- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

IN THE MATTER OF THE JOINT APPLICATION FOR QWEST COMMUNICATIONS, INC. AND CENTURY/TEL, INC. FOR APPROVAL OF INDIRECT TRANSFER OF CONTROL OF QWEST CORPORATION, QWEST COMMUNICATION COMPANY, LLC, AND QWEST LD CORPORATION.	)))	**DOCKET NO. 10-049-16** **DPU Exhibit No. 2.0**

DIRECT

TESTIMONY

OF

CLAIR OMAN

DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

AUGUST 30, 2010

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH THE DIVISION OF PUBLIC UTILITIES.

A. My name is Clair Oman. My business address is Heber M. Wells Building, 160 East 300 South, 4th Floor, Salt Lake City, Utah. I am employed as a Utility Analyst for the State of Utah in the Division of Public Utilities. I am testifying on behalf of the Division of Public Utilities (DPU).

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I received a Bachelor of Science degree from Utah State University and am a Licensed CPA in the state of Utah.

Q. BRIEFLY DESCRIBE YOUR EMPLOYMENT EXPERIENCE?

A. I began my career as an accountant for Beehive Medical Electronics following which I was employed by small CPA firm as an audit supervisor. My next position was Chief Financial Officer for what is now Emery Telecom for more than ten years. I have been employed by the Division of Public Utilities for four years.

Q. **HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE UTAH PUBLIC SERVICE COMMISSION?**

A. Yes, I have testified before the Commission as an expert witness representing the DPU in Dockets 02-2270-01 and 07-2419-03.

II. PURPOSE OF TESTIMONY

Q. PLEASE STATE AND SUMMARIZE THE PURPOSE OF YOUR TESTIMONY.

A. Qwest Communications International, Inc. ("QCII") and CenturyTel, Inc ("CenturyLink") filed a Petition May 19, 2010 requesting the Utah Public Service Commission ("Commission") approve the indirect transfer of control of QCII's operating subsidiaries, Qwest Corporation ("Qwest Corp"), Qwest LD Corporation ("QLDC") and Qwest Communications Company LLC ("QCC") (collectively "Qwest") to CenturyLink.

My testimony will focus on my review of the application filed by the Joint Applicants and whether their petition to merge meets the requirements outlined in Utah Code Ann. §§ 54-4-28, 54-4-29 and 54-4-30, is in the public interest and merits the approval of the Utah Public Service Commission.

I have reviewed the application and find many of the assertions believable if not compelling. It is reasonable that there will be a net benefit as a result of the merger even though in data requests the merging companies were either unwilling or unable to quantify the net benefits. There are economies of scale to be found in the combination of these two organizations. The ability of the management team to lead the organization, and to realize the benefits as indicated by the application is the challenge, as I suppose is the case with any merger. It appears from the representations included in the application that the CenturyLink side of the organization will provide the innovative management impetus and the Qwest organization will provide much of the business base and a complementing rate base. The application portrays part of these net benefits in stating that "The increased scale, more diverse mix of offerings and stronger product pipeline of the combined company will provide a compelling array of products of services to better serve its post-transaction customers." [1] The application asserts there are $575 million annually of operating cost synergies and $50 million of capital expenditure synergies[2]. These synergies are not a given, but are to be proven by management and staff in the competitive marketplace.

Q. **PLEASE GIVE A BRIEF SYNOPSIS OF THE FINANCIAL BACKGROUND OF QWEST.**

A. Qwest has had some unfortunate financial mishaps beginning with the merger with Qwest when it was U S West. It is general knowledge

[1] Joint Application of Qwest Corporations International, Inc. and CenturyTel, Inc. Docket 10-049-16, page 12

[2] Exhibit JSG-1 page 13

that Qwest was allegedly mismanaged and slipped into significant corporate debt. Qwest has since struggled with the effects of this debt and the declining land line market. This is one area where CenturyLink management has shown the ability to slow the loss of land lines in its areas. It does not appear that Qwest has ever shed the giant Bell Operating Company ("BOC") management mentality and transformed itself into a formidable competitor in the telecom industry. The lack of wireless and satellite services offerings by Qwest increases the difficulty of being a viable competitor in the large metropolitan markets. Over the last three years Qwest has not been able to slow the decline in revenues and market share even though it has significant assets that this merger proposes to use to boost the competitiveness of the combined company. The Qwest fiber network is one of these significant assets that will provide connectivity between the serving areas of both companies and increase the competitiveness. Qwest has been able to reduce its debt but not without coincident equity slide further into the negative. As a result the expectation in the telecommunications industry have been that Qwest would be purchased or merged with some organization that could bring the necessary elements to form a more able competitor. The declining revenues and negative equity position has increased the difficulty of

Qwest's ILEC operations by placing its credit ratings one level above the junk bond area.[3] The debt schedule indicates nearly a doubling of debt maturity in 2012 which could pose a challenge for the company. Qwest's net debt to adjusted EBITDA leverage ratio for year ending 2009 was 2.7, which is equal to the fourth quarter 2009 but an improvement over 2008 of 2.9.[4]

Q. **PLEASE GIVE A BRIEF SYNOPSIS OF THE FINANCIAL BACKGROUND OF CENTURYLINK.**

A. CenturyLink provides telecom services to primarily rural communities where it typically faces less competition than companies in urban centers. The acquisition of Embarq in 2009 added exposure to a handful of large markets, but CenturyLink still has a solid rural leaning. CenturyLink has a significant history of successful acquisitions and integrations during the past ten years. This history has been delineated in testimony filed by Jeff Glover.[5] The merger of these two companies appears to have positive potential for both companies and to the Utah customers of Qwest. The significant fiber network that Qwest brings to the combined company will reduce the lease requirements of the CenturyLink companies and boost the

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[3] Debt Schedule & Credit Ratings */Qwest Investor Relations* from Investor.qwest.com attached as Exhibit 2.1

[4] http://news.qwest.com Release of 2009 yearend financial information.

[5] Direct Testimony of Jeff Glover Docket No. 10-049-16

revenues for the combined companies. As indicated in testimony and the application the purchase economies of scale will provide some of the synergies to the combined company.[6] CenturyLink has released its 2010 second quarter report and indications are that the Embarq integration is going well.[7]

Q. WHAT DO YOU MEAN BY THE EMBARQ INTEGRATION?

A CenturyLink merged with Embarq in 2009, this merger added approximately 5 million access lines to the CenturyLink name, bringing the total company access lines to 7 million. The integration refers to the assimilation of the Embarq customers into the CenturyLink billing and customer service systems in order to join the two companies accounting systems. The Embarq integration is expected to be complete in the third quarter of 2011

Q. **CAN YOU EXPLAIN WHY THIS ACQUISITION RAISES A CONCERN WITH REGARD TO THE PRESENT PROPOSED QWEST MERGER?**

A. There is a question of the wisdom of instigating an additional merger with to a 10 million access line company during the process of integrating the prior merger with a 5 million access line company. The

[6] Exhibit JSG-1 Page 13

[7] http://ir.centurylink.com

merger may be in the best interests of both companies but the question begs to be asked is it feasible and is this the opportune time?

Q. IN LIGHT OF THE EMBARQ ACQUISITION, WHAT IS CENTURYLINK'S CURRENT FINANCIAL POSITION?

A. CenturyLink's net leverage ratio prior to the merger is approximately 2.3 which significantly betters Qwest's ratio of 2.7.[8] The combined pro forma 2009 net leverage ratio for the combined company is expected to be 2.4 before synergies.[9] From our review of the financial information it appears that the merger of these two companies is a positive transaction and provides Qwest a better financial future picture than is visible absent the merger. Much of the information received in response to data requests included information considered to be "Highly Sensitive Confidential" by the companies and included what I considered information related to the due diligence of the boards of directors of the two companies in considering the merger. This information also indicates to me that the applicants have approached this transaction from a common sense and pragmatic manner in order to be aware of the key risks and concerns that such a merger of two such dissimilar companies poses.

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[8] Exhibit JSG-1 page 3 of Standard & Poor's
[9] Exhibit JSG-1 page 7

Q. WHY DO YOU CONSIDER THESE COMPANIES TO BE DISSIMILAR?

A. I consider the companies dissimilarities as being in two main areas. One is that each now operates in a significantly different competitive arena. The areas that make up the majority of Qwest's customers are large metropolitan markets and thus the competition is significantly higher as in contrast to the typically smaller rural areas that Century Link is accustomed to. CenturyLink's recent Embarq acquisition added exposure in a handful of large markets but not comparable with the number of large markets that the Qwest merger will add. The other significant area of dissimilarity is in the management roots. Qwest appears to be clinging to the management style and focus of a Regional Bell Operating Company which it once was. This in my opinion has made it less nimble competitively and slower to make necessary operational changes in changing environments.

Q. CAN YOU DESCRIBE THE NATURE OF THE RISKS AND CONCERNS YOU ARE REFERRING TO ABOVE?

A Recent telecom merger history has documented well intentioned combinations that either were poorly thought out or were not executed well. Some merged companies were forced into bankruptcy due to failure to accomplish the synergies that were forecast. Others were left to languish in uncompleted integration longer than was projected, pushing the integration cost significantly beyond any reasonable cost overrun amount. These problems can be the result of poor estimates or failure for management to address the causes of failure to meet the estimates early on. I feel that indications are that this merger has been examined thoroughly; although the proper execution remains the responsibility of the combined company's management team after the transaction is consummated.

Q. DOES IT APPEAR AS IF THE JOINT APPLICANTS HAVE BEEN ABLE TO MITIGATE THESE RISKS?

A. The risks of operating the Qwest Companies as they exist pre merger appears to be lessened by the merger the synergies (although not fully quantifiable at this time) seem to exist, and the harvesting of those benefits will be the challenge of the combined staff and management of both companies. In his testimony, Jeff Glover visits the credit rating issue. He indicates that the credit rating issued by rating agencies applicable to the combined company's debt has a significant impact upon debt cost. It appears that the credit rating issue and therefore the effect on the cost of debt for the merged company will continue to be a challenge through the next few years. But given the positive expectation created by CenturyLink's management of the post-merger company, it is expected that the credit rating would not fall below investment grade for a long period of time, if at all.

Q. **WHAT ARE SOME OF THE FINANCIAL BENEFITS TO QWEST/CENTURYLINK AS A RESULT OF THIS MERGER?**

A. The merged company will have the benefit of a lower net debt to adjusted EBITDA leveraged ratio and possibly a higher credit rating than Qwest. This could translate into a lower cost of debt thus enabling the CenturyLink management team to do what it has excelled at in the past which is reduce debt. This in turn will allow some cash flow previously allocated to debt service costs to be allocated to capital expenditures.

Q. WHAT ARE THE WEAKNESSES OF THE MERGED COMPANIES?

A. The merger will move the CenturyLink management team into significantly more large metropolitan markets where competition tends to be much higher. The customer gains will tend to be much harder to accomplish and the progress slower. The slowing of the land line loss will also be a more difficult battle than they may be accustomed to. This will give the management team a challenge to harvest the synergies and also the revenue benefit, of the more marketable combination of plant that the application indicates that the merger will be joined together by the merger. There are some compliance issues that CenuturyLink will have to deal with regarding Section 271 of the Telecommunications Act of 1996 - That issue will be dealt with in Casey Coleman's testimony for the Division. CenturyLink has indicated that the integration costs of this merger will be $1 billion.

Q. **WHAT IS THE DIVISION OF PUBLIC UTILITIES POSITION ON THIS MERGER?**

A. Based only upon the financial and business analysis, the DPU believes the Commission should approve the merger with the conditions that are outlined in Mr. Coleman's testimony.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.