume or walk away from. However, this freedom of choice does not exist for other, captive stakeholders. Specifically, large numbers of retail customers (in captive segments of retail markets) have little or no choice and neither do wholesale customers, such as CLECs, who critically depend on the Joint Applicants for loops, transport, collocation and a variety of other wholesale network inputs. That is, captive retail and wholesale customers will not only reap *no gains* if the proposed transaction is successful, they may experience great harm when things go awry (as they have in so many of these ventures). This asymmetry in the risk-return profiles between various stakeholders is profound. Hence, the need for a regulatory review process to determine whether the proposed transaction is in the interest of *all* stakeholders.

Q. IS THERE A DIVERGENCE BETWEEN A PUBLIC INTEREST ANALYSIS AND THE PRIVATE RISK-RETURN ANALYSIS GUIDING THE JOINT APPLICANTS?

A. Yes. The Joint Applicants need only consider their private risk-return trade-offs. In contrast, the Board should also consider the interest of other stakeholders who will likely not benefit from the proposed transaction, but may be harmed. Naturally, this is a necessarily broader analysis, and less likely to result in a finding that the proposed transaction should be permitted to move forward as proposed.

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

A. Yes. I have already noted that most mergers are not necessarily successful. However sobering that statistic may be, CenturyLink appears to be upping the ante by trying to swallow no less than a Bell Operating Company ("BOC") while it is still digesting Embarq, a company that was already much larger than the original CenturyTel. If the successful outcome of mergers is generally in question, the outcome of this one is particularly so.

What comes to mind is the fateful path charted by WorldCom, a once-upon-a-time darling of Wall Street that in rapid succession acquired a number of firms of increasing size and complexity, culminating in the fateful MCI acquisition; the end is well known, and not pretty. While WorldCom was brought down by a number of missteps, some of them since found to be criminal, it is fair to say that much of its demise had to do with the failure to successfully integrate the various acquired companies and the escalating challenges of ever larger acquisitions, made possible simply by the growth in market capitalization of the firm – rather than by successes in the market place.

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

	Year	Access Lines[4]	% of Total
CenturyTel	2009	1,300,000	8%
Embarq	2009	5,700,000	34%
Qwest	2010	10,000,000	59%
Total		**17,000,000**	**100%**

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

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

4 Line counts are taken from CenturyLink's testimony, which appear to be approximate line counts. See Direct Testimony of Duane Ring, Docket No. SPU-2010-0006, filed May 25, 2010 ("Ring Iowa Direct") , at p. 5, and Exhibit DR 1, and Direct Testimony of Jeff Glover, Docket No. SPU-2010-0006, filed May 25, 2010 ("Glover Iowa Direct"), at p. 5.

and complex set of operational support systems, is particularly daunting and far beyond anything CenturyLink has faced to date. *Whatever may be CenturyLink's proven track record, integrating and managing a BOC is not a part of it*.[5]

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

A. No. First, SBC and Verizon were large BOCs themselves. Given their common genealogy as Baby Bells, SBC's and Verizon's management knew what they were acquiring and how to run a BOC, with all the attendant regulations and obligations to which it is subject. Further, the BOCs still had a common corporate culture and were mostly working with common engineering practices inherited from Ma Bell. Also, when, for example, SBC acquired Ameritech, SBC was larger than Ameritech – not, as is the case here, smaller by a factor of 10 (using CenturyTel as the base). CenturyLink, which will be trying to absorb the much larger Qwest, is punching well above its weight.

Q. WHY SHOULD THE BOARD BE PARTICULARLY CONCERNED ABOUT POTENTIAL ADVERSE IMPACTS ON CLECS?

[5] 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.

A. CLECs are one of CenturyLink's and Qwest's largest wholesale clients, and possibly the largest clients the companies have. While normally large customers are especially well taken care of, in the instant situation these large customers, CLECs, are captive and have few if any alternatives. Further, CLECs compete with CenturyLink and Qwest in downstream markets, which creates a perverse incentive structure in which CenturyLink and Qwest may have disincentives to maintain quality wholesale services. In light of this and the fact that the economic health of CLECs is critical to local exchange competition, it is important for the Board to ensure that CLECs' interests are considered and protected.

Q. WHAT IS YOUR RECOMMENDATION?

A. I recommend that the Board reject the proposed transaction. As discussed herein and in the testimony of Mr. Gates, there are good reasons to believe that it may have disastrous consequences. However, if the Board nevertheless decides to approve the transaction, then it should recognize the hazards faced by captive wholesale customers, CLECs, and obtain a set of stringent commitments, discussed herein and by Mr. Gates, in order to safeguard competitors and, indeed, competition itself.

III. STANDARD FOR REVIEW

Q. WHAT IS THE APPROPRIATE STANDARD FOR THE BOARD TO USE IN REVIEWING THE JOINT APPLICANTS' PROPOSED REORGANIZATION?

A. While I am not a lawyer, I have reviewed Iowa Code § 476.77. That section appears to provide a broad review that, fundamentally, looks to protect the "the interests of the public utility's ratepayers and the public interest."[6] The statute goes on, however, to list certain specific aspects of the proposed reorganization that the Board may properly consider:[7]

> a. Whether the board will have reasonable access to books, records, documents, and other information relating to the public utility or any of its affiliates.
>
> b. Whether the public utility's ability to attract capital on reasonable terms, including the maintenance of a reasonable capital structure, is impaired.
>
> c. Whether the ability of the public utility to provide safe, reasonable, and adequate service is impaired.
>
> d. Whether ratepayers are detrimentally affected.
>
> e. Whether the public interest is detrimentally affected.

The issues of ratepayer interest and public interest both include the impact of the proposed merger on competition in Iowa. Indeed, in Section 476.95(2), the Iowa legislature specifically mandated that Board shall "consider the effects of its decisions on competition in telecommunications markets and, to the extent reasonable and lawful, shall act to further the development of competition in those markets." There can be no doubt that this decision will impact competition in Iowa if the Board does not ensure that the merged entity does not have the ability or mandates in place to continue providing wholesale obligations required by Iowa and federal law.

---

[6] Iowa Code § 476.77(1).

[7] Iowa Code § 476.77(3).

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

A. Yes. The mandates of the Telecommunications Act of 1996 are also critical in reviewing the proposed merger. Nevertheless, the Application itself makes only a vague reference to "…the laws governing interconnection."[8] The Application and testimony provide no analysis of the Act's requirements or how they will be met under the proposed merger.[9] This lack of information and commitment is a common theme in all the Joint Applicants' applications and testimony I have reviewed, and should be a source of great concern for the Board.

IV. ECONOMICS AND REVIEW OF TELECOM MERGERS

While the proposed merger requires approval from various agencies and shareholders, only this Board is in a position to balance the private interests of shareholders against the interest of the State of Iowa. A review of past mergers in the telecom industry, however, is sobering, and often shows extravagant pre-transaction promises and ensuing failures, demonstrating a need to impose conditions and obtain commitments.

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

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

A. The incentives for mergers and acquisitions are manifold but center around the notion that shareholder value can potentially be increased by merging and streamlining the resources of the pre-merger firms. The benefits from the merger

8 See, Application at p. 14.

9 See, for instance, Direct Testimony of Max Phillips behalf of Qwest, Docket No. SPU-2010-0006, filed May 25, 2010 ("Phillips Iowa Direct"), at p. 9.

may stem from: the ability to lower costs, through increasing the post-merger firm's economies of scale (e.g., allowing it to achieve lower per unit costs) and scope (e.g., increasing the firm's efficiency by being able to offer a broader array of services at larger volumes); capturing synergies associated with merging and streamlining overhead and operational support systems; and/or improving the Merged Company's overall competitiveness and market share by broadening its product offerings and access to a larger customer base, or otherwise from capitalizing on joint talents and expertise. The notion is that bigger is better.

Of course, these are all stock, theoretical considerations raised in mergers, but it is always a question whether or not these benefits will actually materialize. Furthermore, even on a theoretical level, there are serious doubts about whether such alleged benefits necessarily require a merger between firms, or instead whether they could be achieved by the firms individually, through contractual agreements or simply through endogenous growth.[10]

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

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

A vertical merger, by contrast, seeks to integrate the operations of an upstream firm with those of a downstream firm to whom it provides, typically, critical

---

[10] For example, see Joseph Farrell and Carl Shapiro, "Scale Economies and Synergies in Horizontal Mergers," *Antitrust Law Journal*, Vol 68, pages 67 – 710.

inputs. Vertical integration may be motivated, for example, by a desire to leverage the market power the upstream firm has into downstream markets.

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

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

A. While a merger may be motivated by a variety of considerations and objectives, including management's personal ambitions, the ultimate objective of a merger from the perspective of the firms' management should be to increase shareholder value – which is also how the management should evaluate its success or failure.[11]

Q. DOES MANAGEMENT'S OBJECTIVES TO INCREASE SHAREHOLDER VALUE POTENTIALLY CONFLICT WITH THE BOARD'S OBJECTIVE TO PROTECT THE PUBLIC INTEREST AND FURTHER COMPETITION IN IOWA?

A. Yes. Even if we ignore for the moment the possibility that this merger, like most others involving ILECs acquiring large legacy ILEC exchanges may go awry, the private (management's) pursuit of profit and increased shareholder value is easily seen to conflict with the Board's mandate to promote the public interest and competition. For example, the public interest is best served by a vibrant and

[11] 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, pages 45 - 73.

competitive market for telecommunications services; CenturyLink's interests, however, are to strengthen its already dominant market position in order to realize benefits that justify the merger. Given that CLECs rely on CenturyLink's and Qwest's wholesale services, private and public interests diverge: this is why, among other reasons, mergers between ILECs, such as CenturyLink and Qwest, should raise serious concerns about the companies' responsibilities in wholesale markets and the continued viability of retail competition. Specific concerns about how this merger may harm the public interest are discussed in a separate section below.

B. Approvals by FTC/DOJ, SEC, and Shareholders Do Not Ensure that a Merger Is in the Public Interest

Q. WHAT IS THE APPROVAL PROCESS REQUIRED FOR THE CENTURYLINK-QWEST MERGER?

A. There is basically a five step approval process, which generally consists of the following:

- Federal Communications Commission: The FCC reviews mergers and acquisitions under 47 U.S.C. §§ 214(a) and 310(d).
- United States Federal Trade Commission/Department of Justice: In general, the FTC and DOJ review proposed mergers to ensure that they do not prevent or reduce the level of competition in a market.
- Securities and Exchange Commission: The SEC's rules and regulations are designed, in part, to ensure that investors have accurate information about a merger.
- Shareholder Votes: To ensure protection of their private interests, shareholders from each company will have to approve the transaction through a vote.
- State Regulatory Commissions: The state commission in a state in which the merging companies operate may evaluate the merger in its respective state under the applicable state-specific standard, which usually requires the merger to be in the public interest of its state.

Q. CAN THIS BOARD RELY ON REVIEW AND APPROVAL BY THE FTC AND DOJ TO ENSURE THAT THE MERGER IS IN THE PUBLIC INTEREST?

A. No. The FTC's/DOJ's review is primarily concerned with whether the proposed merger is likely to substantially lessen the degree of competition in the market place.[12] As the FTC and DOJ note in their rewrite of the *Horizontal Merger Guidelines ("HMG")*: "The Agencies seek to identify and challenge competitively harmful mergers while avoiding interference with mergers that are either competitively beneficial or neutral."[13] In the past, the DOJ has found that where it concerns two incumbent LECs that for the most part are already monopolists and do not compete with one another, for example, such as in the SBC and Ameritech merger, there is generally not likely to be a lessening of the degree of competition (since there is none or little in the first place), and thus there is little reason, under the Clayton Act, for not approving the proposed transaction.[14]

Of course, under its own statutes,[15] this Board is generally charged with conducting a much broader review to determine whether the proposed merger is in the public interest, considering such issues as the integration of the merging companies' operations, the continued reliability of its systems, the overall quality

---

[12] The DOJ reviews mergers pursuant to section 7 of the Clayton Act, which prohibits mergers that are likely to substantially lessen the degree of competition. 15 U.S.C. Sec. 18.

[13] FTC and DOJ, *Horizontal Merger Guidelines* For Public Comment, Released on April 20, 2010, at p. 1.

[14] For example, 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, Section V.D.2.

[15] See Iowa Code Sec. 476.77

and affordability of retail services, and, importantly, the extent to which the merger may impact the interaction between the Merged Company and its wholesale clients, CLECs, with whom it competes in downstream markets. In doing so, the Board, unlike the FTC and the DOJ, will have to balance the potential benefits (which will be conferred largely on shareholders) against the possible harmful effects (borne by other stakeholders) of the merger.

Q. DO THE FTC'S AND DOJ'S REVISED HORIZONTAL MERGER GUIDELINES (2010) PROVIDE THE BOARD WITH GUIDANCE?

A. Yes. While the focus of an antitrust review of the proposed merger differs from the Board's public interest evaluations, the HMG provides useful guidance on how to assess various claims put forth by the merging companies regarding the alleged benefits of the proposed transaction. Specifically, the HMG stresses that "most merger analysis is necessarily predictive, requiring an assessment of what will likely happen if a merger proceeds as compared to what will likely happen if it does not."[16] The HMG then goes on to note that, in a merger analysis, there is no single uniform formula to be applied, but "rather, it is a fact-specific process through which the agencies, guided by their extensive experience, apply a range of analytical tools to the reasonably available and reliable evidence [...]"[17] These observations are important because, as discussed in the testimony of Mr. Gates and herein, the applicants have provided insufficient information to conduct a "fact-specific" investigation of the likely outcome of the proposed merger.

[16] FTC and DOJ, *Horizontal Merger Guidelines* For Public Comment, Released on April 20, 2010, at p. 1.

[17] *Id.*

(Below I discuss a number of previous mergers that subsequently went awry and show that past applicants made similar claims as Qwest and CenturyLink are making now, demonstrating that the mere promise of benefits in no way ensures that benefits will in fact ensue.) The absence of factual analyses is disconcerting, given the significant interest of the public and other stakeholders, such as CLECs, in the effects of the proposed transaction.

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 Board should not succumb to the belief that the "invisible hand" of the market place will safeguard the public interest in this merger.

C. 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 acquisitions. I believe it is crucial that the Board consider the proposed Qwest-

CenturyLink transaction in light of other, recent mergers and acquisitions. As I shall explain, there are several such cases in which the merging companies' initial high expectations and promised public benefits failed to be realized, in some cases instead leading to crippling financial outcomes, including Chapter 11 bankruptcies.

Q. WHICH ARE POSSIBLY THE TWO MOST PROMINENT MERGERS AMONG TELECOMMUNICATIONS COMPANIES TO RESULT IN FAILURES?

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

WorldCom, which had its genesis in LDDS, experienced precipitous growth in the 1990s, fueled largely by a series of acquisitions,[18] culminating in the $37 billion acquisition of MCI in 1998. After the DOJ rejected a yet larger proposed acquisition of Sprint, at $129 billion, and turmoil in telecom markets, the company got into trouble and ultimately had to file for Chapter 11 bankruptcy protection in 2002, having destroyed much of the shareholder value of both WorldCom and MCI. While the reasons for WorldCom's collapse are many, it is in part explained by the failure to successfully integrate the operations of the acquired companies. As the Bankruptcy Court found:

> Another challenge for WorldCom involved its integration of acquired assets, operations and related customer services. Rapid acquisitions

[18] 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).

> can frustrate or stall integration efforts. Public reports, and our discussions with WorldCom employees, raise significant questions regarding the extent to which WorldCom effectively integrated acquired businesses and operations.[19]

Qwest was founded in 1996 as a largely fiber-based company, installing facilities along railroads of Southern Pacific Railroad to offer mostly high-speed data services. Like WorldCom, Qwest Communications grew aggressively through a series of acquisitions,[20] positioning Qwest not only as a provider of high speed data to corporate customers, but also as a quick-growing provider of residential and business long distance services.

In 2000, Qwest acquired US WEST, a BOC, through a reverse acquisition, a method under which US WEST was deemed the acquirer and Qwest the acquired entity. The total value of the transaction at the time was considered approximately $40 billion.[21] About ten years after the merger, Qwest's market capitalization is approximately $10 billion,[22] which after various ups and downs represents a stunning loss in shareholder value.[23]

The lesson to be learned from the WorldCom/MCI and Qwest/US WEST mergers is, among others, that an applicant's ability to put together a merger, get Wall Street's approval and shepherd a proposed transaction through the various steps of an approval process in no way demonstrates an ability to successfully run the

---

19 *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.

20 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.

21 Qwest 2000 Annual Report, at p. 1.

22 See Money.cnn.com, Ticker Q.

23 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

post-merger firm. Further, generic claims of "synergies," which, as I will discuss in more detail later in my testimony, invariably accompany all merger proposals, and thus mean little or nothing unless they are adequately substantiated by fact-based analyses – and in the instant application they surely are not.

Q. ARE THERE MORE RECENT ILEC MERGERS THAT THE BOARD SHOULD PAY PARTICULAR ATTENTION TO WHEN CONSIDERING THE CENTURYLINK-QWEST APPLICATION?

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

- **Hawaiian Telecom:** The Carlyle Group's acquisition of Verizon Hawaii (renamed Hawaiian Telcom), followed by Hawaiian Telcom's filing for Chapter 11 bankruptcy protection in 2008;
- **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
- **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-office and OSS systems reminiscent of the prior two transactions.[24]

As I will demonstrate, the track record of these types of mergers is not good.

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

---

[24] 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

A. Yes. My Exhibit AHA-2, "The Promises vs. Realities of Recent ILEC Mergers and Acquisitions," supplies a summary of the promised benefits and actual outcomes of the Carlyle-Hawaiian Telcom and FairPoint-Verizon transactions. In addition, the Exhibit summarizes the more recent Frontier-Verizon and CenturyTel-Embarq transactions in the same manner, to the extent possible given that integration activities pursuant to these transactions are still on-going, so that their full impacts and outcomes have yet to be realized.

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

Q. WHAT DOES EXHIBIT AHA-2 SHOW?

A. Exhibit AHA-2 shows the enormous gulf between the anticipated benefits claimed by company management in these types of ILEC transactions, and the ensuing realities. In all cases, company management claimed their proposed merger/acquisition transaction would spur accelerated deployment of broadband and other new services, create jobs,[25] improve service quality and/or be seamless

[25] 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.

to customers, including CLECs relying on wholesale services obtained via OSS, and improve the post-transaction company's financial stability and performance. Unfortunately, as the Exhibit vividly shows, the reality has been far different, particularly for the two earlier transactions (Hawaiian Telecom and FairPoint). Their outcomes included:

- Little or no demonstrated progress in broadband deployment:
  - After its acquisition by Carlyle, Hawaiian Telecom added only 3,247 net retail broadband lines from 2006 through 3Q 2008;[26]
  - 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."[27]
- Severe declines in retail and wholesale service quality:
  - For Hawaiian Telephone, "very significant slow-downs in call answer and handling times in its customer contact centers and errors in its billing…;"[28]
  - For FairPoint, triggering the maximum payment under Vermont's Retail Service Quality Plan in 2009, and widespread disruptions to wholesale customers due to OSS systems failures, order fall-outs, and manual processing work-arounds;
- Net job losses rather than gains:
  - Hawaiian Telephone's employment level had fallen to approximately 1450 by March 2010, a 15% decline from its pre-sale level of 1700 employees;[29]
  - FairPoint's Chapter 11 reorganization plan defers previously-negotiated raises in union contracts, and creates a task force to cut operating expenses by millions of dollars.[30]

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

[27] Dissent of Commissioner Viafades, MPUC Order 7/6/10.

[28] Hawaii PUC Annual Report 2008-2009, at p. 58.

[29] See Hawaiian Telecom Holdco, Inc. Form 10-A, filed 5/26/10, at p. 12 and *Honolulu Star-Bulletin, "Hawaiian Telecom Gets CEO."* 10/14/04.

[30] Nashua Telegraph 2/9/10.

- Financial weakness and instability:
  - Hawaiian Telcom: Chapter 11 bankruptcy filing, December 2008; reported annual rate of return as of June 2009: ─29.3%;
  - FairPoint: Chapter 11 bankruptcy filing, October 2009; VT Public Service Board, "FairPoint's actual performance throughout 2008 and 2009 turned out to be worse than the Board's most pessimistic assumptions."[31]

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

A. The Frontier-Verizon and CenturyTel-Embarq outcomes are largely pending because those transactions are so recent, but the preliminary indications are also troubling in some respects. As noted in my Exhibit AHA-2, Frontier's integration of the former Verizon exchanges has been marred by recent wholesale OSS failures, ordering delays, under-staffed Access Order centers, and trouble report backlogs. These problems are documented in detail in the testimony of Mr. Gates. Already, they appear to belie Frontier's pledge that "this transaction will be seamless for retail and wholesale customers."[32]

For its part, CenturyLink portrays its ongoing integration of Embarq's ILEC operations in 18 states as "highly successful"[33] and "on track"[34] or even "ahead of schedule"[35] relative to some systems integration activities, but here again there are signs of strain.

---

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

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

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

34 *Id*, at p. 9.

35 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.

As Mr. Gates shows in his direct testimony, the CLECs tw telecom and Socket Telecom have been dealing with EASE system failures in the legacy Embarq territories since late 2009.

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

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

- Claims of a strong track record of successful telecommunications acquisitions:
  - Carlyle Group: "Carlyle has a track record of successful telecommunications investments…"
  - FairPoint: "FairPoint has long-term experience in the telecommunications industry. In fact, FairPoint has been acquiring telecommunications companies since 1993…"[36]
  - Frontier: "Frontier has a strong record of successfully integrating acquisitions…"

  CenturyLink-Qwest: *"CenturyLink's management team has some of the longest and most successful tenure in the industry with a proven track record of successful mergers and acquisitions."*[37]
- Claims that proposed transaction will accelerate broadband deployment:
  - Hawaiian Telcom: "In short order we will offer new services to our

[36] FairPoint-Verizon FCC Application, at p. 17.

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

customers, including expanded broadband..."[38]

- "FairPoint plans to increase broadband availability from current levels in Maine, New Hampshire, and Vermont within twelve months after the completion of the merger…"[39]

- "Frontier believes that… it can dramatically accelerate broadband penetration in these new markets over time."[40]

<u>CenturyLink-Qwest:</u> *"the transaction will help to accelerate deployment of broadband services in unserved and underserved areas for both residential and business customers*."[41]

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

  - FairPoint: "...will enhance service quality and promote competition…"[42]

  - Frontier: "this transaction will be seamless for retail and wholesale customers"[43]

  <u>CenturyLink-Qwest:</u> *"The merger will not disrupt service to any retail or wholesale customers…"*[44]

- <u>Claims that transaction will improve financial strength and stability</u>:

  - FairPoint: "the proposed transaction will … improv[e] its overall financial flexibility and stability"[45]

  - Frontier: "the transaction will transform Frontier by strengthening its balance sheet."[46]

  <u>CenturyLink-Qwest:</u> *"the transaction will… create a service provider with improved financial strength and the financial f1exibility to weather the impacts of changing marketplace dynamics…"*[47]

---

38 Carlyle Press Rel. 5/21/04

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

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

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

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

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

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

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

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

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

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

A. No, they were not. In the Hawaiian Telcom case, I am not aware of any specific quantification of transaction synergies made by the parties at the time of their application for regulatory approvals. However, Carlyle did tell the Hawaii PUC that it expected to realize operational efficiencies by creating new back office systems located in Hawaii, to replace Verizon's centralized, legacy systems. As the Hawaii PUC stated at the time the transaction was approved:

> In re-establishing these functions, Carlyle plans to replace Verizon's numerous legacy systems with updated and flexible application systems. Carlyle specifically represents that it will achieve increased economies of scale and improved operating efficiencies from replacing multiple and duplicative systems with a single application.[48]

As Mr. Gates describes in depth in his direct testimony, the build-out of these new systems went seriously awry, and contributed to the financial downfall of the company. Instead of producing synergistic operating efficiencies and cost reductions, development delays and failures in the new systems caused Hawaiian Telcom to incur millions of dollars of additional, unanticipated operating expenses. The company's Form 10-Q SEC filing for the third quarter of 2006

---

[48] 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.

documents over $33 million in such incremental expenses for just the first nine months of 2006, including $22.3 million paid to Verizon to continue using its systems after the planned cutover date, and another $11.3 million for "[t]hird-party provider services and other services required as a result of the lack of full functionality of back-office and IT systems."[49] The Form 10-Q filing explains that:

> Because BearingPoint was unable to deliver the expected full system functionality by the April 1, 2006 cutover date and has continued to be unable to deliver full functionality, it has been necessary for us to incur significant incremental expenses to retain third-party service providers to provide call center services and other manual processing services in order to operate our business. To help remediate 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.[50]

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.[51]

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

A. No. Like Hawaiian Telecom, FairPoint also fell far short of its initial synergy projections for the Verizon transaction, which were largely driven by expected

---

[49] Hawaiian Telecom Communications, Inc. Form 10-Q, filed November 14, 2006, at p. 26.

[50] *Id.*, at p. 26.

[51] *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.

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."[52] 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 direct testimony. By the time the company filed its Form 10-K for 2009, it was forced to admit that:

> 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.[53]

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

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

A. No, judging from the most recently-available public information that I have been

---

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

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

able to review. In their joint Application to the FCC, Frontier and Verizon stated "When fully implemented, Frontier expects to yield annual operating expense savings of $500 million" from the transaction.[54] However, Frontier's Form 10-Q filed May 16, 2010, already admits to a major unanticipated cost increase with respect to systems integration that detracts from those savings:

> 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 be incurred in connection with third-party software licenses necessary to operate the Spinco business after the closing of the merger. Accordingly, the benefits from the merger may be offset by costs incurred or delays in integrating the companies.[55]

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

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

- Mergers and acquisitions involving the transfer and integration of ILEC local telephone operations carry a high degree of risk of failure, even when implemented by self-proclaimed "highly-experienced" management teams and well-financed companies;
- When pursuing these types of transactions, company management tends to overstate the anticipated benefits and understate the risks and uncertainties;
- In particular, the integration of a Bell Operating Company's ILEC operation can prove to be extremely expensive and difficult, and integration failures can be so costly as to not only eliminate the forecasted

---

[54] 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.

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

> transaction cost savings and other synergies, but to place the post-transaction company under severe financial pressure.

Taken as a whole, I believe that these experiences demonstrate that regulators must be extremely skeptical of management's pre-transaction claims and assurances, and be cognizant that such transactions involve significant uncertainties and risks. From a public interest standpoint, those risks simply may not be worth accepting, particularly because, as discussed previously, the risks and gains are unevenly divided between shareholders and other at-risk stakeholders: CLECs' economic viability may be threatened if things go awry but unlike shareholders, they stand to gain nothing if things work out. At a minimum, this asymmetric division of risks must be mitigated by establishing appropriately-tailored, concrete conditions or commitments prior to the transaction's regulatory approval.

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

A. Overview

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

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

Q. DOES THIS REPRESENT AN EXTRAORDINARY GROWTH FOR CENTURYTEL?

A. Yes. If the proposed transaction passes, CenturyTel will have grown from a small rural company with about 1.3 million lines to a nationwide company of about 17 million lines – over the course of a mere three years. The table below, presented previously in the introduction, summarizes CenturyTel's growth:

	Year	Access Lines[56]	% of Total
CenturyTel	2009	1,300,000	8%
Embarq	2009	5,700,000	34%
Qwest	2010	10,000,000	59%
Total		**17,000,000**	**100%**

As discussed previously, it is important to note that this growth is not the result of superior product offerings and customer growth, but rather achieved through putting together a number of companies that were struggling to hold their own in rapidly changing telecommunications markets.[57]

Q. DOES THE PROPOSED MERGER ENTAIL BENEFITS OF VERTICAL INTEGRATION?

---

[56] 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 Duane Ring, at p. 5, and Exhibit DR 1., and Direct testimony of Jeff Glover at p. 5.

[57] 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/qtrlyearnings

A. For the most part, this is a horizontal merger. As noted, the proposed merger seeks to integrate the operations of CenturyLink and Qwest. An evaluation of this merger is further complicated by CenturyLink's ongoing and, as of yet, incomplete efforts to integrate the recently acquired Embarq. Therefore, assessing the synergies claimed with respect to CenturyLink's acquisition of Qwest involves considerations of integrating the operations of three incumbent LECs. That is, in essence, this case concerns a *horizontal* merger across the geographically separate serving areas of three incumbent LECs, CenturyTel, Embarq and Qwest, all three of which are generally in the same line of business.

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

A. Yes. Because it concerns three ILECs, the benefits from the potential merger are necessarily limited, which may explain why the Joint Applicants refer to the alleged benefits in vague terms, like "capitalizing on," "leveraging," "extending," etc. Those vague assertions leave one wondering why, under the right management, such benefits could not be achieved by each of the firms individually.

While mergers often fail to enhance shareholder value, there are types of mergers and acquisitions that (more obviously than the instant transaction) expand a company's abilities and service offerings. For example, when Microsoft acquired Forethought, which had developed a presentation program, it allowed Microsoft to expand its suite of software programs to include Microsoft PowerPoint, and to eventually market a powerful bundle of programs, Microsoft Office, to students and business users. Similarly, Microsoft's acquisition of Visio Corporation, allowed it to further expand its product line by integrating Microsoft Visio. I am not arguing that all of Microsoft's dozens of acquisitions have been successes; rather, I am trying to illustrate an essential difference between these acquisitions of Microsoft and CenturyLink's. While the Microsoft acquisitions are a clear example of how an acquisition adds to a company skills and products that were not previously present, the Centurylink-Qwest merger is an example, for the most part, of adding more of the same in the hope that something better will emerge, under the motto "Bigger is Better" (which we know is not necessarily true.)

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

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

A. No, not really. Looking at how financial markets seem to be responding to the proposed merger, there hardly seems to be a flurry of excitement; in fact, rating agencies have recognized the increased riskiness of the post-merger firm.[58] Also, using a traditional measure of the weighted average cost of capital ("WACC"), it

---

[58] See ratings reports by Moody's, Standard and Poor's, Morgan Stanley, as found in Exhibits 2, 3 and 4, of CenturyLink witness Mr. Glover.

is not clear how the Merged Company is better positioned to attract capital.[59] In fact, given that the Merged Company will be slightly riskier and CenturyLink would be assuming Qwest's massive debt load, one could just as easily argue that financial markets will be less (rather than more) forthcoming in financing CenturyLink's future network expansions. This should be of particular concern to the Board, as access to and cost of capital is a consideration expressly set forth by Iowa Code § 476.77. The Board has already seen and addressed in harsh terms the later-evident public interest problems resulting from reorganizations made on overly optimistic assumptions and high degrees of leverage.[60] The history of Iowa Telecom, from its purchase of GTE assets through its eventual demise at the hands of Windstream, provides a close-to-home lesson of the ongoing struggles that often result from mergers entered with the grandest of expectations. The intervening years were made of contentious cases like RPU-02-4, sharply declining access lines[61], and numerous fights with competitors as to whether Iowa Telecom was meeting its obligations to maintain a competitive marketplace. Particularly given the additional debt being absorbed by CenturyLink, the Board would rightly wonder if it wouldn't be entering a similar cycle should it approve the Applicant's merger proposal.

---

[59] 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.

[60] See *In re Iowa Telecommunications Services*, Docket RPU-02-4, "Final Decision and Order" (IUB, Dec. 26, 2002).

[61] According to the Board's 2007 Market Monitoring Survey, Iowa Telecom experienced a 15% decrease in access lines between the 2003 survey and the 2007 survey. *See 2007 Telecommunications Market Monitoring Survey* (IUB, January 2008) at 23.

B. Vertical Effects

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

A. Yes. To justify the merger and the associated costs of integration, CenturyLink is promising regulators and shareholders merger benefits estimated at about $625 million, to materialize over a period of three to five years.[62] As noted, the premerger companies are struggling to hold their own in changing telecom markets and it is not clear that the merger will soon, if ever, generate revenues and profits to recoup the upfront costs of integration. This raises concerns about cost cutting measures that may negatively impact wholesale services.

Trimming wholesale costs not only saves money on services that are not subject to significant competition but does so without the likelihood of revenue repercussions: i.e., the cost savings directly improve the bottom line. That is, there are added incentives to cut costs in segments of the companies' operations that are not subject to competitive pressures: most notably, the wholesale business charged with meeting the Section 251 and Section 271 obligations under the Telecommunications Act of 1996. In sum, this dynamic places post-merger CenturyLink at odds with captive wholesale customers, such as CLECs.

---

[62] See Direct Testimony of Jeff Glover, page 5.

Q. SHOULD THE BOARD CONSIDER THE IMPACT OF THE MERGER ON CLECS AND COMPETITION?

A. Yes. As discussed previously, a comprehensive review requires consideration of how the merger is likely to impact CLECs and competition, and, in fact, Iowa law requires such a consideration. Of course, if CenturyLink were to become a fiercer competitor, all the better; however, the public interest would be harmed if the competitive landscape becomes distorted as a result of desperate cost cutting, causing a deterioration in wholesale service provisioning. Showing that these concerns are not idle, Mr. Gates discusses in more detail the potentially harmful impact of the merger on the Merged Company's OSS and how it could seriously impair – *as mergers have elsewhere* – the viability of competitors.

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

A. Yes. Part of the FCC's analytical framework in reviewing mergers is to look not only at the horizontal effects of a merger but also the vertical effects, related to the post-merger impact on wholesale markets. Recognizing the potential harm a merger may cause to competitors and competition itself, the FCC notes:

> [w]e need to consider the vertical effects of the merger – specifically, whether the merged entity will have an *increased incentive* or *ability* to injure competitors by raising the cost of, or discriminating in the provision of, inputs sold to competitors.[63] (Emphasis added.)

[63] In the Matter of A&T Inc. and BellSouth Corporation Application for Transfer of Control, Memorandum Opinion and Order, WC Docket No. 06-74, Para. 23.

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

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

A. Yes. Local competition remains critically dependent on the availability of not just UNEs but also special access services. The proposed merger may negatively impact the provision of special access services, which are already being provisioned at rates that appear to be inflated and on terms and conditions that are hampering competitors.[64] In fact, in view of these concerns, the FCC has recently decided to revisit its regulations of special access services.[65] This merger may further unsettle special access markets.

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

A. Yes. CenturyLink is taking on an enormous amount of debt and other risks, so much so, that it is negatively impacting its credit rating[66] (which draws into

---

[64] 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*").

[65] *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.

[66] See ratings reports by Moody's, Standard and Poor, Morgan Stanley, as found in Exhibits 2, 3 and 4, of CenturyLink Witness Mr. Glover. As Moody's notes:

> 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

question the notion that the Merged Company would be a financially stronger entity.) To deal with this debt, and to placate shareholders and financial markets, CenturyLink has stated that it will use its free cash flow to pay down this debt.[67] Given the dearth of information the Joint Applicants have provided to support the alleged merger savings, CenturyLink's stated intentions to pay off its debt raises still more questions about its ability to provide and maintain quality wholesale services and OSS to CLECs, not just for its own pre-merger operations but especially for Qwest's, which is subject to Section 271 obligations. Again, when asked to provide details supporting its projected merger savings, the Joint Applicants respond that those savings have not been calculated at a detailed level or have not yet been developed[68] – but only detailed analyses could be persuasive. Circular answers like "[t]he combined companies regulated entities will benefit from synergies post merger in the form of lower costs to the extent synergies are achieved," are not reassuring, much less credible evidence on which the Board must base findings that the transaction is in the public interest.[69]

In sum, a major concern is that, under the pressure of its debt load and the promises of merger savings to shareholders (to recoup the costs of integration), CenturyLink will be forced to cut costs when integrating the two companies, leading to a degradation of services and harming competitors. Worse, of course, is the prospect – not to be discarded – of yet another merger going awry and

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.

[67] See, for example, Direct Testimony of Glover at 6.

[68] CenturyLink's Response to OCA 1-013F; Qwest's Response to OCA 004.

[69] CenturyLink Response to PAETEC 1-140.

causing upheaval in wholesale markets, impairing retail competition just when rate payers may need it most.

Q. DOES MR. GATES DISCUSS A NUMBER OF MERGER CONDITIONS OR COMMITMENTS THAT COULD SERVE TO ADDRESS CONCERNS ABOUT VERTICAL EFFECTS?

A. Yes. As the FCC noted in previous mergers, economically efficient access by CLECs to the ILECs' unbundled network elements serves to constrain the ILECs' ability to exploit market power in wholesale markets to the detriment of competition in downstream, retail markets.[70] In view of this, it is of paramount importance that the Board safeguard the wholesale ordering and provisioning processes currently in place and ensure the merger will not cause, in any form, a degradation in wholesale services. Mr. Gates discusses conditions and commitments that serve this important purpose.

C. Horizontal Effects

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

A. Yes. A merger of CenturyLink and Qwest reduces competition in areas and for services in which the companies compete. While, for the most part, the companies operate in their own separate service areas, there are significant

[70] 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 Para. 60.

instances in which they do compete. Cleary, a merger would eliminate this competition, and in doing so harm the public interest.

For example, as is evident from CenturyLink's own testimony, the companies serve large numbers of exchanges that are adjacent.[71] As is increasingly common, ILECs often set up CLEC subsidiaries through which they compete in adjacent exchanges. For example, CenturyLink operates as a CLEC in Minneapolis in competition with Qwest.[72] The merger will eliminate any incentives for this type of competition between the two companies. The harm may, in fact, be larger than meets the eye in the sense that it eliminates not just actual instances of such competition but also *potential* ones.

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

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

---

[71] While this may be less of an issue in Iowa than in other states, the proposed merger does eliminate any incentives these two potential competitors might have had to enter one another's serving areas as CLECs.

[72] Http://www.centurylink.com/Pages/AboutUs/CompanyInformation/Regulatory/tariffLibrary.jsp;jsessionid=055C224C462B5CB0FDF05EF67BB97A646E4E4AE78F.dotcomprd19

D. The Merger May Impede Regulatory Oversight

Q. WOULD THE PROPOSED MERGER POTENTIALLY ALSO NEGATIVELY IMPACT THE ABILITY OF REGULATORS TO MONITOR COMPLIANCE WITH THE TELECOMMUNICATIONS ACT OF 1996?

A. Yes. Regulators often rely on comparisons between ILECs to assess whether a specific ILEC's performance or certain terms and conditions fall within a range of reasonableness. A merger between CenturyLink and Qwest eliminates or diminishes these tools for regulators, which is a loss particularly because it concerns two large ILECs that often operate under comparable conditions (e.g., in rural areas of the same or similar states). These issues should be considered in determining how this merger is likely to impact the public interest.

E. Uncertainty and Harm Will Result If Merger Is Approved As Filed

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

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

> "***Immediately*** upon completion of the Transaction, end-user and wholesale customers will continue to receive service from the same carrier, at the same rates, terms and conditions and under the same tariffs, price plans, interconnection agreements, and other

> regulatory obligations as ***immediately*** prior to the Transaction; as such, the Transaction will be transparent to the customers."[73]

What is important is what this statement does *not* say: how long customers will continue to receive service under the same rates, terms and conditions. Indeed, the footnote that follows the above statement is very disconcerting:

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

A fair reading of the Joint Applicants' Application and testimony indicates that changes will indeed take place and there are no specifics about what those changes might be or how and when they might be made.

Q. DOES THIS STATEMENT SATISFY THE PUBLIC INTEREST STANDARD?

A. No. Such a vague and limited commitment is meaningless, and certainly does not demonstrate that the public interest will be protected. Obviously, CenturyLink could implement changes the very next day (or hour) after merger approval. For example, the Merged Company could implement layoffs or require that CLECs re-negotiate all "evergreen" ICAs using CenturyLink's template ICA or attempt to change Qwest's OSS the day (or week) after merger approval – and could still make the argument that it made no "immediate" changes. Surely, Iowa laws and

[73] Application, at p. 5 (emphasis added). See also, Direct Testimony of John Jones, Docket No. SPU-2010-0006, filed May 25, 2010 ("Jones Iowa Direct") at pp. 6-7.

rules were not promulgated to ensure that the public interest is protected for a couple of days or hours. The bottom line (and the reason why the proposed transaction is of such concern to CLECs) is, at this point, there is zero certainty for wholesale customers (as well as retail customers) in the Qwest territories the moment the merger is consummated.

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

A. Because CenturyLink has stated that changes are coming. For example, in testimony before the Oregon Public Utilities Commission, CenturyLink states:

> "…upon merger closing, there will be no immediate changes to Qwest's or CTL's Operations Support Systems. The merger is intended to bring about improved efficiencies and practices in all parts of the combined company, so ***changes could be expected over time***. However, any changes will occur only after a thorough and ***methodical review of both companies' systems and processes to determine the best system to be used*** on a go-forward basis from ***both a combined company and a wholesale customer perspective***."[74]

Though CenturyLink has put CLECs on notice to expect changes, CenturyLink has provided no detail about what will change, when it will change or how CenturyLink will determine which is the "best system"[75] to use. This is

[74] Oregon PUC Docket No. UM-1484, Direct Testimony of Michael R. Hunsucker (CenturyLink), at pp. 8-9 (emphasis added). See also, Form S-4/A, 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.")

[75] To my knowledge, CenturyLink has not provided any 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 no additional details, other than to say that "[i]t has not been determined whether third-party testing will be included in the assessment process." 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 Response to Integra DR No. 49. If CenturyLink is truly

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

Q. CENTURYLINK GOES EVEN FURTHER AND CLAIMS THAT THERE ARE NO "<u>POTENTIAL</u> HARMS THAT COULD RESULT FROM THE MERGER."[76] IS THIS TRUE?

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

For instance, despite CenturyLink's best efforts, if it attempts to integrate any OSS or other systems from the CenturyLink region to Qwest's region and such an attempt fails (like in the case of FairPoint), CLECs would likely suffer substantial harm. As another example, the Joint Applicants' projected synergies and one-time integration costs pose a serious threat to the public interest in at least two respects. First, the pressure to achieve their estimated $625 million in synergies

---

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 CLEC's perspective that Qwest's existing OSS is preferable to existing CenturyLink OSS.

76 Jones Direct Testimony, at pp. 14-15 (emphasis added).

may drive cuts or inattention to the provision of quality wholesale services, including OSS used to support those services. Second, failure to achieve its estimated synergies or higher than expected integration costs could seriously impede the Merged Company's ability to pay down its debt, attract capital and make the investments necessary to ensure adequate service. The free cash flow that CenturyLink claims it will use to reduce debt and invest in its network is based on its estimated $625 million in operating and capital synergies, along with its estimated $650-$800 million in one-time operating costs and $150-$200 million in one-time capital costs.[77] However, if CenturyLink fails to achieve those synergies or if its integration costs significantly exceed the estimates (despite CenturyLink's best efforts to achieve these targets), its ability to pay down debt will be diminished, thereby leaving the merged company highly leveraged and potentially unable to make the needed investments to maintain service quality or the dividends to satisfy shareholders.

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

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

> achiev[ing] 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.[78]

---

77 See e.g., Glover Direct Testimony at pp. 11-12 and p. 5, fn. 5.

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

While the Joint Applicants' prefiled testimony in the instant case sidesteps the issue, in other states they have acknowledged the potential harms or "integration-related risks" associated with beginning the integration of Qwest before the integration of Embarq is complete.[79]

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

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

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

---

[79] See, e.g., Washington Utilities and Transportation Commission Docket No. UT-100820, Direct Testimony of G. Clay Bailey (CenturyLink), filed May 21, 2010, at p. 18 ("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 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.

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.[80] The harms identified by the FCC apply to the proposed transaction.

Q. ARE THERE OTHER REASONS TO TAKE ISSUE WITH JOINT APPLICANTS' 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 business and make prudent investments, and the proposed transaction results in uncertainty in virtually every aspect of the CLECs' relationship with the Merged Company.

F. 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 unambiguous. For instance, if Ford is purchasing tires for its vehicles from Firestone, it is very important for Ford to know and understand what type, size, quality and quantity of tires will be delivered to each manufacturing plant and when. Not surprisingly, the cost of the tires is also important for Ford in setting

---

80 *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.

the prices for vehicles. If Firestone announced that it was being acquired by Tires, Inc. (a fictional company) on December 31, 2010, Ford would likely ask Firestone a litany of question about what Ford could expect in 2011 – e.g., will Firestone deliver the same type and size of tires Ford needs, whether the quality of the tires will be the same, whether the tires will be delivered to the manufacturing plant in a timely manner, etc. If Firestone came back to Ford and said "we don't know and won't know until 2011", Ford would (a) start looking to another tire supplier that can provide more certainty, (b) ask Firestone to provide commitments that can be relied upon in 2011, or (c) both. The point is that Ford would demand certainty so that it could continue to produce vehicles and deliver them to the showroom. Likewise, CLECs – who rely on ILEC-provided services – need certainty in order to deliver their services to the local market place.

Q. DO CLECS HAVE THE SAME OPTIONS AS FORD IN YOUR PREVIOUS ANALOGY?

A. No. Unlike Ford, the CLECs cannot shop elsewhere for the services they purchase from the ILECs. That means that certainty in relation to the services CLECs purchase from ILECs is even more important.

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

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

> In connection with the pending merger, some customers or vendors of each of CenturyLink and Qwest may delay or defer decisions, which could negatively impact the revenues, earnings, cash flows

> and expenses of CenturyLink and Qwest, regardless of whether the merger is completed.

CLECs are customers of Qwest and CenturyLink (wholesale customers), and CenturyLink is correct that the pending merger can result in delayed or deferred decisions from these wholesale customers. And while CenturyLink focuses on the potential negative impacts on revenues, earnings, cash flows and expenses of Qwest and CenturyLink resulting from this uncertainty, CenturyLink ignores that this uncertainty also could cause negative impacts on CLEC revenues, earnings, cash flows and expenses. Likewise, in its recent Reply Comments to the FCC, CenturyLink states that, "the transaction will bring much-needed stability to the incumbent local exchange carrier ('ILEC') sector",[81] but ignores that CLECs also need stability and that the proposed transaction causes severe *un*certainty for CLECs. Because the Merged Company will be pursuing merger-related synergy savings for a three-to-five year period after the merger, the uncertainty for the Merged Company's CLEC wholesale customers will continue well beyond the date of merger approval.

Q. HAS THE BOARD SEEN ANSWERS SIMILAR TO THE JOINT APPLICANTS' THAT CERTAIN DECISIONS WILL NOT BE MADE UNTIL AFTER THE MERGER CLOSES BEFORE?

A. Yes. In the instant proceeding, Joint Applicants have on dozens of issues, in initial testimony and in discovery, said that the relevant decision has not been made yet and will not be made until after the merger. That has been the Joint

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

Applicants' response on almost everything – from which OSS will be used in Iowa to the alleged synergy savings that will come from personnel.[82] This should seem familiar to the Board: Iowa Telecom and Windstream gave similarly evasive answers, and the outcome should give the Board cause for concern.

The Board asked Iowa Telecom and Windstream to supplement their testimony to respond to the question "How will the proposed reorganization affect Iowa jobs?" On March 8, 2010, Windstream filed the Supplemental Testimony of Joseph A. Marano. His response, in relevant part, was "The transition process will likely take several months and the determination by Windstream of which employees will be retained is not anticipated until much later in the process."[83] On June 3, 2010, just one day after the merger closed, Windstream announced layoffs, including 35 employees in Newton (including the Mayor of Newton). Most of those jobs were high-paying professional positions that were either eliminated or moved out of Iowa. The Chief Operating Officer of Windstream claimed that "The restructuring follows a detailed review" – which seems inconsistent with the fact the layoffs were announced just 3 months after Mr. Marano claimed such decisions were far in the distance, and just one day after the merger closed. The Board should rightly question the claims from the present Joint Applicants: it is difficult to believe they could announce a figure for anticipated synergy savings, yet have no idea how they will conduct business in Iowa.

[82] See, my Exhibit AHA-3 and also, e.g., CenturyLink Responses to PAETEC Data Requests Set 1, #4 "at this time decisions regarding the systems or platforms that will be used post-merger have not been made"); #23 ("Qwest CLEC OSS systems… decisions have not been made at this time"); #26 ("Qwest CLEC ASR and LSR process…decisions have not been made at this time"); #136 (Qwest wholesale support centers headcount, "we cannot project the timing or nature of changes, if any").

[83] Before the Iowa Utility Board, In Re: *Windstream Corporation and Iowa Telecommunications Services, Inc. d/b/a Iowa Telecom Proposal for reorganization of Iowa Telecom, Docke*t No. SPU-09-0010, Supplemental Testimony Direct Testimony of Joseph A. Marano, page 3.

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

A. Yes. Attached as Exhibit AHA-3 is a table which lists many of the important and customer-impacting issues that should be examined in determining whether the proposed transaction will cause "no harm" (e.g., systems integration, operations integration, performance assurance plans, wholesale rates, etc.) and matches that list to what the Joint Applicants have said about those issues in discovery responses. This exhibit shows complete uncertainty post-transaction for important issues such as OSS integration, billing systems integration, E911 systems, provisioning intervals, wholesale customer service, change management process, network investment, just to name a few. In each area, the Joint Applicants were unable or unwilling to provide any plans or describe any changes that will take place – other than to say, *we'll let you know after the merger has been approved*. That is too late. The Joint Applicants must demonstrate now that the proposed transaction will do "no harm" and they have failed to demonstrate that as evidenced by this exhibit.

VI. FAILURE TO PROVE BENEFITS RESULTING FROM MERGER

Q. CAN THE BOARD VALIDATE CENTURYLINK'S CLAIMS OF BENEFITS RESULTING FROM THE MERGER?

A. No. Though CenturyLink has identified numerous alleged benefits from the proposed transaction, it has substantiated none of them. In discovery in Iowa and other states undertaking merger reviews, various parties including CLECs, commission staffs and consumer advocates asked the Joint Applicants about their plans regarding the alleged benefits, and in every instance, the Joint Applicants have stated that they have no plans and/or that plans cannot be developed until after the transaction is approved. Again, *we'll let you know after the merger has been approved*. To demonstrate this point, I developed Exhibit AHA-4 which is a table that lists the alleged benefits resulting from the merger claimed by the Joint Applicants and matches that list to what the Joint Applicants have said about those alleged benefits in discovery responses. In each instance, there is no substance supporting the alleged benefit. By way of example, despite repeated claims about benefits related to broadband and IPTV deployment as a result of the merger, when asked about its post-merger plans, CenturyLink was unable to provide any details (i.e., no plans for rollout, no projection, no timeline) and, in fact, CenturyLink explained that it does not even know whether the Qwest network is currently capable of supporting the advanced services deployment that CenturyLink has identified as a benefit of the merger.[84] Obviously, if the Qwest network is not capable of providing the advanced services that CenturyLink touts, then the alleged benefit of IPTV/advanced services deployment will not be realized post-transaction (or will be delayed indefinitely while the necessary upgrades can be made – an unlikely scenario given the Merged Company will be focused on integration efforts and debt reduction post-merger). This exhibit

[84] See, e.g., CenturyLink Response to Oregon 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…").

shows the same results for other alleged benefits, including network investment, free cash flow, debt repayment, synergies, improved access to capital, implementation of CenturyLink's go-to-market model, and others. I was unable to locate a single alleged benefit that CenturyLink could substantiate with facts.

Q. WHAT WOULD THE JOINT APPLICANTS NEED TO SHOW TO SUBSTANTIATE THESE BENEFITS?

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

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 recognized as] cognizable than reductions in fixed cost" because "reductions in marginal cost are more likely to result in lower prices for consumers."[85]

Q. DO THE JOINT APPLICANTS' ALLEGED BENEFITS MEET THESE CRITERIA?

A. No. None of the alleged benefits are "verifiable" because no evidence was provided to support the benefits; rather, the Joint Applicants 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

---

[85] *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.

realized. The alleged benefits fail the 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.[86] To expand this deployment, Qwest filed an application in March 2010, for 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 Transaction will not have any impact on this request."[87] What this means is that advanced deployment in Qwest's legacy territory is not merger-specific: Qwest is pursuing it independent of the merger. The Communications Workers for America (CWA) agreed with this assessment in their comments to the FCC on the proposed transaction:

> Although the Applicants claim that the proposed merger will result in accelerated broadband deployment and increased bandwidth, they provide no concrete, verifiable broadband commitments. The Applicants do not indicate the number of new households, small businesses, or anchor institutions that will have access to broadband; the upgraded capacity that will be delivered; nor the new markets that will be served with IPTV expansion.[88]

When CenturyLink was asked specifically about the third prong – i.e., to identify the marginal cost reductions resulting from the merger, CenturyLink responded:

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

[87] See, e.g., Direct Testimony of Mark S. Reynolds, Exhibit MSR-1T, Washington UTC Docket No. UT-100820, May 21, 2010, at p. 10. Qwest described its grant application in more detail in response to Montana Consumer Counsel Data Request 58: "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.

[88] Comments of Communications Workers of America, WC Docket No. 10-110, July 12, 2010, at p. 13.

"Those cost savings are not broken out between fixed or marginal cost."[89] As such, it is impossible to tell what portion, if any, of the estimated synergies would result in lower prices for consumers, and in turn, impossible for the Joint Applicants to substantiate benefits under the third prong.

Q. HAVE THE JOINT APPLICANTS IDENTIFIED ANY BENEFITS THAT WOULD ACCRUE TO CLECS FROM THE MERGER?

A. No. CenturyLink has not identified a single benefit that would accrue to CLECs. To my knowledge, the only place where CenturyLink discusses benefits to wholesale customers is in the following Q&A:

> **Q PLEASE SUMMARIZE HOW WHOLESALE CUSTOMERS WILL BENEFIT FROM THE MERGER TRANSACTION.**
>
> A. The additional financial resources, combined network capacity and geographic reach afforded by the merger will allow the combined company to continue to serve the wholesale market as valued customers. For example, as the demand for broadband wireless services has mushroomed, the need for additional fiber capacity to serve cellular tower sites (often referred to as wireless backhaul) has increased dramatically. As noted above, Qwest is already committing significant resources to serve the increased demand from wireless carriers in its region, and the combined entity will provide the resources to continue this investment.[90]

The first sentence of the answer does not identify any benefit. First, it simply says that the Merged Company will "continue to serve the wholesale market" – something that would occur independently of the proposed transaction. Second, the reference to the size of the Merged Company's footprint ("geographic reach") does not translate to benefits to wholesale customers unless the efficiencies that come along with that larger footprint are realized by the local

[89] CenturyLink Response to PAETEC Iowa Data Request Set 1, #55a.

[90] Phillips Iowa Direct, at pp. 25-26.

market as well – such as lower transaction costs across the footprint. The remainder of the answer applies to fiber to cell towers – a claim that, even if substantiated, would not accrue to the benefit of CLECs.

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

A. No. Take the larger footprint discussed above as an example. Due to this larger footprint, and associated alleged economies, the Merged Company is expecting $575 million in annual operating cost savings (from such sources as corporate overhead, network and operational efficiencies, IT support, increased purchasing power) and $50 million in annual capital expenditure savings.[91] As a result of these synergies (if realized) the cost-structure of the combined company would decline. This should, in turn, result in lower rates for UNEs and interconnection because these cost-based rates should reflect the reductions in forward-looking costs resulting from the merger-related synergy savings. However, when asked if the Merged Company would adjust its cost-based wholesale rates to reflect these cost savings, CenturyLink replied: "CenturyLink has not evaluated or reached any conclusions concerning this issue at this time…"[92] And without a concrete commitment that allows CLECs to rightfully share in the cost-savings the combined company achieves, this will be very low on CenturyLink's priority list post-transaction. The end result is that the Merged Company will enjoy a cost advantage over its competitors, which is the antithesis of the federal pricing standards for UNEs/interconnection.

---

[91] Glover Iowa Direct at p. 11, Phillips Iowa Direct at pp. 13-14.

[92] CenturyLink to PAETEC Iowa Data Request Set 1, #55b.

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

VII. RECOMMENDATIONS AND CONDITIONS

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

A. I recommend that the Board deny the merger as proposed. The Joint Applicants have not met their own "no harm" standard or the public interest test explicit in the Iowa Code and have failed to materially substantiate the alleged benefits from the merger. However, if the Board disagrees with my primary recommendation and approves the proposed transaction, it should do so only if the transaction is subject to robust, enforceable conditions applied to, or commitments made by, the Joint Applicants. The objective of these is to ensure that the proposed transaction does not harm the industry and ultimately serves the public interest.

In addition to the conditions discussed by Mr. Gates, I recommend that the Board impose the conditions or obtain commitments discussed below. (A full set of conditions is provided as Exhibit TJG-8 to Mr. Gates testimony.)

Q. YOU REFER TO CONDITIONS OR COMMITMENTS. COULD YOU EXPLAIN WHY YOU ARE USING THAT CONSTRUCTION?

A. I am not an attorney, but as I read Iowa Code § 476.77, it does not appear to me to preclude the Board from attaching mandatory conditions as part of the approval of a proposed reorganization as is common in many other states. Indeed, it would not make sense to me for the legislature to set out a list of diverse but discrete topics the Board is to explore, but then force the Board into an all-or-nothing choice of rejecting or approving the proposal as submitted by the Joint Applicants. That said, it is my understanding that the Board has traditionally either approved or not approved such applications, and that in many cases applicants have worked to resolve concerns of the Board and intervenors through voluntary commitments or amendments to the proposal before the Board. It is clear that the Board does have the authority to not approve a specific proposal submitted – that is, the Board can reject but make clear what it would approve if resubmitted. Moreover, I would certainly think that formal commitments made on record by the Joint Applicants could be enforced through the Board's broad complaint authority if they were not upheld. As long as the protection for consumers, competitors and the public interest is enforceable, that is more important than whether the protections take the form of imposed conditions or obtained commitments. For ease and for consistency with other states, in the following description I use the term "condition" to mean either a condition or enforceable commitment.

A. Wholesale Service Availability

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

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

- Condition 1 states that the Merged Company will make available and not discontinue for the Defined Time Period any wholesale service offered to a CLEC at any time between the merger filing date and the closing date (except as approved by the Board).
- Condition 6 states that the Merged Company will assume or take assignment of all obligations under Qwest's "Assumed Agreements" (which includes Qwest's wholesale agreements and tariffs) and AFOR plans, and not require wholesale customers to execute documents in order for the Merged Company to assume responsibility for those agreements. This condition also states that the Merged Company shall offer and not terminate or change the rates, terms and conditions under the Assumed Agreements for at least the Defined Time Period (or until the expiration date, whichever is longer) unless requested by the wholesale customer or required by change of law. This condition also states that 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 opt into any ICA to which Qwest is a party in

any state in which it is an ILEC. This condition permits the state Board 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 overarching concern underlying these conditions is that the availability of wholesale services should be stable over the foreseeable future to offset the substantial uncertainty caused by the proposed merger as well as the Merged Company's efforts to achieve synergy savings post-merger. These conditions ensure that the Merged Company does not direct its integration efforts to the detriment of wholesale customers by withdrawing services or dramatically changing the offerings Qwest currently makes available in the name of "best practices."

These conditions also recognize the undisputed fact that the Merged Company will be a larger carrier with a bigger footprint, presumably resulting in economies and efficiencies. To serve the public interest, those economies and efficiencies should accrue to benefit of captive wholesale customers and the general public as well as the merged company; otherwise, the Merged Company will enjoy an insurmountable cost advantage over its captive customers/competitors. As a result, the merger should decrease the costs associated with interconnecting with the Merged Company. Allowing the Merged Company to be the sole beneficiary of the economies and efficiencies resulting from the merger would have an anti-competitive and discriminatory impact on the merged company's captive wholesale customers, who depend on interconnection with and services purchased from the ILEC to compete. Such a result would be inconsistent with the pro-competitive mandate of the Act, FCC orders, and state law, and contrary to the public interest.

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

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

Q. REGARDING CONDITION 1, WHY IS IT IMPORTANT THAT THE MERGED COMPANY CONTINUE TO PROVIDE WHOLESALE

SERVICES THAT IT PROVIDED ANYTIME BETWEEN THE MERGER FILING DATE AND CLOSING DATE?[93]

A. The withdrawal of wholesale services after the Filing Date would signal a move toward the Merged Company impeding competition, and in turn, a merger-related harm. Even if a condition or voluntary commitment requires the Merged Company to maintain the wholesale services available at the Closing Date for a period of time, it would not cover the wholesale services that were eliminated between the Filing Date and Closing Date – merger-related harm could still result.

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

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

> Qwest Corporation does not cease to exist as a result of the parent-level Transaction but remains an ILEC, subject to the same terms and obligations of its interconnection agreements, tariffs, commercial agreements, line sharing agreements, and other existing arrangements with wholesale customers immediately after the merger as immediately prior to the merger.[94]

Since Qwest does not cease to exist as a result of the transaction, there should be no reason for wholesale customers to have to execute documents in order for the

---

[93] "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')."

[94] CenturyLink Response to PAETEC Data Request Set 1, # 113(a).

Merged Company to assume the obligations under the existing wholesale agreements (*e.g.*, ICAs) and tariffs. Second, the transfer of control should be as smooth and seamless as possible, and requiring wholesale customers to receive, review, and execute documents for this purpose could result in disruption or delay during the transfer of control. And that disruption and delay would be exacerbated if wholesale customers disagree with the terms included in the documents the Merged Company wants wholesale customers to execute.[95]

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

A. Yes. Condition 6 would result in the Merged Company offering the same commercial agreements at the same rates in CenturyLink's legacy territory as Qwest provides in its legacy territory. The Joint Applicants have boasted the national breadth[96] and local depth of the Merged Company[97] as "key" benefits of the proposed merger. These benefits (or economies) should not accrue only to the Merged Company, however, or else the transaction will further entrench the Merged Company's monopoly position. One way to allow those benefits to accrue to the benefit of competition is for the Merged Company to offer the same

95 This is not a theoretical concern. For example, in the instant proceeding, Joint Applicants and PAETEC had difficulty agreeing to the terms of the proprietary agreement that would govern the access and use of confidential information in this case. Although PAETEC suggested that the parties use a proprietary agreement that had previously been used between Qwest and PAETEC, the Joint Applicants insisted on different terms. This caused significant delay in accessing the proprietary information associated with the Joint Applicants' discovery responses. This delay was particularly burdensome in this instance because the Joint Applicants have requested expedited approval of the merger and the intervenor testimony due date in Iowa is the earliest intervenor testimony due date in any state that is reviewing the proposed transaction that I am aware of.

96 Application at p. 12 ("national telecommunications company")

97 Jones Iowa Direct, at p. 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.")

commercial agreements in legacy CenturyLink territory as it does in legacy Qwest territory.

CenturyLink's service territory includes 10 of the 14 states in which Qwest operates as a BOC, with more than two hundred adjacent exchanges[98] and more exchanges in close proximity. Once the companies merge, all of these exchanges will be under a single umbrella and there is no reason why commercial agreements from the Merged Company in one exchange should not also be available in the adjacent or neighboring exchange. This would provide consistency across the Merged Company's territory for those carriers who currently operate in both Qwest and CenturyLink territories and may encourage new competitors to enter the legacy territories of CenturyLink or Qwest.

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

A. Yes. A similar provision was offered as a voluntary commitment to the FCC by AT&T and BellSouth.[99] Likewise, a similar condition was adopted by the Illinois Commerce Commission,[100] Public Utilities Commission of Ohio,[101] and Oregon

---

[98] Joint Applicants' FCC Application, Exhibit 5, cited at Comments of Joint Commenters, WC Docket No. 10-110, July 12, 2010, at p. 18.

[99] AT&T/BellSouth FCC merger order, Appendix F, "UNEs" commitment #4.

[100] ICC Order No. 09-0268, Conditions Appendix, Condition 5.

[101] 2010 Ohio PUC Lexis 142, *17.

Public Utilities Commission[102] as a condition of the Frontier/Verizon merger. While the time period for extension in previous decisions has ranged between 2.5 years and 3 years, the Defined Time Period is tied to the facts of this case.[103]

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

A. The reference to "evergreen" ICAs (or ICAs that continue past their expiration date) is particularly important in this instance because Qwest currently operates under evergreen ICAs with numerous carriers and has for several years. For example, PAETEC operates under evergreen ICAs with Qwest in all 14 Qwest BOC states. The Qwest/PAETEC ICAs in Iowa and Minnesota have been in place since the 1997-1998 timeframe, and ICAs in other states have been in place since the 1999-2002 timeframe.[104] This means that terms and conditions under these "evergreen" ICAs have been acceptable to both companies for an extended period, and each carrier's respective network configuration (trunking, collocation arrangements, points of interconnection, traffic exchange, etc.) are based on those terms and conditions. Requesting carriers should not be required to endure the disruption and expense to renegotiate and (potentially) arbitrate the terms under which they have operated with Qwest for, in some cases, more than a decade – particularly given that the Merged Company will have its hands full post-merger

---

[102] 2010 Ore. PUC LEXIS 64, *141.

[103] Mr. Gates discusses the "Defined Time Period" in his direct testimony.

[104] 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.")

as it tries to deliver on its synergy savings estimates and integrate the two companies.

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

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

Condition 9 also states that the Merged Company will allow a requesting carrier to use its pre-existing ICA, including ICAs entered into with Qwest, as the basis for negotiating a replacement ICA. The existing ICAs between CLECs and Qwest have been approved by state commissions as compliant with federal and state law, sometimes after lengthy and contentious arbitration cases in which considerable (yet scarce) CLEC resources are expended. The CLECs should not have to start this process all over again by negotiating agreements from scratch, particularly because doing so would signal a reluctance on the Merged Company's part to make available the same wholesale offerings Qwest has provided for years. Further, the negotiations template proposal that CenturyLink may introduce is a complete mystery at this point,[105] and CLECs should not be forced to negotiate from scratch all over again based on what CenturyLink may come up with as its going-in negotiations proposal. This same condition was adopted by the Oregon PUC as a condition of the Frontier/Verizon merger.[106]

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

A. Yes. As Mr. Gates explains, Qwest's Statement of Generally Available Terms (SGATS) were reviewed during the 271 approval process.[107] These "generally available terms" were incorporated into CLEC ICAs, many of which are part of currently-effective ICAs. For example, the framework, general numbering scheme, and many sections of the current Qwest-Integra interconnection agreement in Minnesota are substantially similar to Qwest's Minnesota SGAT terms.[108] In addition, CLECs have used Qwest's SGAT "as a key source to help frame interconnection agreement ('ICA') negotiation positions"; "as a resource

---

[105] See, e.g., CenturyLink Response to PAETEC Data Response Set 1, #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.

[106] 2010 Ore. PUC LEXIS 64, 124.

[107] *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.").

[108] 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).

for attempting to resolve disputes with Qwest such as in billing, carrier relations, and Change Management Process ('CMP') contexts"; and "as an internal resource" to, among other things, confirm state commission-approved terms and filed requirements.[109] By contrast, CenturyLink's interconnection agreement terms were not reviewed under a 271 approval process, but instead, are currently in the process of being developed.[110]

Q. CONDITION 10 ALLOWS CARRIERS IN CENTURYLINK LEGACY TERRITORY TO OPT INTO QWEST ICAS IN THE SAME STATE.[111] WHAT IS THE RATIONALE FOR THIS CONDITION?

A. The same rationale that applies for Condition 6 applies here. The FCC previously adopted a similar condition in conjunction with the AT&T/BellSouth merger, which required AT&T/BellSouth to make available to any CLEC any ICA (negotiated or arbitrated) to which a AT&T/BellSouth ILEC is a party in any state within the AT&T 22-state footprint, subject to state-specific pricing and technical feasibility. Notably, the CLEC-proposed condition permits the state commission

---

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

110 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 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).

111 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.

to modify the ICA before opt in if the Merged Company demonstrates technical infeasibility or if the TELRIC-based prices in the ICA are inconsistent with the TELRIC-based prices in the state in question.

Q. WOULD THIS OPT-IN CONDITION ALLOW CARRIERS TO "CHERRY-PICK THE BEST ICA TERMS"[112]?

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

Q. PLEASE EXPLAIN THE BUSINESS NEED FOR CONDITION 12.

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

> [CenturyLink's] Application states that CenturyLink is a "rural telephone company," as that term is defined in the Act, 47 U.S.C. § 153. CenturyLink goes on to state that, pursuant to Section 251(f)(1) of the Act, it is exempt from Section 251(c) of the Act. Notwithstanding that exemption, the companies have agreed and entered into this Agreement for purposes of exchanging local traffic. The Company also states that "execution of the Agreement does not in any way constitute a waiver of limitation of CenturyLink's rights under Section 251(f)(1) or 251 (f)(2) of the Act." The Company "expressly reserves the right to assert its right to an exemption or waiver and modification of Section 251 (c) of

[112] Joint Applicants' Reply Comments, WC Docket No. 10-110, July 27, 2010, at p. 32.

> the Act, in response to other requests for interconnection by CLEC or any other carriers."[113]

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

Q. PLEASE EXPLAIN THE BUSINESS NEED FOR CONDITION 14.

A. Condition 14 states that the Merged Company will not reclassify as "non-impaired" any wire centers or file any new forbearance petitions related to obligations under sections 251 or 271 of the Act for the Defined Time Period. The overall purpose of this condition is to provide the much-needed certainty for wholesale customers related to the bottleneck inputs they purchase from the Merged Company, while the Merged Company integrates the two companies and pursues synergy savings. Though classification of "non-impaired" wire centers is an exercise of counting business lines and fiber-based collocators, there have been numerous disputes between ILECs and CLECs over the ILECs' proposed classification of "non-impaired" wire centers. These disputes stem largely from the methodology that ILECs employ when counting business lines and fiber-based collocators (e.g., what criteria an ILEC uses to determine whether a collocator "operates a fiber-optic cable or comparable transmission facility…"[114]) As such, a change in the ILEC's counting methodology could have a negative impact on the access to critical bottleneck elements, and, in the absence of Condition 14, the Merged Company could attempt to change its counting methodology in an effort to boost its bottom line and achieve its synergy savings estimates.

---

113 *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).

114 47 C.F.R. §51.5 Definition of "Fiber-based Collocator."

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

A. Yes, in three distinct respects. First, the FCC's June 2010 decision on Qwest's forbearance petition in the Phoenix, Arizona MSA applies a new analytical framework for the evaluation of BOC forbearance petitions, which replaces the approach that the FCC developed in its 2005 decision granting Qwest forbearance in the Omaha MSA, and has applied in subsequent reviews of BOC petitions seeking similar relief.[115] While that new framework appears to be a substantial improvement, its introduction alone will tend to heighten the uncertainty surrounding future forbearance petitions to the FCC, given that the BOCs vigorously pursued previous FCC rejections of their forbearance decisions in the courts,[116] and may well test the new framework in the same way. Adopting Condition 14 for the Defined Time Period would avoid the uncertainty created by these events during that interim period.

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

> …the Commission has long recognized that a vertically integrated firm with market power in one market – here upstream wholesale

---

[115] *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 ("*Phoenix Forbearance Order*"), at ¶¶ 16-24.

[116] 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.

> markets where…Qwest remains dominant – may have the incentive and ability to discriminate against rivals in downstream retail markets or raise rivals' costs…assuming that Qwest is profit-maximizing, we would expect it to exploit its monopoly position as a wholesaler and charge supracompetitive rates, especially given that (absent regulation) Qwest may have the incentive to foreclose competitors from the market altogether.[117]

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

And third, the justification invoked by the FCC for moving to its new analytical framework shows why Condition 14's temporary moratorium on forbearance petitions is essential to preserve competition during the post-merger transition period. In the *Phoenix Forbearance Order*, the FCC all but declares that the grant of forbearance to Qwest in the Omaha MSA was a colossal mistake, finding that in the *Omaha Forbearance Order* "the Commission eliminated all unbundled loop and transport obligations based largely on predictive judgments…" that were not borne out in the marketplace.[118] In hindsight, the Commission found that the analytical framework applied in the *Omaha Forbearance Order* was seriously flawed in that it was "not supported by current economic theory,"[119] "inappropriately assumed that a duopoly always constitutes effective

---

117 *Phoenix Forbearance Order*, ¶ 34.
118 *Id.*, ¶ 26.
119 *Id.*, ¶ *28*.

competition,"[120] and "appears inconsistent with Congress' imposition of unbundling obligations as a tool to open local telephone markets to competition in the 1996 Act."[121] The FCC ultimately concluded that the outcome of that forbearance has been a substantial reduction in competitive activity in the Omaha MSA, as "the record indicates that McLeodUSA has removed most of its employees from the Omaha marketplace, has limited its operations primarily to serving its existing customer base, and has ceased sales of residential and nearly all business services in Omaha;" while Integra abandoned its plans to enter the Omaha market after the Commission released the *Omaha Forbearance Order*.[122]

Q. DID THIS BOARD UNDERSTAND THAT GRANTING QWEST'S FORBEARANCE PETITION IN THE OMAHA MSA COULD LEAD TO DIMINISHED COMPETITION THERE?

A. Yes, indeed. In December 23, 2004, comments filed by the Board in the FCC's proceeding to review Qwest's forbearance petition for the Omaha MSA, the Board warned that "Without access to Qwest's wholesale facilities by competitors, developed levels of competition could dissipate."[123] As the FCC has now acknowledged, this is exactly what happened.

Q. HAS PAETEC SOUGHT TO REVERSE THE FCC'S GRANT OF FORBEARANCE IN THE OMAHA MSA IN THE CONTEXT OF THE FCC'S CENTURYLINK-QWEST MERGER REVIEW PROCEEDING?

---

120 *Id.*, ¶ *29*.

121 *Id.*, ¶ *32*.

122 *Id.*, ¶ *34*.

123 Additional Comments of the Iowa Utilities Board, December 23, 2004, WC Docket No. 04-223, at p. 4.

A. Yes. PAETEC has proposed the following condition in its initial comments in the FCC's on-going proceeding to review the CenturyLink-Qwest merger transaction, which were filed jointly with several other CLECs:

> Applicants shall voluntarily stipulate that McLeodUSA's Petition for Modification be granted and thereby, relinquish forbearance relief obtained in Omaha in WC Docket No. 04-223 and comply with Section 251(c)(3) UNE obligations throughout the Omaha MSA.[124]

Taking this step as a voluntary commitment would be the most efficient way to redress the Omaha situation. While the Board need not take any action with respect to PAETEC's proposal to the FCC, adoption of Condition 14 by the Board in the instant case would be compatible with and complementary to that proposal.

B. Wholesale Rate Stability

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

A. There are four conditions in this category – conditions 2, 3, 7, and 24:

- Condition 2 states that the Merged Company will not recover or seek to recover through fees paid by CLECs (and hold CLECs harmless from), one-time transfer, branding, or any other transaction-related costs.
- Condition 3 states that the Merged Company will not recover or seek to recovery through fees paid by CLECs (and hold CLECs harmless from), any increases in overall management costs that result from the transaction.
- Condition 7 states that the Merged Company shall not increase prices for wholesale services above the level at merger announcement, or create new rate elements for functions that are currently recovered in existing rates, for the Defined Term Period. This condition also states that the Merged Company will continue to offer any term and volume discount plan offered at merger announcement (without change) for at least the Defined Time Period, and will honor existing contracts on individualized term pricing plan

[124] PAETEC et al., Comments of Joint Commenters, July 12, 2010, WC Docket No. 10-110, at p. 67.

arrangements for the duration of the term. This condition also states that in the legacy CenturyLink territory the Merged Company will comply with its obligation to provide transit in ICAs and at rates no higher than the cost-based rates approved for Qwest (or the current tandem transit rate, whichever is lower).

- Condition 24 states that the Merged Company shall not assess porting charges, NID access fees, or directory storage and maintenance fees after the closing date, to the extent that those charges were not charged by legacy Qwest territory based upon Board-approved rates before the closing date.

Q. WHY ARE THESE CONDITIONS NECESSARY?

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

These conditions would also hold wholesale rates harmless from the one-time transaction related costs associated with marrying the two companies – costs that have traditionally not been recovered through wholesale rates. Finally, Condition 24 is necessary to prevent the Merged Company from adopting as a "best practice" in Qwest's territory anti-competitive charges assessed in legacy CenturyLink ILEC territory.

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

A. No. When asked whether CenturyLink would seek to recover through wholesale rates or fees paid by CLECs "any one-time transfer, branding or any other merger-related costs" or "overall management costs", CenturyLink did not provide a straightforward answer. Instead, CenturyLink stated that it would record costs according to FCC Part 32 and would use forward-looking cost studies to develop UNE rates – rates that would include the Merged Company's management cost structure post-merger.[125] CenturyLink's response ignores the issue – i.e., that wholesale customers should not have to pay for costs of the merger and essentially bear the brunt of CenturyLink merging the two companies. This is especially true since CenturyLink claims there will be hundreds of millions of dollars in savings associated with the merger. These principles have

[125] CenturyLink Response to PAETEC Data Response Set 1, #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.

been recognized in numerous previous mergers[126] and the same principle has been applied to retail service rates.[127]

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

A. Yes. On April 30, 2010 (after the Merger Announcement Date[128]), Qwest filed a "Product Notification"[129] (with an effective date of June 1, 2010) "to change its Regional Commitment Program (RCP) from a unit based plan to a revenue based plan and raise the commitment level from 90% to 95% of the total Company-provided in-service DS1 and DS3 Revenue."[130] This change was made to the entire 14-state Qwest ILEC territories covered by its Tariff F.C.C. No. 1 (interstate access tariff). A RCP is an pricing plan that allows DS1 and/or DS3 customers to receive price reductions for committing to a minimum volume on DS1 and/or DS3 circuits for a certain period of time.[131] As of May 31, 2010 (the day before the effective date of Qwest's Product Notification), the former RCP provisions were no longer available to wholesale customers, and the new, less

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

[127] See, ICC order in Verizon/Frontier merger, and Oregon PUC order in Embarq/CenturyTel merger.

[128] 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.

[129] PROD.RESL.04.30.10.F.07809.DS1_DS3_Services

[130] Product Notification: PROD.RESL.04.30.10.F.07809.DS1_DS3_Services, filed April 30, 2010.

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

favorable terms are required going forward.[132] As Integra informed Qwest, these RCP changes "greatly diminish the value of the RCP" by "increasing the risk associated with the plan" and were put in place shortly before "some of these plans are about to expire."[133] I have attached Qwest's Product Notification and Integra's correspondence with Qwest on this issue as Exhibit AHA-5. The point here is that the Joint Applicants are taking steps after the Merger Announcement Date and before the Closing Date to raise barriers to entry and enhance its revenues on the backs of wholesale customers. While this is one example, there can be no question that the Joint Applicants are geared towards improving the combined company's financial condition, and because it is most profitable for them to boost revenues at the expense of their competitors, there are (and/or will be) likely other similar examples. The Joint Applicants have stated that "[o]ne of the Transaction's key benefits is the resulting financial condition of the combined company" and a "financially stronger company can…compete against cable telephony providers, wireless carriers, VoIP offerings, and CLECs…"[134] I do not object to robust competition with the Merged Company so long as the competition is fair, but what I do object to in this instance (and what this example shows) is the Joint Applicants attempting to hinder the CLECs ability to compete with the Merged Company before the proposed transaction is even approved. That is why it is important to provide protections for the time period between the Merger Announcement Date and Closing Date as well as for the Defined Time Period.

---

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

133 See Exhibit AHA-5. 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.

134 Application, at p. 14.

VIII. ADDITIONAL CONSIDERATIONS

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

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

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

Q. ARE ANY ADDITIONAL SAFEGUARDS APPROPRIATE TO ENSURE THAT MERGER-DRIVEN COST REDUCTIONS WOULD FLOW THROUGH ON A NON-DISCRIMINATORY BASIS TO ALL

WHOLESALE AND SPECIAL ACCESS CUSTOMERS, RATHER THAN JUST AFFILIATES OF THE MERGED COMPANY?

A. Yes. To the extent that UNEs are required to be priced at TELRIC, forward-looking cost savings should be reflected in lower UNE rates as a matter of law.

With respect to the pricing of special access services, this is an issue that applies primarily to the federal arena (since the vast majority of special access circuits are deemed jurisdictionally interstate). However, to the extent that the Merged Companies do ultimately pass through merger-related cost savings to their special access customers, they may attempt to do so in a discriminatory, anti-competitive manner. CLECs such as PAETEC frequently rely upon ILEC-supplied wholesale special access services to link up enterprise customers to their advanced network services, against which the ILECs compete with their own enterprise-oriented offerings. Unless specific prohibitions are established against it, the Merged Companies could attempt to give their affiliates an unfair competitive advantage in the enterprise market, by applying merger-driven cost savings towards selective reductions of the wholesale access rates paid by their affiliates, while leaving the wholesale rates paid by the CLEC unchanged. In order to prevent this type of discriminatory conduct, PAETEC has proposed that the FCC adopt the following two additional merger conditions prior to granting its approval to the Joint Applicant's merger:

- Applicants shall not provide special access offerings to the Applicants' wireline affiliates that are not available to other similarly situated special access customers on the same terms and conditions; [135] and

[135] PAETEC et al., Comments of Joint Commenters, July 12, 2010, WC Docket No. 10-110, at p. 61.

- To ensure that Qwest/CenturyLink not provide special access offerings to its affiliates that are not available to other special access customers, before Qwest/CenturyLink provides a new or modified contract tariff service, it will certify to the FCC that it provides services pursuant to the contract tariff to an unaffiliated customer other than Verizon, AT&T or their wireline affiliates and will not unreasonably discriminate if offering grooming of special access facilities. [136]

These conditions are in fact a well-tested tool in the arena of FCC merger reviews, as they were offered as "voluntary commitments" by the applicants and accepted by the FCC as binding conditions to its approval of the prior mergers of SBC-AT&T, Verizon-MCI, and AT&T-BellSouth.[137]

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

Q. WHAT IS THE RURAL EXEMPTION?

A. The Federal Telecommunications Act of 1996 generally requires all ILECs to interconnect their networks and exchange traffic with other telecommunications carriers (Section 251, Section 252). Section 251(f), however, provisionally exempts rural ILECs from the obligations under Section 251(c) until they receive a bona fide request for interconnection from a telecommunications carriers. Once such a request is made, the exemption may be terminated by a state commission, if the commission finds that certain conditions are satisfied. Specifically, Section 251(f)(1) generally states that the state commission shall terminate the rural

---

[136] *Id.*, pp. 61-62.

[137] See, *In the Matter of SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, released November 17, 2005 ("*SBC/AT&T Merger Order*"), at Appendix F, pp. 123-124; *Verizon Comm., Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, released November 17, 2005 ("*Verizon/MCI Merger Order*"), at Appendix F, pp. 129-130; and *In the Matter of AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, Memorandum Opinion and Order, released March 26, 2007, ("*AT&T/BellSouth Merger Order*"), at Appendix F, pp. 150-151.

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.[138]

Q. SHOULD THE MERGED COMPANY COMMITMENT TO WAIVE ITS RIGHT TO SEEK THE RURAL EXEMPTION UNDER SECTION 251(F)(1) AND SUSPENSION AND MODIFICATION 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

[138] FCC's *Connecting America, the National Broadband Plan*, page 49.

the unbundling and resale provisions of the Telecommunications Act of 1996, such as the costs associated with the development of sophisticated OSS. These considerations are not relevant with respect to a post-merger CenturyLink; hence, I recommend that the Merged Company commit to waive its right to seek the exemption for rural telephone companies under Section 251(f)(1) and its right to seek suspensions and modifications for rural carriers under Section 251(f)(2) of the Communications Act.

IX. SUMMARY AND CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY AND STATE YOUR CONCLUSIONS.

A. In this testimony, I have discussed the troublesome history of mergers and demonstrated that the Board should prepare for the possibility that this merger, like many others, could fail or otherwise create havoc for the industry, and require that the Joint Applicants agree to certain conditions and make commitments necessary to protect CLECs and the competitive process. To that purpose, I have identified and discussed specific commitments and/or conditions that should be required of Joint Applicants as prerequisites for the merger to be approved. (A complete list is provided by Mr. Gates.)

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.