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STATE OF IOWA

DEPARTMENT OF COMMERCE

IOWA UTILITIES BOARD

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

SPRINT NEXTEL

DIRECT TESTIMONY

OF

JAMES A. APPLEBY

August 16, 2010

Q. Please state your name and business address.

A. My name is James A. Appleby. My business address is 6450 Sprint Parkway, Overland Park, Kansas 66251.

Q. What is your position and who are you representing in this proceeding?

A. I am employed as a Regulatory Policy Manager by Sprint United Management Company. I am testifying on behalf of Sprint Communications Company, L.P., Sprint Spectrum, L.P., Nextel West Corp., and NPCR, Inc. (collectively, "Sprint Nextel" or "Sprint"). Sprint is a provider of wireline long distance service, wireless communications services and wholesale services to cable providers in Iowa.

Q. Please summarize your educational background and business experience.

A. I hold a Bachelor of Science degree in accounting from Shippensburg University in the state of Pennsylvania. I became a Certified Public Accountant in Pennsylvania in 1989. I have been employed by Sprint since 1989. I began working with Sprint's Regulatory Policy Group in 1996. In my current position as Regulatory Policy Manager, I am responsible for the development of state and federal regulatory and legislative policy for all divisions of Sprint Nextel Corporation. I am also responsible for the coordination of policy across business units. The specific policy issues that I address include, among other things, intercarrier compensation, universal service, pricing, access reform, reciprocal compensation and local competition.

Q. Have you previously testified before this Board and other state Commissions and Boards?

A. Yes. In my position I have testified before the Board in Docket No. FCU-07-02. I have also testified before the Public Service Commission of South Carolina, the Missouri Public Service Commission, the Indiana Utility Regulatory Commission, the Michigan Public Service Commission, the New Jersey Board of Public Utilities, the Virginia State Corporation Commission, the Nebraska Public Service Commission, the Kansas Corporation Commission, the Arizona Corporation Commission, the Illinois Commerce Commission and the Pennsylvania Public Utility Commission. Additionally, I have testified before state legislative committees, and I have also worked with the various state Commissions' staff and the Federal Communication Communication's ("FCC") staff.

Summary of Testimony

Q. Please summarize your testimony.

A. The proposed merger of CenturyLink and Qwest is a significant transaction that would nearly double the size of Qwest nationally, one of the Regional Bell Operating Companies ("RBOC") created in the AT&T divestiture. The combined company will also increase its market concentration in the mass market long distance, enterprise and broadband markets. In short, the merged company will significantly increase its market power nationally. The proposed merger has the potential to cause substantial harm to the competitive balance within the telecommunications marketplace. The Board must ensure that appropriate conditions are imposed on this transaction to mitigate the public interest harms created by the merger and to ensure that there are public benefits from the significant synergies created by the combined company. Specifically, Iowa Code Sec. 476.77(d) and (e) directs the Board to consider the impact on ratepayers and the public interest when reviewing proposed mergers. Absent the conditions Sprint recommends, ratepayers and the public in general will be harmed as a result of the merger's adverse impact to intermodal competition.

In this Testimony, Sprint proposes several conditions to mitigate the potential competitive harm posed by this application including: (1) interconnection agreement obligations, and (2) mandatory adoption of best carrier-to-carrier business practices that facilitate competition.

Merger Concentrates CenturyLink's Market Power

Q. Has CenturyLink provided information about the increase in the magnitude of its operation if the merger with Qwest is permitted?

A. Yes. CenturyLink states that after the merger it will serve a nationwide total of 17 million access lines, more than 5 million broadband customers,[1] over 1.4 million video subscribers and 850,000 wireless customers.[2] Postmerger CenturyLink will have access lines in 37 states and will be approximately 60% the size of Verizon. This proposed merger of CenturyLink and Qwest will result in a company that is nearly double the size of Qwest nationally, one of the RBOCs created in the AT&T divestiture. This significantly larger company will have a greatly enhanced ability to

[1] Phillips Direct p. 11 line 19-20
[2] http://news.qwest.com/centurylinkqwestmerger (last viewed August 5, 2010).

wield market power in the markets for several telecommunications and broadband services. For purposes of this Testimony, I will refer to the proposed post-merger combined entity as the "Merged Firm."

Q. Will CenturyLink also add a facility-based long distance service provider to its Corporation?

A. Yes. CenturyLink will now own its own facility-based long distance service provider, Qwest Communications Company, LLC.

Q**. What is the financial benefit for CenturyLink post-merger of adding a facility-based long distance provider?**

A. The Merged Firm will enjoy owner's economics on all terminating switched access and special access circuits over a broader swath of customers.[3]

Q**. Please provide several examples of the financial benefits.**

A. Qwest Communications Company, LLC services can be provisioned to customers within the legacy CenturyLink service territories without the prices for Qwest's service offerings having to cover the inflated switched terminating access service prices of CenturyLink ILECs. Similarly, Qwest will not incur the inflated special access services rates that CenturyLink imposes on all other carriers. The Qwest Communications Company, LLC offerings in the enterprise and mass markets can now ignore these once onerous input costs. Qwest Communications Company, LLC,

[3] In the merger of Verizon and MCI, the MCI Board cited these "access economics" as one reason for its acceptance of the revised proposal from Verizon. MCI Press Release, *MCI Accepts Revised Proposal From Verizon*, March 29, 2005

unlike other service providers competing in the enterprise and mass markets, will not be burdened by the inflated access charges of legacy CenturyLink ILECs.

Q. Does this reduction in the input costs Qwest Communications Company, LLC incurs provide it with a competitive advantage?

A. Yes. Switched and special access service costs are significant input costs of mass market and enterprise services. The Merged Firm will internalize these input costs. Accounting rules require the corporation to eliminate an equal amount of access cost and access revenue reflective of these intra-company transactions on the corporation books. The only real financial impact of the services provided within the corporation is the actual economic cost of the function provided. The merged company need price its long distance service to cover only the true economic cost rather than the inflated access service price that all other long distance carriers must pay, and that Qwest's long distance arm had to pay before the merger. With the vast difference between the true cost of access services, special and switched, and the inflated prices that CenturyLink charges, the merged company will possess a substantial input cost advantage over all other non-affiliated providers trying to serve the market. The other carriers attempting to compete in the markets with Qwest will continue to face those excessive switched and special access charges, and will not be able to compete as vigorously on price as they would if the merged company's access charges were set at economic cost. Thus, this merger will adversely affect competition in the enterprise and mass market long distance services markets that use access as an input, to the detriment of Iowa consumers.

Q. Do the inflated prices of legacy Qwest ILEC switched access and special access rates also contribute to the competitive disadvantage the other competitors face when competing with Qwest Communications Company, LLC within legacy Qwest ILEC service areas?

A. Absolutely. Legacy Qwest ILEC switched and special access rates are also greatly inflated. The vertical integration of ILEC and long-haul provider imparts a competitive advantage to the combined service provider.

<u>The Merger Should Not Impact the Development of Competitive Choices for Consumers</u>

Q. Does CenturyLink believe competition for telecommunications is impacting its business?

A. Yes. CenturyLink witness Jones explains, "Competition for voice, Internet, data and video is widespread with increasing competition from wireless companies, cable operators, VoIP providers and new, start-up entities."[4] He also states, "the pressure on all of these companies to be responsive, invest and innovate is intense."[5]

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[4] Jones Direct p. 7 lines 16-18
[5] Jones Direct p. 7 lines 19-20

Q. Does CenturyLink testify that the merger will improve its ability to compete?

A. Yes. "The company will be better situated, both financially and operationally, with more flexibility to meet the challenges of a rapidly changing and intensely competitive communications environment."[6]

Q. Does CenturyLink acknowledge the value of competitive choice to the customers?

A. Yes. Mr. Jones states, "Competition is most robust in markets where there is intermodal competition: that is, where services are being delivered over wireless, wireline and cable platforms. If any of those platforms is rendered unsustainable, it would negatively impact competition and the consumers."[7]

Q. Will the merger transaction truly be transparent to customers[8] if CenturyLink ILECs generate a competitive advantage from the merger and competing carriers are adversely impacted by the merger?

A. No. If the Merged Firm is permitted to impose onerous conditions on competing carriers, delay entry into new markets or simply increase the costs competitors incur to interconnect in CenturyLink operating territories, the merger will not be "transparent to customers." Telecommunications service choices and prices in the market could be adversely impacted.

[6] Jones Direct p. 9 lines 21-23
[7] Jones Direct p. 14 lines 14-17
[8] Phillips Direct p. 4 line 10

Q. Does a larger CenturyLink have more potential to engage in anticompetitive behavior within the footprint as a dominant ILEC?

A. Yes. The synergies and economies of scale and scope created by this merger will increase the Merged Firm's ability to engage in anticompetitive behavior more than legacy Qwest or legacy CenturyLink could do absent the merger. Further, the increasing level of competition within their service areas increases CenturyLink's incentive for such acts.

Q. Are merger conditions necessary to maintain the current competitive balance and improve the competitive landscape going forward?

A. Yes. Conditions are necessary. CenturyLink has testified the merger improves their competitive position. CenturyLink also recognizes the value to the customers of intermodal competition. The conditions Sprint recommends are meant to ensure customer choice for intermodal providers is not reduced or negatively impacted by the merger but instead increased over time.

Synergy Savings Should Accrue to CenturyLink's Customers Including Wholesale Customers

Q. What synergies has CenturyLink announced are likely 3-5 years after the close of the merger with Qwest?

A. CenturyLink has announced it anticipates saving $575M annually in operating expenses 3-5 years after the merger closes and an additional $50M annually in capital expenditure savings as a result of this transaction.[9]

Q. Do you have reason to believe CenturyLink will achieve their target synergy savings?

A. Yes. CenturyLink provides guidance to its shareholders quarterly on the synergy results achieved in its last merger transaction, the purchase of the Embarq local telephone companies. The following is what was provided in its second quarter of 2010 quarterly results press release:

> "CenturyLink achieved approximately $75 million in operating cost synergies during second quarter 2010 and expects to achieve approximately $330 million in annual run rate synergies by year end 2010."[10]

CenturyLink will have achieved $30 million more than the originally forecasted $300M[11] in merger synergies from the Embarq merger within 18 months of the close of the merger in 7-1-09. CenturyLink originally estimated the synergies could be achieved within the first 3-5 years after the merger.[12]

[9] *See* CenturyLink and Qwest Merger Conference Call, April 22, 2010 slide 6
[10] CenturyLink Reports Second Quarter 2010 Earnings released August 4, 2010
[11] CenturyLink increased the anticipated synergy savings to $375M after the close of the Embarq merger.
[12] http://www.centurytelembarqmerger.com/keyMaterials.cfm

I am aware that other intervenors in Iowa and other states are concerned that the claimed synergies may not happen -- that the merger may go badly and that carriers and customers should be protected from the fallout of that possibility. I understand that position, but I come at this from a different angle: I assume that the Joint Applicants will make their synergy targets because investors will require it. To me, then, the question is how they achieve such large synergy savings, and whether competition and consumers benefit or not. Put differently, does the Merged Firm achieve such large savings by raising costs to competitors like Sprint, making customer choice more expensive, reducing wholesale staff, and cutting corners on OSS integration? Or does it achieve savings in a more responsible way and use those savings to generate broader benefits by integrating best competition practices throughout their newly-enlarged geography so that wholesale and retail customers can benefit from the increased scale, scope and efficiencies of a merged company? The purpose of my testimony is to encourage the Board to require that the Joint Applicants do the latter, not the former. Synergy savings should not come at the expense of competition, and merger benefits should be shared not only among the merged Company's investors, but among the various classes of customers and communities as well.

Q. Qwest witness Phillips states "Customers will benefit from the efficiencies and synergies realized by the combined company."[13] Does the testimony detail how wholesale customers will benefit?

A. No. Qwest points out that it will have additional resources to deploy fiber to cell sites.[14] But Qwest's ability to generate more revenues in the wireless backhaul market it dominates within its ILEC service territory doesn't guarantee any benefits to wireless carriers. If the services provided to wireless carriers are priced like current special access services, far above the actual cost of the services, wireless carriers receive little or not benefit from CenturyLink's investment in fiber to the cell sites.[15] And non-wireless wholesale providers receive no benefit whatsoever from fiber to the cell site deployment.

Q. Absent regulatory mandate, does CenturyLink plan to share any input cost savings with its wholesale customers?

A. No. Without regulatory intervention, the wholesale customers will not benefit from the massive synergies the Merged Firm may realize.

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[13] Phillips Direct p. 24 lines 12-13

[14] Phillips Direct p. 25 line 25 through p. 26 line 8

[15] http://ir.centurylink.com/phoenix.zhtml?c=112635&p=irol-newsArticle_Print&ID=1456278&highlight= CenturyLink 2Q 2010 earnings – Revenue increases were primarily driven by growth in high-speed Internet customers and data transport demand from wireless providers.

Q. What portion of the merger synergies from the Qwest transaction should accrue to the operations in Iowa?

A. Based on the ratio of Iowa access lines to total lines for the merging companies, approximately 4.12%[16] of the $575 million in operating synergies, or $23.7M, and $2 million of the $50 million in capital synergies should accrue to Iowa operations. The magnitude of these savings suggests wholesale customers should receive some benefits in Iowa from the merger transaction.

Q**. Is there any other financial information that the Board should consider in determining if CenturyLink should be required to share merger synergies with its wholesale customers?**

A. Yes. CenturyLink is a profitable company before the merger with Qwest and its testimony explains that it plans to be even more profitable post-merger. CenturyLink has indicated the dividend payout per share will remain at the same high level.[17] To illustrate the profitability of CenturyLink, the current distribution of profit to its shareholders via dividends is $10.79 for each access line per month.[18] Customers – including carrier customers – should receive the types of benefits described in the next section of this Testimony rather than all of the profits being used to enrich equityholders.

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[16] Phillips Direct p. 11 line 20-23; 700,000/17,000,000 = 4.12%

[17] http://news.qwest.com/centurylinkqwestmerger (last viewed August 5, 2010). CenturyLink pre-merger dividend is $2.90 per share and that policy will continue post-merger.

[18] http://ir.centurylink.com/phoenix.zhtml?c=112635&p=irol-newsArticle_Print&ID=1456278&highlight= CenturyLink 2Q 2010 dividends paid June 21, 2010 were $219 million divided by 6,767,000 access lines = $32.36 per quarter, divided by 3 = $10.79 per line per month.

<u>The Merger Should Reduce Interconnection Agreement Transaction Costs Between the Merged Company and the Rest of the Industry</u>

Q. What specific transaction costs are you asking the Board to limit?

A. I am referring to the administrative and operational costs carriers incur to negotiate/arbitrate and implement interconnection agreements under sections 251 and 252 of the Telecom Act.

Q. What is the benefit of reducing these transaction costs in conjunction with this merger?

A. By reducing the transaction costs, merger synergies benefit the rest of the industry and provide a broader benefit to the public as a whole. Competition is also enhanced by limiting these costs, to the benefit of end users in Iowa.

Q. What actions can the Board take to limit local interconnection contract transaction costs?

A. Transaction costs between the Merged Firm and all other interconnecting carriers could be greatly reduced if the Board would impose merger conditions that: 1) require the Merged Firm to extend the life of existing contracts, 2) allow requesting parties to port interconnection agreements to other CenturyLink companies and across state lines, and/or 3) require the adoption of standard agreements across the entire footprint of the merging ILECs.

1) <u>Extending Existing Contracts</u>

Q. Why is it beneficial to the industry to extend the life of existing local interconnection contracts?

A. Competing carriers can avoid the burdensome cost of contract negotiations and potentially arbitration if existing contracts are extended. As long as the terms are satisfactory to the requesting carrier, the ability to extend interconnection agreements for a substantial period of time provides requesting carriers with a real benefit from the merger. Instead of extended and costly negotiations with the CenturyLink and Qwest ILECs over interconnection terms and conditions, the companies can focus resources on providing the best service offers for retail consumers.

Q. What is Sprint's specific recommendation for the extension of existing contracts?

A. Sprint recommends an existing interconnection agreement, whether in its initial term or otherwise currently effective, may be extended from the date the merger closes by a requesting carrier for 48 months or for three years after a request is granted, whichever is longer.

2) **<u>Porting Existing Contracts to Other CenturyLink Companies and Across State Lines</u>**

Q. Why is it beneficial to the industry to port interconnection agreements to other Merged Firm ILECs?

A. Like contract extensions, the ability to port a contract from one Merged Firm ILEC to another Merged Firm ILEC avoids the burdensome incremental cost of contract negotiations and potentially arbitration to establish a new contract. With more than 100 Merged Firm ILECs nationally[19] and CenturyLink's stated plan to retain each legal entity, management of the interconnection arrangements can be repetitive and burdensome. CenturyLink and a carrier wishing to interconnect with CenturyLink in multiple locations would need to negotiate the myriad of issues over and over again. It makes much more sense and benefits the industry as a whole to permit porting existing language from one Merged Firm ILEC to another, even if the agreement originated in another state. The porting of existing agreements may also result in one nationwide interconnection agreement.

Q. What is Sprint's specific recommendation for porting existing agreements between one Merged Firm ILEC and another Merged Firm ILEC?

A. The Merged Firm shall permit a carrier customer to "port" the entirety of an existing interconnection agreement (except for state-specific rates), whether negotiated or arbitrated, entered into with any CenturyLink or Qwest ILEC in Iowa, to any other CenturyLink or Qwest ILEC within Iowa and shall permit a carrier customer to "port"

[19] Nationally, the Merged Firm will have approximately 75 legacy CenturyTel ILEC legal entities, approximately 25 legacy Embarq ILEC legal entities and 13 legacy Qwest ILEC legal entities.

the entirety of an existing interconnection agreement (except for state-specific rates), whether negotiated or arbitrated, from another state in the Merged Firm's territory where it is currently effective to Iowa and apply that agreement (whether an in-state agreement or an agreement from another state) to all carrier customer affiliates and aggregate all carrier customer affiliate arrangements under one ported agreement. For purposes of this condition, state-specific rates do not include billing arrangements such as bill-and-keep for the exchange of traffic or contractual provisions to share the costs of interconnection facilities. This condition shall continue for 48 months after the closing date of the merger and shall apply to any existing agreement, whether in its initial term or outside its initial term but still effective, and to any new agreements created during the 48 month period. Any agreement so ported more than 12 months after the merger shall be effective for 36 months after the porting request is granted. If an agreement is ported from another Merged Firm entity within a state or across state lines, any interconnection agreement that would otherwise apply is cancelled without penalty.

3) <u>One National Standard Interconnection Agreement</u>

Q. Why would it be beneficial to require the adoption of one standard agreement across the entire footprint of the merging ILECs?

A. CenturyLink indicates that the Merged Firm will continue to operate each of the existing ILEC legal entities post-merger, which would require carriers wishing to interconnect with CenturyLink in more than one CenturyLink ILEC service territory to negotiate and potentially arbitrate a local interconnection agreement with each and every CenturyLink ILEC. Clearly this position inflates the costs of entering the market, or of remaining in the market if entry has already occurred. Competitive offerings in the new market could be delayed or, at a minimum, the interconnecting company surely will have incurred more administrative/operational costs that must be recovered in some manner, likely through higher retail service rates. This really is just a matter of adopting the best practices among the merged entities. Qwest's SGAT, which is largely consistent except for local pricing, is an example of a movement toward a unified template across a range of service territories. The resulting Merged Firm should be expected to do the same.

Q. What is Sprint's specific recommendation for one national standard interconnection agreement?

A. The Merged Firm shall recognize that porting of existing agreements across state lines and applying them to affiliated carrier customers may result in a nationwide interconnection agreement. Any negotiations necessary to facilitate such porting to accommodate application of such agreements in multiple states or among requesting carrier customers shall occur in a timely fashion and the results shall apply retroactively to the date that such porting was requested by a carrier customer. Negotiations concerning new or amended interconnection agreements shall be accomplished on a nationwide basis and include all Merged Firm ILECs in one contract.

Q. Is Sprint concerned about the enforcement of any merger commitments that are included in a Board Order approving the merger? If so, how can that concern be addressed?

A. Yes. Due to its experience in attempting to implement supposed competition-enhancing merger conditions included in other ILEC mergers, Sprint is concerned that the Merged Firm, whether intentionally or unintentionally, may not interpret a merger condition in the same manner that Sprint does. Sprint also has encountered objections from ILECs as to what the appropriate forum is for bringing a regulatory or legal action to enforce merger conditions. To erase any doubt about merger condition enforcement and to encourage the Merged Firm to implement in good faith all of the merger conditions approved by the Board, Sprint proposes another Merger Condition that addresses these issues.

Q. What is Sprint's specific recommendation for a merger condition that addresses enforcement of the other merger conditions?

A. The Federal Communications Commission, state Commissions, and the courts shall each have jurisdiction to enforce these merger conditions. CenturyLink will be responsible for paying attorneys fees of complaining parties in any case where complaining parties seek to enforce merger conditions and are successful in such enforcement. In addition, in any instance where a complaining party seeks to enforce a merger condition through complaints to the Federal Communications Commission, a state commission, or the courts, and is successful in such enforcement, the complaining party may also require, at its option, that the term of any merger commitment so enforced be extended for an additional 48 months in addition to the initial term.

<u>The Merger Cannot Result in the Adoption of Worst Practices</u>

Q. Sprint is aware of several business practices that are handled very differently by Qwest and CenturyLink pre-merger. What is the first practice that concerns Sprint?

A. Currently legacy CenturyLink has a limit of 10 circuit migrations a day for carrier customers, while Qwest has set its limit at 50. Sprint has found CenturyLink's limit to be restrictive and it harms Sprint's ability to compete and offer services in an efficient manner. The merged entity should be required to adopt best practices rather than be allowed to harm competition by adopting worst practices. Both CenturyLink and Qwest should be required to allow 50 circuit migrations a day to facilitate competition. And to tie this back to a point I made above, when CenturyLink is paying investors nearly $11 in dividends per access line, there is no excuse for only having the capability of 10 migrations per day. CenturyLink should be expected to invest some of its synergies in better meeting its obligations to facilitate fair competition.

Q. What is another practice that causes Sprint concern?

A. CenturyLink recently filed with the FCC a request to delay its implementation of the one-day local number portability standard.[20] Ironically, the reason CenturyLink gave was that it has not finished integrating the CenturyTel and Embarq OSS from the *last* merger. CenturyLink states that it seeks to finish adopting the Embarq porting system across its footprint rather than update two separate systems to one-day porting, and that it cannot satisfy both the timeline for merger conditions put in place by the FCC and the one-day porting requirement deadline. On the other hand, Qwest already provides one-day porting in Iowa. Failure to implement one-day porting delays customers who wish to switch carriers and could cause some customers to not switch at all. The merged CenturyLink can not be permitted to choose practices that inhibit competitive choice. As a condition of approval of the merger in Iowa, the Board should require that the Merged Firm adopt the best practices of the Qwest ILECs and impose a requirement that the Merged Firm in Iowa comply with the FCC's one day porting requirement and not degrade the existing Qwest capabilities.

Q. Does this conclude your Direct Testimony?

A. Yes.

[20] *See* Local Number Portability Porting Interval and Validation Requirements; Telephone Number Portability, WC Docket No. 07-244, *Century Link Petition for Waiver of Deadline* (filed June 7, 2010)