

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

In the Matter of)	
)	
Application for the Transfer of Control)	WC Docket No. 08-238
Of Embarq Corporation)	
to CenturyTel, Inc.)	

**Reply Comments of
Communications Workers of America**

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I. INTRODUCTION AND SUMMARY

The Communications Workers of America (“CWA”) and the International Brotherhood of Electrical Workers (“IBEW”) submit these reply comments on the application of CenturyTel, Inc. (“CenturyTel”) and Embarq Corporation (“Embarq”) to transfer control of Embarq to Century Tel,¹ pursuant to the pleading cycle established by the Commission.²

CWA and the IBEW represent 1.45 million employees in communications, media, construction and maintenance, utilities, airlines, manufacturing, and public service. The CWA and IBEW represent 3,600 workers employed by Embarq and 1,600 workers employed by CenturyTel. We are vitally concerned with the outcome of this proceeding because our members and their families will be affected by the merger in terms of their interests as workers, consumers and residents. Indeed, this transaction could adversely affect the economic health of their states and local communities.

CWA and IBEW substantially concur with the many concerns raised by the New Jersey Division of Rate Counsel (“New Jersey Rate Counsel”).³ The New Jersey Rate Counsel convincingly demonstrates that the Applicants have failed to provide the Commission with sufficient information to evaluate the impact of the transaction on consumers. The Applicants have provided virtually no financial documentation to support their claim that the merged entity will be financially fit, nor have they provided any evidence to demonstrate their vague assertions

¹ Application to Transfer Control of Domestic Authorizations Held by Embarq Corporation to CenturyTel, Inc. Under Section 214 of the Communications Act, WC Docket No. 08-238, Nov. 25, 2008 (“Application”).

² Public Notice, Applications Filed for the Transfer of Control of Embarq Corporation to CenturyTel, Inc., WC Docket No. 08-238, Dec. 9, 2008 (rel).

³ Comments of the New Jersey Division of Rate Counsel, Application to Transfer Control of Domestic Authorizations Under Section 214 of the Communications Act, WC Docket No. 08-238, Jan. 8, 2009 (“Comments of New Jersey Rate Counsel”).

of post-merger synergies. The Commission should require the Applicants to provide more complete and forward-looking financial information, subject to review by all parties to the proceeding, in order to conduct a thorough analysis of the financial viability of the merged entity.

CWA and IBEW have conducted a preliminary analysis of the proposed transaction, based on the sparse information provided in the Application and our review of publicly available documents. Our preliminary analysis concludes that the Applicants fail to demonstrate that the proposed merger will result in a financially fit company. Rather, we conclude that the merged entity will be confronted with managing an urgent competition for resources among operational needs, capital requirements, lenders' demands, and shareholders' hopes for significant payouts. Absent Commission conditions to protect consumers, the merged entity will likely sacrifice investment in capital, operational, and human resources, reducing resources available for quality telephone service and broadband deployment, in order to satisfy the competing demands of lenders and shareholders.

CWA and IBEW also agree with the New Jersey Rate Counsel that the Applicants fail to demonstrate concrete, verifiable benefits from the proposed merger. Rather, the Applicants proffer vague promises of \$400 million in synergies and increased broadband deployment. CWA and IBEW concur with New Jersey Rate Counsel that the Commission should require the Applicants to commit to specific service quality and broadband build-out benchmarks as a condition of merger approval.⁴

In order to protect the public interest in quality, affordable service and rapid deployment of

⁴ Comments of New Jersey Rate Counsel, 21.

broadband services, CWA and IBEW urge the Commission take the following steps:

1. Conduct an Extensive Merger Review and Thorough Analysis. The Commission should conduct an extensive merger review of the proposed transaction since it poses significant risks for the public interest. The Commission should create a complete factual record including all relevant information that was available to CenturyTel's and Embarq's Boards of Directors, management, and advisors, as well as subsequently developed data regarding either of the companies, the transaction, and refined projections regarding the post-merger "new" CenturyTel. The Commission would also benefit from a review of the testimony and cross examination transcripts from state commission proceedings. Once all this information is obtained, the Commission will be able to conduct a thorough financial and operational analyses, including sensitivity analyses, concerning the range of potential and likely results of the combined entity's operations.

2. Impose Conditions to Ensure Public Benefit from the Proposed Transaction. The Commission should impose the following conditions to ensure that the proposed merger serves the public interest with concrete, verifiable benefits.

- a. Limit the amount of dividend payments to shareholders and repurchase of shares by the "new" CenturyTel, conditioned on the company meeting specific service quality and broadband commitments. We recommend that the Commission set a maximum Leverage Ratio that would require the "new" CenturyTel to suspend payments to shareholders (dividends or share repurchases) if they exceed that ratio. This is especially important since it appears that CenturyTel has used federal Universal Service Fund support to finance above-industry-average dividend payments to shareholders.
- b. Require service quality improvements based on performance as measured by the FCC in its ARMIS reports and/or equivalent measurements required by the State regulatory authorities.
- c. Require build-out of broadband services throughout the region by 2010.
- d. Require expansion of IPTV services to at least 25 markets by 2010.

II. STANDARD OF REVIEW AND PUBLIC INTEREST FRAMEWORK

Pursuant to sections 214(a) and 310(d) of the Communications Act, the Commission must determine whether the Applicants have demonstrated that the proposed transfer of control of Embarq's licenses and authorizations to CenturyTel will serve the public interest,

convenience, and necessity.⁵ The Commission considers whether the proposed transaction could result in public interest harms by substantially frustrating or impairing the objectives or implementation of the Communications Act or related statutes.

The public interest standards of sections 214(a) and 310(d) involve a balancing process that weights the potential public interest harms of the proposed transaction against the potential

⁵ 47 U.S.C. §§ 214(a), 310(d).

public interest benefits.⁶ The Applicants bear the burden of proving, by a preponderance of the evidence, that the proposed transaction serves the public interest.⁷ As the harms to the public

⁶ See, e.g. *AT&T Inc. and BellSouth Corporation Application for Transfer of Control*, WC Docket No. 06-74, Memorandum Opinion and Order, March 26, 2007, para.19 (March 26, 2007 rel)(“*AT&T/BellSouth Order*”); *SBC Communications, Inc. and AT&T Corp. Applications for Approval of Transfer of Control*, WC Docket No. 05-65, Memorandum Opinion and Order, 20 FCC Rcd 18300, para 16 (2005) (“*SBC/AT&T Order*”), *Verizon Communications, Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, WC Docket No. 05-75, Memorandum Opinion and Order, 20 FCC Rcd 18443, para. 16 (2005) (“*Verizon/MCI Order*”), Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation For Consent to Transfer Control of Licenses and Authorizations, WT Docket 04-70, *Memorandum Opinion and Order*, para. 40, Oct. 26, 2004 (rel) (“*Cingular-AT&T Order*”); Applications for Consent to the Assignment of Licenses Pursuant to Section 310(d) of the Communications Act from NextWave Personal Communications, Inc., Debtor-in-Possession, and NextWave Power Partners, Inc., Debtor-in Possession, to Subsidiaries of Cingular Wireless LLC, WT Docket 03-217, *Memorandum Opinion and Order*, 19 FCC Rcd. At 2580-81 para. 24 (2004) (“*Cingular-NextWave Order*”); General Motors Corporation and Hughes Electronics Corporation, Transferors, and The News Corporation Limited, Transferee, MB Docket No. 03-124, *Memorandum Opinion and Order*, 19 FCC Rcd. at 483 para. 15 (2004) (“*GM-News Corp. Order*”); WorldCom, Inc. and Its Subsidiaries (Debtors-in-Possession), Transferor, and MCI, Inc., Transferee, WC Docket No. 02-215, *Memorandum Opinion and Order*, 18 FCC Rcd. 26,484, 26,492 para. 12 (2003) (“*WorldCom-MCI Order*”); Applications for Consent to the Transfer of Control of Licenses from Comcast Corporation and AT&T Corp., Transferors, to AT&T Comcast Corporation, Transferee, MB Docket No.02-70, *Memorandum Opinion and Order*, 17 FCC Rcd. 23,246, 23,255 para. 26 (2002) (“*AT&T-Comcast Order*”); Application of EchoStar Communications Corporation (A Nevada Corporation), General Motors Corporation, and Hughes Electronics Corporation (Transferors) and EchoStar Communications Corporation (A Delaware Corporation) (Transferee), CS Docket No. 01-348, *Hearing Designation Order*, 17 FCC Rcd. at 20,574 para. 25 (2002) (“*EchoStar-DirecTV HDO*”); VoiceStream Wireless Corporation, PowerTel, Inc., Transferors, and Deutsche Telekom AG, Transferee, IB Docket No. 00-187, *Memorandum Opinion and Order*, 16 FCC Rcd. 9779, 9789 para. 17 (2001) (“*Deutsche Telekom-VoiceStream Order*”); GTE Corporation, Transferor, and Bell Atlantic Corporation, Transferee, CC Docket No. 98-184, *Memorandum Opinion and Order*, 15 FCC Rcd. at 14,045, 14,046 paras. 20, 22 (2002) (“*Bell Atlantic-GTE Order*”); Applications of VoiceStream Wireless Corporation or Omnipoint Corporation, Transferors, and VoiceStream Wireless Holding Company, Cook Inlet/VS GSM II PCS, LLC, or Cook Inlet/VS GSM III PCS, LLC, Transferees, *Memorandum Opinion and Order*, 15 FCC Rcd. 3347 para. 12 (2000) (“*VoiceStream-Omnipoint Order*”); AT&T Corp., British Telecommunications, PLC, VLT Co. L.L.C, Violet License Co. LLC, and TNV [Bahamas] Limited Applications, IB Docket No. 98-212, *Memorandum Opinion and Order*, 14 FCC Rcd. at 19,150 para. 20 (1999) (“*AT&T Corp.-British Telecom. Order*”); Application of WorldCom, Inc. and MCI Communications Corporation for Transfer of Control of MCI Communications Corporation to WorldCom, Inc., CC Docket No. 97-211, *Memorandum Opinion and Order*, 13 FCC Rcd. At 18,031 para. 10 (1998) (“*WorldCom-MCI Order*”); Applications to Assign Wireless Licenses from WorldCom Inc. (Debtor-in-Possession) to Nextel Spectrum Acquisition Corp., WT Docket No. 03-203, *Memorandum Opinion and Order*, 19 FCC Rcd. at 6241-42 para. 23 (WTB, MB 2004) (“*Nextel-WorldCom Order*”); Applications of SBC Communications Inc. and BellSouth Corporation, WT Docket No. 00-81, *Memorandum Opinion and Order*, 15 FCC Rcd. at 25,464, 25,467 paras. 13, 18 (WTB, IB 2000) (“*SBC-BellSouth Order*”); Vodafone AirTouch, PLC, and Bell Atlantic Corporation, *Memorandum Opinion and Order*, 15 FCC Rcd. 16,512 , 16,517 paras. 13, 25 (WTB, IB 2000) (“*Bell Atlantic-Vodafone Order*”).

interest become greater and more certain, the degree and certainty of the public interest benefits must also increase commensurately.⁸

The Commission's public interest evaluation encompasses the "broad aims of the Communications Act"⁹ which include, among other things, the preservation and advancement of universal service, the accelerated deployment of advanced services, and whether the merger will affect the quality of communication services.¹⁰

⁷ See, e.g., *AT&T/BellSouth Order*, at para. 19; *SBC/AT&T Order*, 20 FCC Rcd at 18300, para 16; *Verizon/MCI Order*, 20 FCC Rcd at 18443, para. 16; *Cingular-AT&T Order* 19 FCC Rcd at 21542-44, para. 40; *Cingular-NextWave Order*, 15 FCC Rcd. at 2581 para. 24; *GM-News Corp. Order*, 19 FCC Rcd. at 483 para. 15; *AT&T-Comcast Order*, 17 FCC Rcd. at 23,255 para. 26; *EchoStar-DirectTV HDO*, 17 FCC Rcd. at 20,574 para. 25; *Bell Atlantic-GTE Order*, 15 FCC Rcd. at 14,046 para. 22; *VoiceStream-Omnipoint Order*, 15 FCC Rcd. at 3347 para. 11; *SBC-BellSouth Order*, 15 FCC Rcd. at 25,464 para. 13; *Bell Atlantic-Vodafone Order*, 15 FCC Rcd. at 16,512 para. 13; Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from Tele-Communications, Inc., Transferor, to AT&T Corp., Transferee, CS Docket No. 98-178, *Memorandum Opinion and Order*, 14 FCC Rcd. 3160, 3169 para. 15 (1999) ("*AT&T-TCI Order*"); *WorldCom-MCI Order*, 13 FCC Rcd. at 18,031-32 para.10.

⁸ *AT&T/MediaOne Order* para 154 quoting from *SBC-Ameritech Order* 14 FCC Rcd at 14825; *Bell Atlantic-NYNEX Order*, 12 FCC at 20063 para. 157.

⁹ See *Cingular-AT&T Order*, at para. 41; *GM-News Corp. Order*, 19 FCC Rcd. at 483 para. 16; *AT&T-Comcast Order*, 17 FCC Rcd. at 23,255 para. 27; *EchoStar-DirectTV HDO*, 17 FCC Rcd. at 20,575 para. 26; Applications for Consent to the Transfer of Control of Licenses and Section 214 Authorizations from MediaOne Group, Inc., Transferor, to AT&T Corp., Transferee, CS Docket No. 99-251, *Memorandum Opinion and Order*, 15 FCC Rcd. 9816, 9821 para. 11 (2000) ("*AT&T-MediaOne Order*"); *VoiceStream-Omnipoint Order*, 15 FCC Rcd. at 3346-47 para. 11; *AT&T Corp.-British Telecom. Order*, 14 FCC Rcd. at 19,146 para. 14; *WorldCom-MCI Order*, 13 FCC Rcd. at 18,030 para. 9.

¹⁰ See *AT&T/BellSouth Order*, para. 20; *SBC/AT&T Order*, 20 FCC Rcd at 18301, para. 17; *Verizon/MCI Order*, 20 FCC Rcd at 18443-44, para. 17; *Cingular-AT&T Order*, at 19 FCC Rcd at 21544, para. 41; *AT&T-Comcast Order*, 17 FCC Rcd. at 23,255 para. 27; *AT&T-MediaOne Order*, 15 FCC Rcd. at 9821-22 para. 11; *WorldCom-MCI Order*, 13 FCC Rcd. at 18,031 para. 9.

In its evaluation, the Commission must consider whether the new entity will have the requisite financial, technical, and other qualifications to provide the public interest benefits that the Applicants claim the transaction will provide.¹¹

The Commission's public interest authority enables the Commission to impose and enforce narrowly tailored, transaction-specific conditions that ensure that the public interest is served by the transaction.¹² Section 214(c) of the Act authorizes the Commission to attach to the certificate "such terms and conditions as in its judgment the public convenience and necessity may require."¹³ Indeed, the Commission's public interest authority enables the Commission to rely upon its extensive regulatory and enforcement experience to impose and enforce conditions to ensure that the merger will yield overall public interest benefits.¹⁴

¹¹ Sprint-Nextel "will demonstrate that the New Local Company will possess the requisite financial strength, in addition to managerial and technical capability, to fully perform its public service obligations." Letter from Gary D. Foressee, Chairman and CEO, sprint corp., and Timothy M. Donahue, President and CEO Nextel Communications, Inc., to Ms. Marlene H. Dortch, Secretary, FCC, WT Docket No. 05-63 (filed Aug. 2, 2005) *See Sprint-Nextel Order* at 183 and fns. 431 – 434.

¹² *See, e.g., AT&T/BellSouth Order* at para. 22; *SBC/AT&T Order*, 20 FCC Rcd at 18302, para. 19; *Verizon/MCI Order*, 20 FCC Rcd at 184445, para. 19; *Bell Atlantic-GTE Order*, 15 FCC Rcd. at 14,047 para. 24; *AT&T Corp.-British Telecom. Order*, 14 FCC Rcd. at 19,150 para. 15; *WorldCom-MCI Order*, 13 FCC Rcd. at 18,032 para. 10; *Deutsche Telekom-VoiceStream Wireless Order*, 16 FCC Rcd. 9779 (2001); *Cingular-AT&T Order* paras. 251-267 (2004); *Sprint-Nextel Order* at para. 23.

¹³ *AT&T/BellSouth Order* at para. 22; *SBC/AT&T Order*, 20 FCC Rcd at 18302, para. 19; *Verizon/MCI Order*, 20 FCC Rcd at 184445, para. 19; *Cingular-AT&T Order* at 43 (2004); *GM/News Corp.*, 19 FCC Rcd at 477 para 477; *Bell Atlantic-GTE Order*, 15 FCC Rcd. at 14,047 para. 24; *AT&T Corp.-British Telecom. Order*, 14 FCC Rcd. at 19,150 para.15; *WorldCom/MCI Order*, 13 FCC Rcd at 18304-35 para 14; *In the Matter of Applications for Consent to the Assignment and/or Transfer of Control of Licenses Adelfia Communications Corporation (and subsidiaries, debtors-in-possession), Assignors to Time Warner Cable In. (subsidiaries), Assignees; Adelfia Communications Corporation, (and subsidiaries, debtors-in-possession), Assignors and Transferors, to Comcast Corporation (subsidiaries), Assignees and Transferees; Comcast Corporation, Transferor, to Time Warner, Inc., Transferee; Time Warner Incl, Transferor, to Comcast Corporation Transferee*, Memorandum Opinion and Order (July 21, 2006 rel.) at para. 28 ("*Adelfia-Comcast-Time Warner Order*"); *Sprint-Nextel Order* at para. 23.

¹⁴ *See, e.g., Cingular-AT&T Order* at 43 (2004); *GM-News Corp. Order*, 19 FCC Rcd. at 477 5; *Bell Atlantic-GTE Order*, 15 FCC Rcd. at 14,047-48 para. 24; *WorldCom-MCI Order*, 13 FCC Rcd. at 18034-35 para. 14; *Schurz Communications, Inc. v. FCC*, 982 F.2d 1043, 1049 (7th Cir. 1992); *Adelfia-Comcast-Time Warner Order* at para. 28; *Sprint-Nextel Order* at para. 23.

III. THE COMMISSION SHOULD CONDUCT AN EXTENSIVE MERGER REVIEW OBTAINING ALL NECESSARY DOCUMENTS AND THOROUGHLY ANALYZING THE APPLICANTS' PROJECTIONS AND ASSUMPTIONS IN ORDER TO PROPERLY EVALUATE THE IMPACT OF THE SALE ON THE PUBLIC INTEREST

The Commission's decision in this case will directly affect nearly eight million telephone consumers and more than two million broadband subscribers in 33 states. The merged entity will rank as the fifth largest telephone company in the country. The proposed transaction will also affect economic development in these states and in local communities not just in terms of basic services but also in terms of advanced services.

The Commission should only issue a decision in this proceeding after it obtains all pertinent documentation including those not made public by the Applicants and after it develops a comprehensive and complete record of data and analyses upon which to reach an informed decision. This record should include a thorough analysis of the Applicants' financial and operational projections as well as the assumptions upon which these projections are based.

The Application presented to the Commission cannot form a basis for any comprehensive analysis of the supposed benefits of the proposed transaction. The Applicants have provided only one sentence to the Commission regarding the future financial viability of the merged entity, and this small tidbit of financial information is based on *backward-looking data*.¹⁵ In contrast, the Applicants' SEC filings are replete with references to *forward-looking* analyses and projections performed by the management of both companies and by three top financial advisory firms, for use by the two companies' boards of directors during their deliberations. Clearly, the companies went to great lengths to develop sophisticated, and almost certainly competing, projections of the

¹⁵ "The post-transaction company is expected to have pro forma revenue in excess of \$8.8 billion." Application, Public Interest Statement, 10.

likely future prospects of the combined entity.

The Application contains vague, unverifiable statements concerning the proposed benefits of the sale. There is no real supporting documentation or specific commitments. These statements amount to unenforceable promises and should not be used by the Commission to reach its decision on the proposed transaction.

The Commission should review all relevant information that was available to CentruyTel's and Embarq's Boards of Directors, management, and advisors as well as subsequently developed data regarding either of the companies, the transaction, and refined projections regarding the post-closing "new" CenturyTel. Further, we recommend that the Commission obtain the record of the technical hearings in the states that are reviewing the proposed merger along with all of the proprietary and/or confidential information that CenturyTel and Embarq will have provided to the state regulatory commissions.

IV. THE PROPOSED TRANSACTION WILL NOT SERVE THE PUBLIC INTEREST

CWA and IBEW have conducted a preliminary analysis of the proposed transaction, based on our review of publicly available documents. (We could not base an analysis on financial information provided to the Commission, since the Applicants provided no financial documents to the Commission.) Our preliminary analysis concludes that the Applicants fail to demonstrate that the proposed merger will result in a financially fit company. Rather, we conclude that the merged entity will be confronted with managing an urgent competition for resources among operational needs, capital requirements, lenders' demands, and shareholders' hopes for significant payouts. The financial risks involved in the transaction overwhelm any supposed

benefits. Absent Commission conditions to protect consumers, the merged entity will likely sacrifice investment in capital, operational, and human resources to the competing demands of lenders and shareholders.

The New Jersey Rate Counsel cites CenturyTel's Form S-4 SEC filing in which CenturyTel itself cites the significant and numerous risks posed by the transaction. They include: increased indebtedness post-merger; proposed reforms to the Universal Service Fund and intercarrier compensation that could reduce CenturyTel's revenues; integration costs; operational issues including employee retention, continuing line loss that will reduce revenues, earnings, and cash flows, and rebranding expenses; capital requirements for the development of CenturyTel's 700 MHz products; among other factors.¹⁶ While these statements may appear to be a pro forma statement of risk, our preliminary analysis indicates that these risks are real and must be thoroughly investigated by this Commission.

CenturyTel and Embarq are the only investment grade "mid-major" telecommunications companies. They have enjoyed steady cash flows and have balance sheets that are appreciably stronger than their peers. As do all telecommunications firms, they face serious competitive and financial challenges. While the companies argue that the proposed transaction will help them meet these challenges, there is also a danger that this merger could only serve to exacerbate negative trends that are already observable.

The interplay of six key factors could seriously affect the combined company's financial fitness:

¹⁶ Comments of New Jersey Rate Counsel, 8-11.

1. What appears to be an imbedded – and accelerating -- line loss trend for both companies with the attendant likely declines in revenues and cash flows;
2. The deep economic downturn which could well exacerbate the companies' line losses and revenue declines, particularly if the recession is more prolonged or severe than expected;
3. The ability of the companies to achieve the \$400 million in annual “run rate” synergies that seem to be an integral part of their plan;
4. The continuing “credit squeeze,” which in combination with high line losses and an extended downturn could make it more difficult or expensive to refinance over \$2.8 billion in debt coming due over the next five years;
5. The companies' high dividends and recent history of significant share repurchases; and,
6. The impact of these five factors on the combined companies' ability to fund known as well as unexpected operational and capital requirements, transition expenses, pension and other-than-pension-employee-benefits (OPEB) shortfalls, and so forth.

a. Accelerating line loss will weaken the merged entity's financial position

It is no secret that the wireline business faces tremendous challenges, with most companies suffering significant losses in market share to cable companies and wireless operators. Embarq lost slightly over six percent of its switched access lines annually in 2006 and 2007, and excluding its acquisition of Madison River's access lines, CenturyTel lost five to six percent of its access lines annually since 2006.¹⁷

¹⁷ Application, Public Interest Statement, 10-11.

Goldman Sachs, in the detailed models it maintains for the two companies, projected (as of January 2, 2009) that through 2012, CenturyTel would have a compounded annual line loss of 5.9 percent and that Embarq would have an even worse annual loss of 8.2 percent. Through 2014, Goldman projected that the annual line losses would be 5.5 percent and 7.6 percent respectively. If the Goldman Sachs projections prove to be accurate, the combined companies will lose 29 percent of their lines over the next four years and 37.3 percent over the next six years. Instead of having the approximately 8 million access lines that the Applicants base their financial case upon, the two companies would be left with around 5.5 million lines in 2012 and only 4.8 million lines in 2014.¹⁸

Of course, wireline companies are well aware of their eroding access lines and attempt to compensate with higher revenue offerings, such as broadband, double/triple/quadruple play packages and so forth. Indeed, Goldman Sachs' model (which appears to be in line with those of other analysts) projects revenue declines that are roughly half on a percentage basis of those reflected by the access line losses; that is, revenue declines of 15.8 percent by 2012 and 20.0 percent by 2014 to \$7.3 billion to \$7.0 billion respectively. However, Goldman believes that operating costs (including depreciation and amortization) are unlikely to decline at the same pace as revenues. Thus, its projections for combined EBITDA of the two firms over the next four and six years is for a decline that is more rapid than that for revenues (-21.3% and -27.7%); under Goldman's model, the combined firm's EBITDA would be \$3.0 billion in 2012 and \$2.8 billion in 2014.

¹⁸ "CenturyTel Model – Telecom Services – Wireline/Wireless" and "Embarq Model – Telecom Services – Wireline/Wireless," Goldman Sachs, January 2, 2009 (both). While these models were updated well after the proposed merger was announced, no attempt is made by Goldman Sachs to project a combined entity. We have arithmetically combined the Goldman Sachs calculations.

Even assuming that all of the \$400 million in claimed synergies are achieved (and not subject to the same downward pressures occasioned by access line, revenue and EBITDA declines) and further assuming that these synergies flow completely to EBITDA, the Goldman model would suggest that the combined companies would generate around \$3.4 billion in EBITDA four years hence and \$3.2 billion six years from now.

The Applicants fail to provide the Commission with any of this documentation – or even better, with the internal documentation provided to their Boards of Directors, management, and advisors as well as subsequently developed data regarding either of the companies, the transaction, and refined projections regarding the post-closing “new” CenturyTel. By limiting their financial “evidence” to unadjusted historic data and unsupported assertions of synergies, the Applicants have failed to demonstrate that the proposed merger will result in a financially fit company.

It is entirely possible for a company to have what appears to be a healthy EBITDA and still have negative net cash flows. The critical point to remember is that EBITDA *excludes* such items as cash taxes, interest, capital expenditures, dividends and debt retirement (it also excludes potential positive cash flows from new borrowings, asset sales, non-cash taxes, etc).

For example, in the calculations we provide (relying on the Goldman Sachs models), the combined company would have an EBITDA of \$3.038 billion in 2012 and \$2.791 billion in 2014.¹⁹ However, the merged entity would also have very large additional cash requirements. Assuming a continuation of roughly \$900 million in dividends,²⁰ the combined interest, tax,

¹⁹ For the sake of clarity in this example, I have excluded any adjustments for “synergies.”

²⁰ Also assuming tax charges are all cash .

capital expenditure and dividend outflows would be \$2.967 billion in 2012 and \$2.864 in 2014, *leaving a net cash flow in this example of a positive \$71 million in 2012 and a negative \$74 million in 2014.* Thus a multi-billion-dollar positive EBITDA can still be generated by a firm with break-even or even negative cash flows.

We would also note that just because they are a part of the cash flows embedded in these calculations, depreciation and amortization are not “free.” They essentially represent repayment for past capital expenditures, but, if not replaced with new capital spending, the company’s productive capacity is likely to atrophy.

A longer or more severe recession would almost certainly result in an even more rapid decline in access lines, even lower revenues, lower EBITDA, and shrinking Free Cash Flow. In turn, the combined company would likely be less able to reduce debt, make needed capital expenditures, or possibly even pay dividends. The companies’ financial structure would come under pressure as lower EBITDA and higher-than-anticipated debt lead to a decline in key metrics employed by lenders and investors to measure the health of the company (leverage ratios, payout ratios, interest coverage), probably leading to ratings downgrades, higher borrowing costs, fewer new product offerings, and so forth.

b. The Applicants do not provide any documentation to support their claim that the post-transaction company will realize \$400 million in “synergies”

The Commission must insist that the Applicants provide more detailed information about the assumed \$400 million synergies that the Applicants claim will result from the proposed transaction. One of the attractions of transactions like this is the potential (not always realized) to achieve various types of cost savings and new revenue opportunities. The companies’ description of the hoped-for synergies, however, is not very enlightening.

To cite but one among many examples of exaggerated synergy projections provided to this Commission, last year, FairPoint Communications obtained approval to acquire Verizon's Northern New England landline businesses. A key point of contention in the state commission proceedings on the proposed transaction – and one on which much of the credibility of FairPoint's plans turned – was FairPoint's projection that it could squeeze an annual \$60 million to \$75 million out of cash operating expenses by replacing some 600 back office and network functions and systems currently being provided by Verizon with FairPoint's own built-from-the-bottom-up operation. These projected "synergies" represented between 7.3% and 9.1% of the total Verizon NNE operating expense (excluding depreciation). In order to achieve these projected savings, FairPoint hired CapGemini to engineer the new back office and network operation, at a cost of \$200 million – *essentially three times the cost of its projected synergies.*²¹

By contrast, the \$300 million in operating expense synergies projected in this case represents about 6.0% of combined cash operating expense for the two companies, not too much smaller than the claimed savings in the FairPoint/Verizon transaction but with apparently none of the "soup-to-nuts" aspects of those synergies.

Although CenturyTel has a long history of acquiring and integrating telecom operators, it has never attempted anything on this scale (Embarq is, after all, about 2.4 times larger than CenturyTel in terms of revenues and 2.9 times larger in terms of access lines). Closely related to "synergies" is the issue of "integration." Again, the Applicants are almost completely opaque on how they intend to approach a plethora of integration issues.

²¹ The processes being replaced are so central to the Northern New England operations that the regulators in Maine, New Hampshire and Vermont imposed a third-party monitoring process that essentially served as a post-closing regulator, delaying "cut-over" by six very expensive months. Although this transaction closed on March 31, 2008, it has taken ten months to make the new systems ready for operation.

As one commentator discussing the projected CenturyTel/Embarq synergies put it: “This estimate seems pretty high, given the focus on cutting costs at both firms in recent years and strong cash flow that both already generate.”²²

c. The credit squeeze could negatively impact the combined companies

The previously mentioned FairPoint transaction almost unraveled at the last minute as the result of the credit squeeze. The last piece of the transaction involved the placement of some \$600 million in senior notes. Due to the terrible state of the credit markets, the notes could not be placed at the 8.5 percent interest rate that was assumed as part of the regulatory approvals; they were ultimately placed at around 13.5 percent. Just days before the closing was to take place, all three state regulatory bodies needed to reconvene to determine whether or not the added interest charges would have a material impact on the transaction they had already approved.

As anyone who reads the financial press knows, corporate borrowers frequently encounter severe difficulties obtaining financing, or refinancing, on terms that make economic sense for them. CenturyTel is committed to refinancing some \$800 million in Embarq bank debt, and it has arranged an equivalent amount of financing in case the Embarq debt cannot be renegotiated. Next year, CenturyTel has \$513 million in debt maturing, followed by another \$511 million in 2012. Then, in 2013, Embarq has \$1.0 billion in senior notes due. Put another way, the combined companies will be committed to refinancing or retiring some \$2.8 billion in debt over the next five years.

²² Morningstar, “Another Look at the CenturyTel-Embarq Merger,” October 28, 2008

In the end, perhaps the companies will have no difficulties obtaining these funds on acceptable terms. On the other hand, the Applicants have failed to provide this information to the Commission. In this era of tremendous financial industry uncertainty, it is not only reasonable, but essential, for the Commission to satisfy itself that the Applicants will be in a position seamlessly to refinance or retire all of the \$2.8 billion in debt coming due over the next five years.

The companies' ability to refinance this amount of debt on reasonable terms will be highly dependent on their success in reducing line and revenue losses and achieving operating synergies. It is far from certain that the companies can do any of this.

d. The companies' high dividends and recent history of significant share repurchases reduce the cash available for capital and operational expenses, challenging the Applicants assertion that the merger will result in quality service and increased broadband deployment

Both Embarq and CenturyTel can fairly be characterized as having "high yield" stocks, with Embarq currently paying dividends over 7 percent and CenturyTel almost 10 percent (depending on the share price at any particular time). CenturyTel was, until last year, a quite low-yield stock, until its board of directors increased the dividend ten-fold to \$2.80 annually. The companies have announced that it is the new board's intention to maintain this high-yield dividend policy. Based on the number of Embarq shares that will be converted into CenturyTel shares (at a 1.37 conversion ratio), we estimate that the combined company will be paying about \$900 million in dividends annually.

In addition to paying significant dividends, both companies have maintained significant share buyback programs. In all, since 2005, the companies have "returned" almost \$2.7 billion to shareholders via these programs (\$2.2 billion for CenturyTel and \$500 million for Embarq).

CenturyTel still has \$246 million authorized for additional repurchases, but it has suspended the program at least until the Embarq transaction has been completed. It is not clear what the “new” CenturyTel will do.

e. CenturyTel’s Universal Service Fund support substantially financed its share of its share buyback program

CenturyTel “returned” \$ 1.8 billion to shareholders via its share buyback program in the 2005-2007 time frame. Over that same period, CenturyTel received \$ 912 million from federal support programs. For these years, government support payments “paid” for half of the share buyback program. In other words, approximately half the federal support that CenturyTel received during those years went to shareholders, rather than to support the cost of communications services to rural consumers.²³

The Commission must ensure that the post-merger entity uses any USF and federal support it receives for its statutory purpose, which is to support affordable service in high-cost rural areas, rather than to benefit shareholders with above-industry average dividend payments. Absent Commission conditions that would limit dividend and share buyback programs, it is highly likely that the merged entity would continue its past practice of directing USF subsidies to benefit shareholders, not consumers.

f. Absent conditions to protect consumers, the proposed transaction will not service the public interest

The Applicants’ financial projections are not credible and may very well be highly (perhaps even wildly) over-optimistic. The Commission has not been provided with anything approaching sufficient information to make a considered decision on the financial viability and

²³ CenturyTel SEC Form 10-K for 2006 and 2007.

public interest benefits of the proposed transaction. Moreover, it appears that the combined companies may generate significantly less cash than Applicants suggest.

The situation only gets worse if we are indeed in the middle of a more serious economic downturn. Moreover, whether or not the projected synergies are theoretically achievable, there will almost certainly be less opportunity to implement them if access lines, revenues, EBITDA and Free Cash Flow are significantly lower than projected.

If we are in the midst of an extended downturn, the chances of an extended credit freeze would seem to be higher as well. This raises serious concern regarding the companies' plans to pay out roughly \$900 million in dividends each year and their recent history of buying back around \$2.7 billion in shares.

CenturyTel and Embarq have emphasized their "investment grade" ratings. However, they both have the lowest investment grade rating possible. Any lower and they'll be non-investment grade. On the day this transaction was announced, Standard & Poor's RatingsDirect service reaffirmed Embarq's BBB- rating: "Still, we remain concerned about the ongoing access-line losses at both companies, which totaled 6 percent at CenturyTel and 8.6 percent at Embarq as of the 2008 third quarter, and the potential for future debt-financed acquisitions and/or shareholder-friendly initiatives. A significant acceleration of access-line losses and integration issues could prompt a revision of the outlook to negative."²⁴

A very recent RatingsDirect update on Embarq noted: "If debt to EBITDA approaches the high-2x area because of accelerating access-line losses, or post-transaction operational

²⁴ Standard & Poor's, RatingsDirect, "CenturyTel Inc. Ratings Unaffected By Announced Acquisition of Embarq Corp.", October 27, 2008

missteps, and prospects for improvement in this metric are minimal, we could revise the outlook to negative.”²⁵

In summary, the Applicants’ financial justification for this transaction lacks not only detail, but also probity. In the very difficult environment in which wireline telecommunications firms will be operating (even under the best of circumstances), there will inevitably be significant uncertainty about what resources the business will generate even just a year or two in the future.²⁶ It seems quite likely that, if approved, this new firm will be confronted with managing an urgent competition for resources among operational needs, capital requirements, lenders’ demands, and shareholders’ hopes for significant payouts.

V. RECOMMENDATIONS

It is clear that the proposed merger between CenturyTel and Embarq poses many risks to the public interest in quality service and deployment of advanced broadband services.

Consequently, CWA and IBEW propose the following recommendations to the Commission:

1. **Conduct an Extensive Merger Review and Thorough Analysis.** The Commission should conduct an extensive merger review of the proposed transaction since it poses significant risks for the public interest. The Commission should create a complete factual record including all relevant information that was available to CenturyTel’s and Embarq’s Boards of Directors, management, and advisors, as well as subsequently developed data regarding either of the companies, the transaction, and refined projections regarding the post-merger “new” CenturyTel. The Commission would also benefit from a review of the testimony and cross examination transcripts from state commission proceedings. Once all this information is obtained, the Commission will be able to conduct a thorough financial and operational analyses, including sensitivity analyses, concerning the range of potential and likely results of the combined entity’s operations.

²⁵ Standard & Poor’s RatingsDirect, “Embarq,” January 8, 2009

²⁶ Channel Trend, an independent investment research provider noted that in 2010, CenturyTel “expects a major capital expenditure related to the implementation of LTE (the Long Term Evolution Standard), which it has chosen over WiMAX as its next generation technology.” January 2, 2009

2. Impose Conditions to Ensure Public Benefit from the Proposed Transaction. The Commission should impose the following conditions to ensure that the proposed merger serves the public interest with concrete, verifiable benefits.

- a. Limit the amount of dividend payments to shareholders and repurchase of shares by the “new” CenturyTel, conditioned on the company meeting specific service quality and broadband commitments. We recommend that the Commission set a maximum Leverage Ratio that would require the “new” CenturyTel to suspend payments to shareholders (dividends or share repurchases) if they exceed that ratio. This is especially important since it appears that CenturyTel has used federal Universal Service Fund support to finance above-industry average dividend payments to shareholders.
- b. Require service quality improvements based on performance as measured by the FCC in its ARMIS reports and/or equivalent measurements required by the State regulatory authorities.
- c. Require build-out of broadband services throughout the region by 2010.
- d. Require expansion of IPTV services to at least 25 markets by 2010.

VI. CONCLUSION

The Applicants have failed to provide the Commission with sufficient information to determine whether the proposed transaction serves the public interest in quality telephone service and deployment of advanced broadband services. The Commission must obtain more documentation from the Applicants in order to conduct a thorough review of the financial viability of the post-transaction company. Further, the Commission must ensure that the proposed merger results in concrete, verifiable public interest benefits. If the Commission, upon thorough review, determines that the post-merger company will be financially fit, the Commission should impose conditions to ensure that benefits flow to consumers and not simply to shareholders.

Respectfully Submitted,



Debbie Goldman
Telecommunications Policy Director
Communications Workers of America



Edwin D. Hill
International President
International Brotherhood of Electrical Workers

January 23, 2009

DECLARATION OF DEBBIE GOLDMAN

My name is Debbie Goldman. I am Telecommunications Policy Director and Research Economist with the Communications Workers of America. My business address is 501 Third Street N.W., Washington, D.C. 2001.

The Communications Workers of America is a labor organization representing 700,000 workers, in communications, media, airlines, manufacturing and public service.

The International Brotherhood of Electrical Workers is a labor organization representing 750,000 workers who work in a wide variety of fields, including utilities, construction, broadcasting, telecommunications, manufacturing, railroads and government.

Together, CWA and IBEW represent 5,200 workers at CenturyTel and Embarq.

I am familiar with the contents of the foregoing Reply Comments. The factual assertions made in the Reply Comments are true to the best of my knowledge and belief.

I declare under penalty of perjury that the foregoing is true and correct.
Executed on January 23, 2009.



Debbie Goldman