

1 **Public Interest Analysis**

2 *Merger Benefits*

3

4 **Q. In your opinion, what are the most significant attributes of the proposed merger?**

5 A. The merger would combine companies with fundamentally different strengths and weaknesses;
6 as a result, the combination has a unique potential for generating substantial profits for
7 shareholders. US West has a long history as the dominant provider of local and intraLATA
8 services within its 14 state region, and it owns and operates a very extensive network within
9 that region. In contrast, Qwest is a much younger company, with a relatively brief operating
10 history. However, it has already built and is currently operating one of the few nationwide fiber
11 optic networks. None of the other Regional Bell Operating Companies can make that claim.
12 The few other firms that operate comparable nationwide networks (e.g. AT&T and MCI
13 Worldcom) do not enjoy the benefits of also operating a region-wide incumbent local exchange
14 carrier.

15 The closest analogous situation is enjoyed by Sprint, which is the third largest
16 interLATA carrier in the country, and operates as an incumbent local exchange carrier in
17 various parts of the country. However, Sprint doesn't enjoy the benefits of dominating local
18 telecommunications markets throughout a contiguous, multi-state region. Moreover, Sprint's
19 local exchange operations are widely scattered, and they are primarily located in small, low
20 density markets. Sprint dominates the Las Vegas and Tallahassee markets, whereas US West
21 dominates a much longer list of major metropolitan markets, including Boise, Denver,
22 Minneapolis, Omaha, Phoenix, Portland, Salt Lake City, Seattle, and Tucson. While the list of
23 major metropolitan areas served by SBC and Bell Atlantic is even more impressive, these
24 carriers don't operate nationwide networks like Qwest. If they want to enter the national
25 interLATA market, they will need to risk enormous amounts of capital in building a national
26 network, or they will be forced to rent capacity from competitors like Qwest or MCI

1 Worldcom. Either way, the other Regional Bell Operating Companies will be burdened with
2 risks and costs which the Qwest and US West combination will avoid.

3
4 **Q. Do you agree with the companies' claim that the public can benefit from the merger?**

5 A. Yes, to a degree. By combining US West's local and intraLATA networks with Qwest's
6 national fiber optic network, the merged entities will be uniquely positioned to provide a wide
7 array of traditional telephone services, Internet services, and broadband services to customers
8 throughout the country. However, it is certainly less than clear what these services will be, or
9 which customers will benefit from them. Qwest states that "the merger will create additional
10 opportunities to develop and release new products and services more quickly than would
11 otherwise be economically or technically possible for either company absent the merger."
12 [Response to AT&T IR 1-14]. However, with regard to what these services will be, Qwest
13 states:

14
15 Qwest and US West do not yet have a detailed prediction of future
16 technological developments and economic variables. As a result, a precise
17 description of the anticipated "expanded and innovative service offerings" does
18 not exist. In addition, no decisions have been made regarding specific
19 deployment of new services by the combined company post-merger. [Id.].
20

21 Similarly, the companies have not performed any analyses regarding "the details of utilizing or
22 interfacing the companies' respective networks". [See, Response to Staff IR 1-13]. Without
23 any detail regarding the companies' plans to integrate their networks or the additional services
24 the combined company will be able to provide, it is difficult to pass judgement on the extent to
25 which customers will benefit from "new and innovative services" and "one stop shopping".
26 More importantly, as I discuss later in my testimony, assuming such benefits will result, it is
27 difficult to determine the extent to which Arizona ratepayers in general and Arizona residential

1 customers in particular will be the beneficiaries of new and improved product offerings. It is
2 easy to see the benefits of combining one of the Regional Bell Operating Companies with one of
3 the few carriers that operates a nationwide fiber optic network, from the perspective of their
4 stockholders. It is more difficult to visualize the benefits to the public. Potentially, customers in
5 non-US West regions could potentially benefit if the merged companies are effective in
6 breaking down the monopoly power enjoyed by the incumbent local exchange carriers which
7 dominate those regions. It is more difficult to assess the potential for benefits which might flow
8 to members of the public in the US West region.

9
10 **Q. What about the companies' claim that synergies and cost savings will result in**
11 **increased investment in services and infrastructure?**

12 A. Again, the companies have provided very little detail regarding the extent to which these savings
13 and synergies are likely to occur, and how any cost decreases or revenue increases might
14 benefit the public. Qwest does state that a portion of the savings resulting from the merger and
15 funds made available from decreased dividends will go towards certain out-of-region services
16 and facilities. [Response to AT&T IR 1-5]. However, the companies are much less forthcoming
17 with regard to the remaining synergies, and the extent to which any such savings will be spent
18 on infrastructure or other improvements within US West's region. "The companies have not yet
19 made specific decisions with respect to the amount or timing of investments, nor have they
20 made specific decisions regarding services and technologies that will be invested in". [Qwest
21 Response to AT&T IR1-87].

22 US West witness Maureen Arnold claims that "customers throughout Arizona and
23 elsewhere in the 14 state region should be the first beneficiaries of all of the benefits that this
24 merger will bring". [Arnold, p. 11]. When asked to elaborate on and provide details regarding
25 this claim, US West simply stated that "it is too early to quantify specific benefits". [See,
26 Response to Staff IR 4-90]. Similarly, US West states that there is no budget for capital

1 expenditures by the combined company in Arizona for years 2000 and beyond. [Response to
2 AT&T IR 1-19]. In fact, the claim itself seems rather questionable. Most of the benefits arise
3 out of the unique combination of nationwide and regional/local networks and expertise; but
4 initially the combined companies won't be allowed to bundle local and interLATA services
5 within the US West region. Consequently, it is hard to see how customers in the US West
6 region will gain much from this combination unless and until Section 271 authority is granted.
7 Logically, then, the first beneficiaries would seem to be Qwest customers in other regions, for
8 example, when they place calls to the US West region. Also, if Qwest decides to expand its
9 competitive local exchange operations in other regions, customers in those areas may benefit
10 from expertise which is obtained from US West.

11 It is quite possible that the merger will result in significant cost savings and other
12 synergies. However, it is not clear whether these savings will flow entirely to Qwest
13 stockholders, or whether some of the benefits will be shared with out-of-region customers, in
14 region customers, or some combination of the two groups.

15
16 **Q. Do you agree with the companies' claim that after the merger they will be in a better**
17 **position to compete with other newly merged telecommunications providers?**

18 A. Yes. Consolidation is the current trend in the telecommunications industry. Major players in
19 both the local and long distance markets are positioning themselves to better survive the
20 anticipated trend towards more intense competition. The combination of US West and Qwest
21 will result in a firm that definitely will be in a better position to compete with other very large
22 entities, like Bell Atlantic/Nynex/GTE, Pacific Bell/Southwestern Bell/Ameritech, MCI
23 Worldcom/Sprint and AT&T. From the perspective of management and stockholders, the
24 merger clearly offers an improvement in the two companies' competitive posture. From a public
25 interest perspective, however, the picture is more complex, and it depends upon the market
26 being considered: long distance; out-of-region local; or, in-region local.

1 Without a doubt, acquiring US West's 14 state local and intraLATA networks and its
2 more than 25 million end users will put Qwest in a better position to compete in the interLATA
3 market against market leaders such as AT&T, MCI and Sprint. The Qwest network has
4 rapidly grown to include approximately 20,000 miles of fiber optic cable in North America, and
5 another 1,400 miles in Mexico. [www.qwest.com]. Less than 3 years ago, Qwest had just
6 4,900 route miles of conduit including only 900 miles of lit fiber. [Qwest S-1, April 18, 1997,
7 p. 3]. Over the past few years, Qwest has rapidly deployed an extensive national network; the
8 major challenge it faces is obtaining the traffic it needs to fill this network. Qwest stands to
9 benefit tremendously if it is allowed to provide interLATA service to US West's customers.

10 Acquiring US West will significantly enhance Qwest's ability to compete in the long
11 distance arena; the other carriers operating nationwide networks (e.g. MCI Worldcom and
12 AT&T) do not enjoy the "captive" customer base of an incumbent local exchange carrier which
13 can feed traffic into their networks. To the extent "one stop shopping" becomes increasingly
14 feasible and important, it is likely that this trend will favor the dominant local exchange carriers,
15 rather than the long distance carriers. Giving your long distance business to your local carrier
16 will seem natural, and relatively risk free. The reverse choice (having your long distance carrier
17 take over your local phone service) is certainly a possibility, but most customers won't be as
18 inclined to seriously pursue this option. This difference in market dynamics follows logically
19 from the inertia that is currently associated with local service; unless they've moved to a new
20 city that is served by a different carrier, most customers have used the same carrier for their
21 entire lives. They've never even considered the option of changing local carriers, much less
22 overcome the associated complexities and logistics. In contrast, many customers have plenty of
23 experience with switching long distance carriers. It is quick and easy and cheap. Some
24 customers even change long distance carriers on a frequent basis, depending upon who is
25 offering the best deal of the moment.

26 By acquiring US West, Qwest will greatly enhance its ability to compete against

1 carriers such as Bell Atlantic, Bell South and SBC in their respective regions. Qwest will be
2 able to combine its national broadband network with the knowledge, expertise and
3 management skills and market credibility of a long-established 14-state incumbent local
4 exchange carrier. This combination may prove effective in strengthening its ability to break
5 down barriers to entry into local markets outside of the US West region. If so, the public in
6 those areas will benefit, because Qwest will be able to place increased competitive pressure on
7 the dominant carriers serving those markets.

8 However, the same factors which will strengthen US West's competitive position
9 outside of its region will also serve to strengthen its position within its own region. Long distance
10 carriers and competitive local exchange carriers (CLECs) will find it even more difficult to
11 overcome the competitive advantages enjoyed by US West as the dominant provider of local
12 services within its region. These very advantages cited by the companies, including the ability to
13 bundle local and long distance services once Section 271 authority is obtained, will make it
14 more difficult for other carriers to gain a foothold, or maintain their presence, in
15 telecommunications markets within the US West region.

16
17 **Q. The companies claim that incentives to enter the in-region interLATA market will**
18 **actually facilitate competition in US West's local markets. Do you agree with this**
19 **claim?**

20 A. Yes and no. I agree that US West will have a strong incentive to gain Section 271 approval,
21 because it will be anxious to use fill its nationwide network with traffic generated in the US
22 West region. And, it will be anxious to fill in the "14 state hole" that will result from Qwest's in
23 region interLATA divestiture. However, US West already has a strong incentive to obtain
24 Section 271 authority, and it is likely to gain this authority at some point in the future regardless
25 of whether or not the merger occurs. Unfortunately, with or without the merger, US West has
26 an economic incentive to do the bare minimum necessary to gain entry into the in-region

1 interLATA market. From US West's perspective, the less it can do to open its local markets,
2 and the more it can retain a dominant share of those markets, the better. From the perspective
3 of a Regional Bell Operating Company, the ideal outcome is to obtain Section 271 authority
4 while doing as little as possible to actually break down barriers to entry into its markets.

5 The economics incentives are not changed much by the proposed merger. With or
6 without the merger, US West is anxious to obtain Section 271 authority. Either way, it is
7 anxious to retain as large a share of the market as possible. Either way, it wants to reduce
8 barriers to entry into its markets as little as possible. Certainly, if the merger is approved US
9 West will have a stronger incentive to obtain Section 271 authority, but it won't have an
10 incentive to open its markets one iota more than the minimum necessary to obtain that authority.
11 Joining forces with Qwest will not fundamentally change this situation, and there is no reason to
12 assume that US West's markets will be opened wider to competition simply because the
13 combined company will have a strong incentive to obtain Section 271 authority.

14
15 **Q. Can you summarize your opinion of the potential benefits associated with the merger**
16 **of Qwest and US West?**

17 A. The primary beneficiaries of the proposed merger will be the companies and their stockholders.
18 Consumers outside of US West's region may also benefit, if the combined companies become
19 more aggressive in trying to gain market share in other parts of the country. The merger may
20 enable the combined companies to offer new and innovative services to its customers.
21 However, the company has provided no detail regarding any plans to provide such services.
22 Furthermore, increased service offerings and innovative new products are the expected result of
23 competition. The company has not shown how the merger will result in any products and
24 services that wouldn't naturally arise out of the ongoing trend towards increased competition.
25 The merger will also result in cost savings and other synergies. However, the companies
26 contend that any such benefits are speculative, and they have not made any commitment to

1 share the benefits with their in-region customers. [See, e.g., Response to AT&T IR 1-5]. To
2 the extent these benefits do occur, it seems likely that they will primarily result in increased
3 profits for stockholders, and perhaps secondarily these synergies will result in increased
4 investments—most likely outside the US West region.

5 The merger will produce a stronger company that will be in a better position to compete
6 in the local and long distance markets. However, the long distance markets are already
7 relatively competitive, with AT&T's market share dropping to approximately 50% of total
8 access minutes. [See, FCC Long Distance Market Share Report]. The combined entity may be
9 successful in taking away a substantial chunk of this market share, but the net impact on
10 consumers will not be as great as if the long distance market were currently a monopoly. In
11 contrast, within US West's 14 state region, the merger may result in prolonging US West's
12 market power. To the extent the merger makes it easier for an already dominant carrier to
13 continue to dominate the market, the net effect can hardly be described as ideal outcome, at
14 least from a public interest perspective.