ILEC Mergers and Implications for the Competitive Landscape

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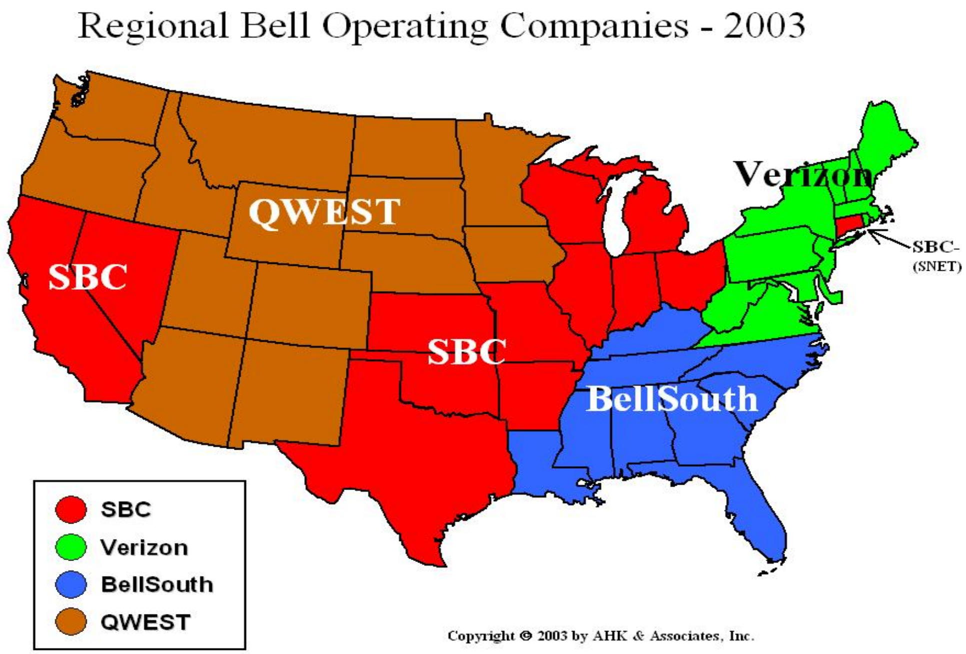
INTRODUCTION & SUMMARY

- Recent History of ILEC Mergers
- Impact of ILEC Mergers on CLECs as Wholesale Customers
- Regulatory Review – FCC and State PUCs
  - Standard of review
  - Typical wholesale conditions
  - MFN clauses
  - Unintended consequences of non-wholesale conditions

RECENT HISTORY OF ILEC MERGERS

The Trend: Bigger is Better?

- Verizon/GTE/Bell Atlantic



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SBC/AT&T/BELL SOUTH

- The RBOC Mergers
  - "Ma Bell" Returns
    - The "T1000" of Corporations

RURAL ILEC ACQUISITIONS

- CenturyTel – Embarq
- Frontier – Verizon
- CenturyLink – Qwest

BIGGER IS BETTER

Table 3
Comparison of Relative Sizes of Buyers and Sellers in Selected Telecom Mergers and Acquisitions
Access Lines in Millions

	Buyer remained financially stable			Buyer in bankruptcy		????
Verizon Acquisition of GTE Companies	**Bell Atlantic Acquisition of GTE Companies (1)**	**SBC Acquisition of Ameritech Companies (2)**	**Qwest Sale of Exchanges to Citizens (2000) (3)**	**Verizon Sale of GTE-Hawii to Carlyle Group (2005) (4)**	**FairPoint Acquisition of Verizon ME, NH, and VT (March 2008) (5)**	**Frontier Acquisition of Selected Verizon GTE Exchanges**
Pre-Merger Acquiring Company	41.6	34.0	1.40	0.00	0.3	2.3
Pre-Merger Parent of Exchanges being Sold	26.0	20.8	18.00	49.30	46.0	43.4
Exchanges Being Acquired	26.0	20.8	0.017	0.700	1.5	4.7
Post-Merger Entity	67.6	54.8	1.42	0.7	1.8	7.0
Ratio of Total Seller Access Lines to Lines Sold	1.00	1.00	0.00	0.01	0.03	0.11
Ratio of Acquired Lines to Total Buyer Lines	0.6	0.6	0.0	n/a	4.9	2.0
% Buyer Access Lines Increased	63%	61%	1.2%	n/a	487%	204%

Sources:
(1) Annual Reports of GTE Corporation (1999) and Bell Atlantic Corporation (1998). Both available on Verizon website www.verizon.com.
(2) *SBC to acquire Ameritech*, Network World, August, 1998. Available at www.networkworld.com.
'02.
(4) Verizon 3rd Quarter 2006 Earnings Report. Available on Verizon Webstite www.verizon.com and FCC Trends in Telephone Service, Feb '07
(5) Annual Report, Verizon (2008). Available on Verizon website www.verizon.com.

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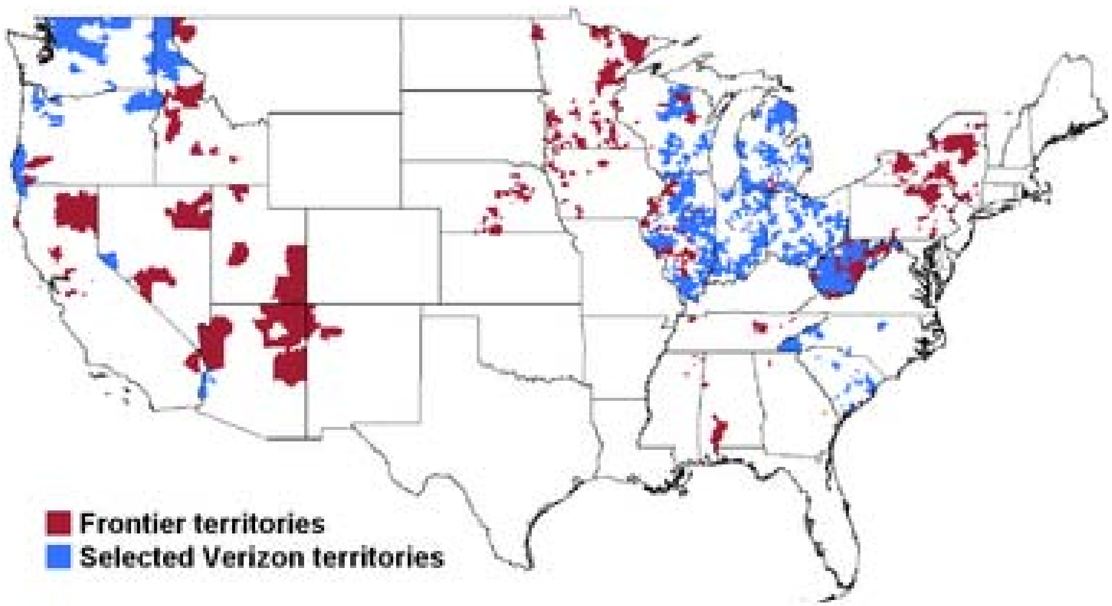
BIGGER IS BETTER (cont.)

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

FRONTIER - VERIZON



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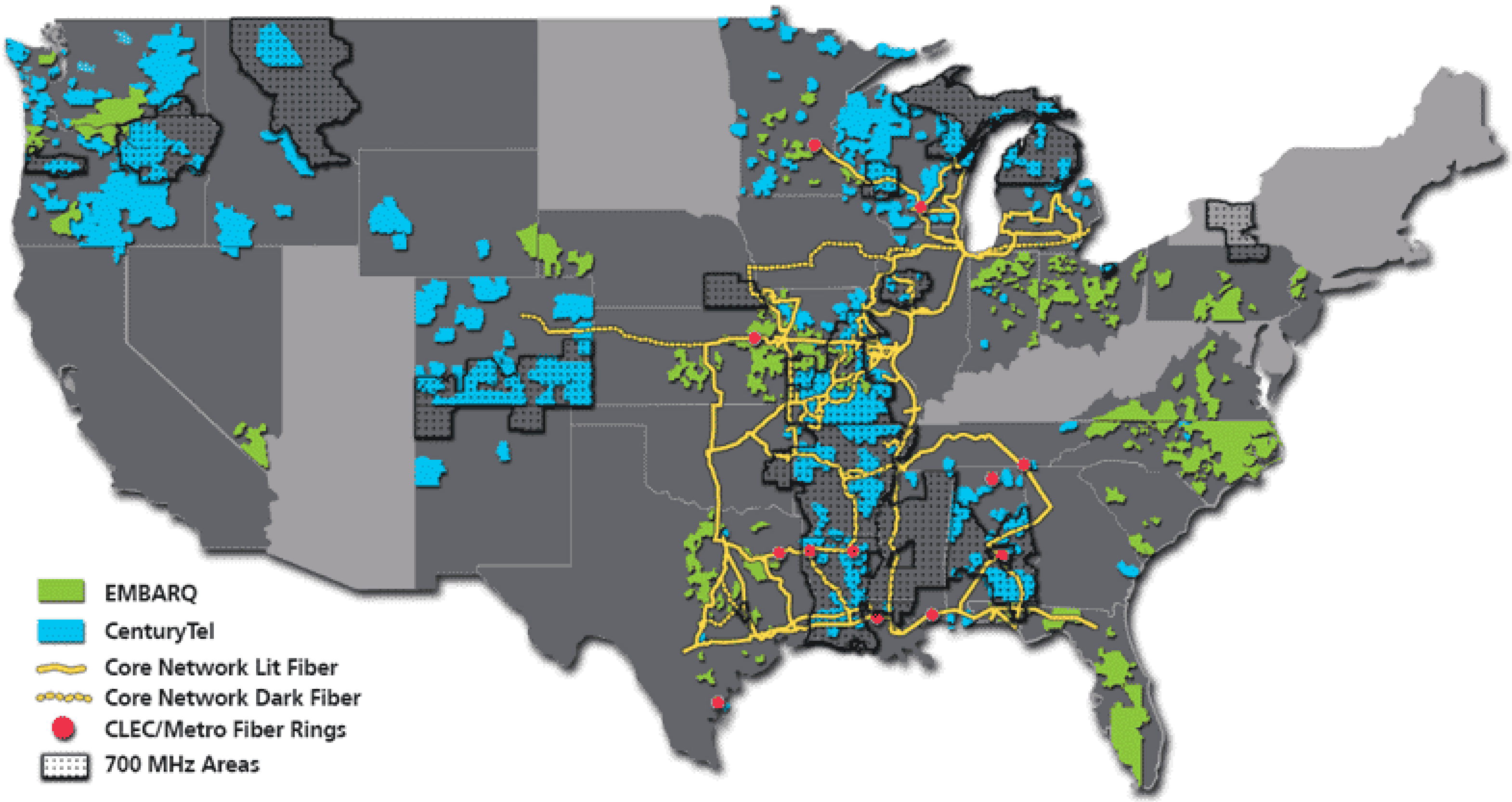
CENTURYTEL - EMBARQ



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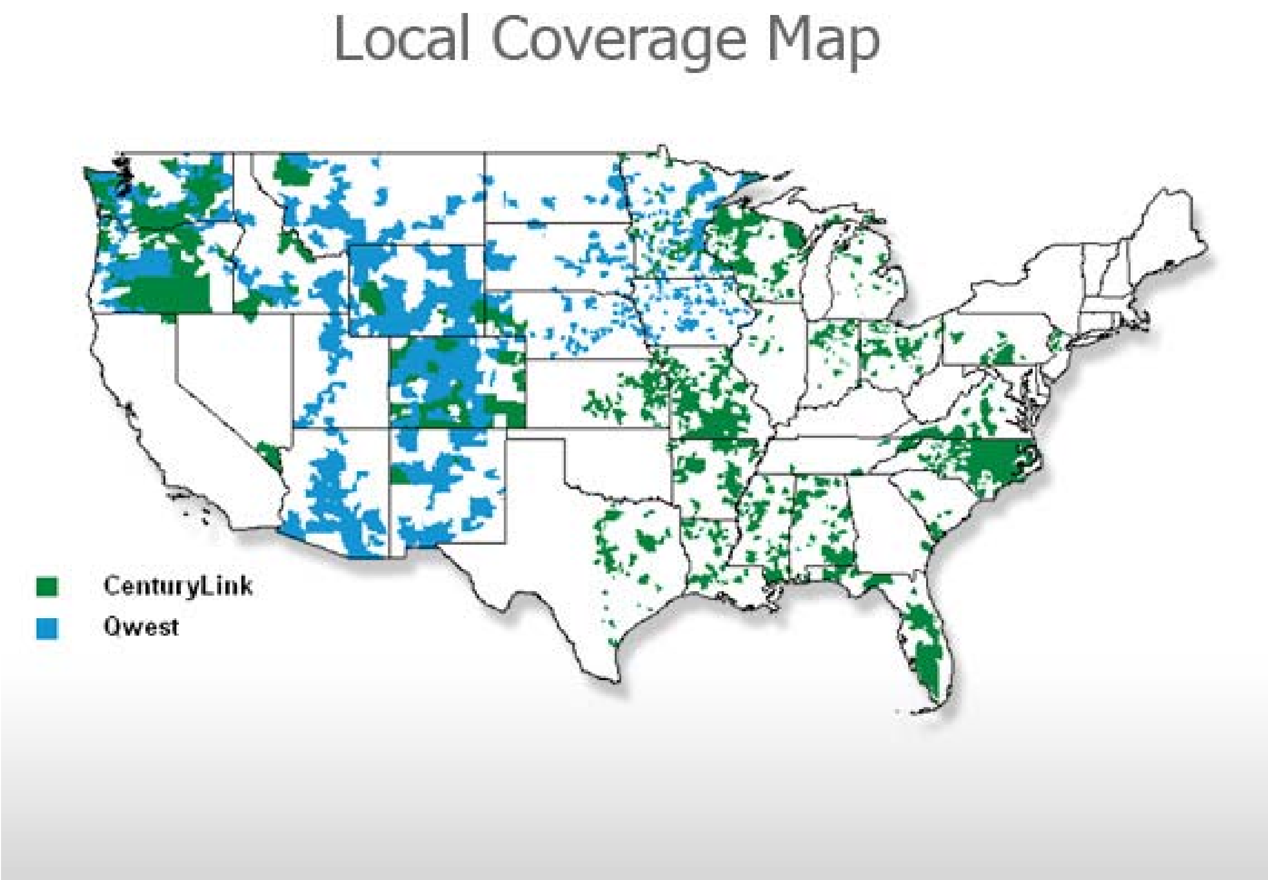
CENTURYLINK - QWEST



“THE WHY”

Ability to Compete with Cable and Wireless

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I would like to spend just one quick moment commenting on the parties who did not participate in this docket. AT&T Wireless and Verizon Wireless are not here. Comcast is not here. Google and Microsoft are not here. Now, I mention these parties because they represent the real competitors that CenturyLink and Qwest must face whether these companies merge or not. These are very large nonregulated entities.

"THE WHY" (cont.)

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CenturyLink and Qwest need to combine to gain the strength to be effective competitors with these entities. Only then will the state of Washington have a viable

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wireline competitive alternative to these entities. And only then will CenturyLink and Qwest be in a position to continue to provide service in higher cost areas that these entities have chosen not to invest in or provide services in.

Excerpt from Transcript of WUTC Hearings – January 5, 2011
(Opening Statement of CenturyLink Counsel)

"WHY CARE"?

Competitive Local Exchange Carrier (CLEC) Concerns as Wholesale Customers

- The Failed Experiments:
  - MCI – WorldCom
  - Qwest – US West
  - GTE – Hawaii-Tel
  - FairPoint
  - Frontier – Verizon
- OSS COLLAPSE

LESSONS FROM HISTORY

"Those who do not heed the lessons of history are doomed to repeat them."

- MCI – WORLDCOM (1998)
  - Following the acquisition, the company had to file for Chapter 11 bankruptcy protection in 2002, after having destroyed much of the shareholder value of both WorldCom and MCI.
- QWEST – US WEST (2000)
  - The total value of the transaction at the time was considered approximately $40 billion. About ten years after the merger, Qwest's market capitalization was approximately $10 billion in 2010.

LESSONS FROM HISTORY (cont.)

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

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THE RURAL CARRIER "PERSONA"

- Different Corporate Cultures
  - "Additionally, to the extent that CenturyLink has been less willing to cooperate with competitors than Qwest, CenturyLink may extend this behavior to the acquired territories following the transaction." (FCC decision at para. 28)

REGULATORY REVIEW

- DOJ Review
- FCC Review
- State PUC Review

DEPARTMENT OF JUSTICE REVIEW

- The Department of Justice (DOJ) reviews telecommunications mergers pursuant to section 7 of the Clayton Act, and if it wishes to block a merger, it must demonstrate to a court that the merger may substantially lessen competition or tend to create a monopoly. DOJ' s review is also limited solely to an examination of the competitive effects of the acquisition, without reference to other public interest considerations.

FCC REVIEW

- Pursuant to sections 214(a) and 31O(d) of the Communications Act of 1934, as amended (Communications Act or Act), and sections 34 through 39 of the Cable Landing License Act, the Commission must determine whether the proposed transfer of control . . . will serve the public interest, convenience, and necessity.

- Our public interest evaluation necessarily encompasses the "broad aims of the Communications Act”, which include, among other things, ***a deeply rooted preference for preserving and enhancing competition in relevant markets***, accelerating private-sector deployment of advanced services, ensuring a diversity of license holdings, and generally managing spectrum in the public interest.

FCC REVIEW (CONT.)

- The Commission's competitive analysis under the public interest standard is somewhat broader [than the DOJ's] - for example, it considers whether a transaction will enhance, rather than merely preserve, existing competition, and takes a more extensive view of potential and future competition and its impact on the relevant market.
- Our public interest authority enables us, where appropriate, to impose and enforce narrowly tailored, transaction-specific conditions to ensure that the public interest is served.

SAMPLE FCC WHOLESALE CONDITIONS

OSS-Related Conditions

- Qwest's OSS will not be replaced for a period of at least 30 months following close date, and thereafter will provide a level of wholesale service quality that is not less than that provided by Qwest prior to the close date.
  - **This condition also requires the merged company to provide functionally equivalent support, data, functionality, performance, electronic flow through, and electronic bonding.**
  - **180 days prior to the replacement or integration of any of the Qwest OSS, CenturyLink will notify the FCC, affected states and affected wholesale customers, file its proposed transition plan with the Commission and affected states, and seek input from affected wholesale customers on such transition plan. (The FCC condition also sets forth specific details regarding the OSS integration plan.)**
  - **The OSS replacement-related conditions will <u>not</u> expire three years following the close date.**

Source: Standard & Poor's LCD, Leveraged Lending Review 4Q08

SAMPLE FCC WHOLESALE CONDITIONS (CONT.)

ICA-Related Conditions

- CenturyLink will honor all obligations and extend for a period of 36 months existing Qwest and CenturyLink ICAs in effect as of the close date.
- Any wholesale customer with a pre-existing ICA may use that agreement as the basis for negotiating a successor agreement.
- CenturyLink will permit any requesting carrier "under Section 251(b) desiring interconnection agreements with more than one CenturyLink ILEC operating within the same state" to simultaneously negotiate ICAs will all such ILECs operating in the same state.
- CenturyLink will not assert that any state lacks Section 252 jurisdiction over a Section 251(b) interconnection agreement or dispute on the grounds that such agreement or dispute also arises under these commitments and conditions.
- Following the close date, CenturyLink will not assert that any of its rural telephone companies are exempt from Section 251(c) obligations pursuant to Section 251(f)(1) of the Act. This condition will not expire three years following the close date.

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SAMPLE FCC WHOLESALE CONDITIONS (CONT.)

Other / Miscellaneous Conditions

- Orders will be processed in compliance with federal and state law, as well as terms of applicable ICAs.
- For 12 months following closing, CenturyLink will not discontinue any Qwest wholesale service offered to CLECs in the Qwest territory, except as permitted by the FCC.
- Interstate term and volume discount plans offered for tariffed services by Qwest as of the merger close date will be extended by 12 months, or until May, 2013 (whichever is later).
- CenturyLink will not recover through wholesale service rates one-time transfer branding or other merger specific-costs.

FCC WHOLESALE CONDITIONS (CONT.)

Wholesale Service Quality

- CenturyLink will maintain wholesale functionality, performance and e-bonding at a level that is at least comparable to what Qwest is providing prior to the close data. CenturyLink will maintain and report metrics on pre-ordering, ordering, provisioning and repair/maintenance functions for certain UNE and resale order types.

- CenturyLink will continue to report on wholesale performance metrics and associated reporting requirements to CLECs, state commissions and FCC staff.

STATE COMMISSION REVIEW – WASHINGTON

- The Commission's authority and responsibility regarding transfers of ownership and control of public services companies are found in RCW 80.12 and WAC 480-143. (See attached materials)
- The Commission has consistently imposed a "no harm" public interest standard when reviewing telecommunications mergers.

STATE COMMISSION REVIEW – WASHINGTON (cont.)

The WUTC also looks at the impact on competition:

- "… we must be concerned here with whether the transaction might distort or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service"
- "The impact on competition at the wholesale and retail level, including whether the transaction might distort or impair the development of competition."

STATE COMMISSION REVIEW – WASHINGTON (cont.)

- "At the state level, among the factors we consider in evaluating transactions brought to us for approval, are the provisions of RCW 80.36.300 which set forth a number of components of state telecommunications policy two of which speak directly to telecommunications competition and the need for effective wholesale service conditions: "the policies to "[m]aintain and advance the efficiency and availability of telecommunications service and to [p]romote diversity in the supply of telecommunications services and products in telecommunications market throughout the state."

STATE COMMISSION REVIEW – WASHINGTON (cont.)

- "An ILEC merger like the one between CenturyLink and Qwest in this case has unique and profound public interest implications relating to these policies. Absent rigorous scrutiny and establishment of meaningful conditions, the merger could very well disturb the existing wholesale relationship between the two merging ILECs and their competitors and produce harmful competitive conditions in Washington. This is possible because of the dual role with respect to their competitors as both retail competitors and suppliers of important wholesale facilities and services."

STATE COMMISSION REVIEW – WASHINGTON (cont.)

- Notable WUTC Wholesale Conditions that go beyond the FCC Conditions:
  - Switched access charge reductions
  - OSS replacement review proceeding could include third-party testing
  - Single POI of interconnection

STATE COMMISSION REVIEW – WASHINGTON (cont.)

Separate Statement of Chairman Goltz

- I do not think it is self-evident that the "no harm" standard is the correct one.
- In this proceeding Qwest suggests that we should derive some meaning from the 2009 legislation that established a "net benefits" standard for transfers of property by energy utilities.
- I do not share Qwest's inference about any legislative intent with regard to telecommunications property transfers as a consequence of a change to the statute governing energy property transfers.
- A "net benefits" test would seem to be at least minimally more consistent with our mission to balance these competing interests. Further, as a practical matter, the Commission has sought to ensure that ratepayers actually benefit from property transfers.

OREGON'S TWIST –
THE "MOST FAVORED STATE" CONDITION

- ". .. it is important that the Commission have available to it the collective expertise and wisdom of numerous other agencies who must also examine the issues faced in Oregon."
- "numerous approval orders by various states and the FCC have been issued only very recently. As a result, there has not been adequate time to review the relevant provisions contained in each order."
- the Conditions may be expanded or modified as a result of regulatory decisions in other states and the FCC including conditions imposed by settlements or other commitments related to this merger.

UNINTENDED CONSEQUENCES

- Some of the “Retail” Conditions State Commissions Impose Have Unintended Impacts on Competition
  - Broadband conditions
  - Retail rate freezes

DISCUSSION

- Open Discussion of the Impact of ILEC Mergers on the Competitive Landscape
  - Opportunities for the smaller competitors?
  - Impact on competitors as vendors to the ILECs?