

**BEFORE THE ARIZONA CORPORATION COMMISSION**

GARY PIERCE

Chairman

BOB STUMP

Commissioner

SANDRA D. KENNEDY

Commissioner

PAUL NEWMAN

Commissioner

BRENDA BURNS

Commissioner

IN THE MATTER OF APPLICATION OF )  
QWEST CORPORATION D/B/A CENTURYLINK- )  
QC ("CENTURYLINK") TO CLASSIFY AND )  
REGULATE RETAIL LOCAL EXCHANGE ) DOCKET NO. T-01051B-11-0378  
TELECOMMUNICATIONS SERVICES AS )  
COMPETITIVE, AND TO CLASSIFY AND )  
DEREGULATE CERTAIN SERVICES AS NON )  
ESSENTIAL )

REBUTTAL TESTIMONY  
OF PATRICK J. QUINN ON BEHALF OF RUCO  
APRIL 23, 2012

PUBLIC VERSION

1 **Q. DID YOU FILE DIRECT TESTIMONY IN THIS DOCKET?**

2 A. Yes.

3 **Q. WHAT IS THE PURPOSE AND SCOPE OF YOUR REBUTTAL TESTIMONY?**

4 A. I will reiterate RUCO's position that based on common sense and the facts presented, the  
5 telecommunication environment in Arizona for residential customers is very competitive and  
6 CenturyLink qualifies to be classified as competitive under AAC R14-2-1108(B). I will support  
7 CenturyLink's request for competitive reclassification for its residential services and will discuss the  
8 testimony of other interveners. I will address some of the concerns raised by the interveners' analysis  
9 and recommendations, including developing a methodology to determine which customers need to be  
10 provided with safeguards. Finally, I will make recommendations on what actions the Arizona  
11 Corporation Commission ("Commission") should take to protect residential customers in Arizona.

12 **Q. IS IT RUCO'S POSITION THAT THE TELECOMMUNICATIONS ENVIRONMENT IN**  
13 **ARIZONA IS VERY COMPETITIVE FOR RESIDENTIAL CUSTOMERS? WHAT DO YOU**  
14 **BASE THIS POSITION ON?**

15 A. Yes. From a brief observation of the market and using common sense it is obvious that significant  
16 competition exists. Specific facts provided support a case of a very competitive environment. Based on  
17 these facts, from an evidentiary and fairness perspective CenturyLink should be allowed to reclassify its  
18 residential services to competitive. Below is a summary of the competitive data [begin confidential].

19 Residential Market Share

20 <u>Provider</u>	<u>Share</u>
21 CenturyLink	XX

1	Wireless Providers	XX
2	Cable Providers	XX
3	Other (no voice)	XX
4	Other CLEC and VoIP	XX

5 CenturyLink, Wireless and Cable providers each XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX in  
6 Arizona [end confidential]. CenturyLink’s residential access lines have decreased 61% since 2001.  
7 Wireless providers offer service in all but four wire centers and for nearly all customers in  
8 CenturyLink’s service territory. Cable providers operate in 119 of the 132 wire centers comprising  
9 98.4% of CenturyLink’s access lines. While CLECs play a smaller role in providing services there are  
10 one or more CLECs in all 132 wire centers. Many CLECs are authorized to provide residential services.  
11 The data presented above demonstrates that the residential customer market in CenturyLink’s service  
12 territory is very competitive and warrants granting their request to reclassify their residential services to  
13 competitive.

14 **Q. WAS THERE ANY OTHER ANALYSIS PERFORMED TO DETERMINE IF**  
15 **CENTURYLINK’S APPLICATION FOR COMPETITIVE RECLASSIFICATION SHOULD BE**  
16 **APPROVED?**

17 A. Yes, as stated in my Direct Testimony R14-2-1108 Section B, provides the six conditions that must be  
18 met to allow competitive classification of telecommunications services. RUCO believes CenturyLink  
19 complies with the six conditions. Commission Staff (“Staff”) performed a detailed analysis for each of  
20 the six conditions. Staff determined that CenturyLink complied with five of the six conditions. On  
21 condition three Staff originally stated that CenturyLink did not comply, but later reversed their position

1 when CenturyLink provided the response to Staff's Eighth Data Request. In subsequent testimony, Staff  
2 returned to their original position of non compliance regarding Condition Three.

3 **Q. WHAT IS CONDITION THREE?**

4 A. Condition Three requires CenturyLink to provide an estimated market share held by each alternative  
5 provider.

6 **Q. DOES RUCO BELIEVE THAT CENTURYLINK IS IN COMPLIANCE WITH CONDITION  
7 THREE?**

8 A. Yes. In reviewing the response to Staff's Eighth Data Request, CenturyLink made what appears to be a  
9 good faith effort in complying with this condition, listing 35 providers and their market share. It is  
10 unrealistic to expect Centurylink, or any Company for that matter to be able to produce market share  
11 information on all of its competitors. To do so would set a standard that is virtually impossible to meet.  
12 Competitors are under no obligation to provide Centurylink with such information and Centurylink has  
13 no other way to ascertain the information. Clearly, Condition Three was not meant to impose such an  
14 overly burdensome requirement on a Company seeking competitive classification.

15 **Q. WHAT IS THE STAFF'S FINAL POSITION ON COMPLIANCE WITH CONDITION THREE?**

16 A. Staff Witness Fimbres' Testimony at times is confusing and contradictory. See page 6, line 9 through  
17 page 7, line 5. Originally Fimbres stated that CenturyLink did not comply. After receiving Staff's  
18 Eighth Data Request response, he concluded that CenturyLink did comply with the condition, only to  
19 reverse himself on the next page, relying on Brigham's Testimony to conclude that CenturyLink does  
20 not comply with Condition Three. RUCO believes that the information, in response to Staff's Eighth  
21 Data Requests, provides sufficient data for CentryLink to comply with condition three.  
22

1 **Q. WAS THERE ANY OTHER ANALYSIS PERFORMED TO DETERMINE THE**  
2 **COMPETITIVE ENVIRONMENT IN ARIZONA?**

3 A. Yes. Staff Witness Fimbres used the Herfindahl-Hirschman Index (“HHI”) to demonstrate that the  
4 telecommunications market in Arizona was highly concentrated and therefore not competitive.

5 **Q. WHAT IS THE HHI AND HOW IS IT USED?**

6 A. In my testimony Exhibit PJQ-1 gives the U.S. Department of Justice and the Federal Trade Commission  
7 definition and use of the HHI. Basically this calculation is used to determine if the merger of two  
8 companies will cause a market to become more concentrated giving more market power to the merged  
9 company.

10 HHI is defined as “a commonly accepted measure of market concentration. It is calculated by squaring  
11 the market share of each firm competing in a market, and then summing the resulting numbers.<sup>1</sup> The  
12 HHI number can range from close to zero to 10,000. The HHI is expressed as:

$$HHI = s1^2 + s2^2 + s3^2 + \dots + sn^2 \text{ (where } sn \text{ is the market share of the } ith \text{ firm).}$$

14 The closer a market is to being a monopoly, the higher the market's concentration (and the lower its  
15 competition). If, for example, there were only one firm in an industry, that firm would have 100%  
16 market share, and the HHI would equal 10,000 (100<sup>2</sup>), indicating a monopoly. Or, if there were  
17 thousands of firms competing, each would have nearly 0% market share, and the HHI would be close to  
18 zero, indicating nearly perfect competition.”<sup>2</sup>

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<sup>1</sup> www.investopedia.com/terms/h/hhi.sap

<sup>2</sup> www.investopedia.com/terms/h/hhi.sap

1 **Q. IS THE HHI AN APPROPRIATE TOOL TO USE IN THE ANALYSIS OF CENTURYLINK'S**  
2 **APPLICATION?**

3 A. No. First, HHI is not required by R14-2-1108 to determine competitive status for services. Second,  
4 HHI's primary purpose is to determine whether mergers would change the concentration of market  
5 power in a given industry, not assess whether services are competitive. Third, HHI assumes that all  
6 companies in an industry are measured under the same market and regulatory conditions, which is not  
7 the case for companies in the residential telephone services industry. Competitors of CenturyLink have  
8 relaxed pricing regulations and are under no obligation to unbundle their networks. Allowing  
9 CenturyLink the same relaxation on pricing should increase competition in Arizona not reduce it.  
10 Relying on HHI to interpret competition in this market is misleading.

11 **Q. HOW IS HHI MISLEADING IN THIS CASE?**

12 A. In Staff Witness Fimbres' Testimony he calculated an HHI value of 2520 for the Arizona residential  
13 market. This suggests that the market is highly concentrated in a few companies and not very  
14 competitive. He then used the high HHI value to justify his position that the market is not competitive,  
15 that CenturyLink is the dominant provider, and that CenturyLink should not be granted competitive  
16 classification for residential services. The scenario below demonstrates how HHI results are misleading.

17       If CenturyLink lost just 2.5% of the market to [begin confidential] XXX [end confidential] the  
18 HHI would only drop to 2512, the market would still not be competitive, and [begin confidential] XXX  
19 [end confidential] would then be the largest provider of residential services. Thus, [begin confidential]  
20 XXX [end confidential] would become the dominant provider and should lose its competitive  
21 classification for pricing based on Staff's analysis. In this scenario, a 2.5% swing in the market can  
22 cause a change in who the dominant provider is, and demonstrates the current competitive nature of the

1 market not withstanding a high HHI value. A mere 2.5% market share shift does not seem  
2 unreasonable given that since 2001 CenturyLink has lost 61% of its access lines.<sup>3</sup>

3 While the HHI is a valuable tool when evaluating mergers, it is not very useful in evaluating  
4 competitiveness in markets with high operating costs that limit participants to a few companies. This is  
5 true whether it is the telecommunications industry, large jet aircraft manufacturers or other industry with  
6 high capital and cost requirements for market entry. The large jet aircraft manufacturing market HHI  
7 value is high because there are only two major players, and would show a highly concentrated non  
8 competitive market. The fact that only a few large companies are in the market does not limit the actual  
9 competitiveness of the market as seen in jet aircraft manufacturing, which despite only a few players is  
10 highly competitive.

11 **Q. WHAT IS YOUR CONCLUSION ABOUT USE OF THE HHI TO DETERMINE IF**  
12 **CENTURYLINK SHOULD BE GIVEN COMPETITIVE CLASSIFICATION FOR**  
13 **RESIDENTIAL SERVICES?**

14 A. There are so many factors about a competitive market analysis that are not included in an HHI that it is  
15 of no relevance to the determination of CenturyLink's application. However, it is relevant to determine  
16 whether the residential customers have a competitive alternative provider from which to buy their  
17 services. Actual competitive choices available to residential consumers are the true measure, not  
18 whether the market is theoretically competitive.

19 **Q. DID YOU REVIEW THE TESTIMONY OF THE OTHER INTERVENERS IN THIS DOCKET?**

20 A. Yes.

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<sup>3</sup> If CenturyLink lost two thirds of its residential customers to one competitor the HHI would increase to 6857. The market would be considered extremely non competitive and CenturyLink would still not be given competitive classification.

1 Q. **WHAT ARE YOUR COMMENTS AND CRITICISMS OF THE INTERVENERS'**  
2 **TESTIMONY?**

3 A. Generally, the interveners recognized that there is growing competition in the telecommunication  
4 industry in Arizona. There were differing opinions on how much and where the competition exists.  
5 Each intervener approached their analysis from a distinctive perspective. Arizona Investment Council's  
6 (AIC) Witness Yaquinto approached the question of competitiveness from an investor's point of view  
7 and was in favor of granting the competitive classification but did not address the deregulation portion.  
8 The Witness for tw telecom Nipps was only concerned about maintaining the status quo for wholesale  
9 customers and was opposed to both reclassification and deregulation. DOD/FEA's Witness Ankum  
10 represents a large number of government customers and opposed both reclassification and deregulation.  
11 His main concern was maintaining competitive pricing for the products and services his government  
12 customers' purchase.

13 Q. **DID YOU HAVE ANY COMMENTS ON STAFF'S TESTIMONY?**

14 A. In addition to my earlier statements on Staffs analysis and conclusion of the six conditions found in  
15 R14-2-1108 and the use of a HHI, there are some other concerns I have with their testimony.

16 Q. **WHAT ARE THE OTHER CONCERNS YOU HAVE ABOUT THE COMMISSION STAFF'S**  
17 **TESTIMONY?**

18 A. Staff's Testimony is perplexing and inconsistent in many regards.

19 Q. **WHAT IS PERPLEXING ABOUT THE STAFF'S TESTIMONY?**

20 A. Staff denied CenturyLink's competitive reclassification application in total, for residential, small and  
21 medium business because CenturyLink did not provide enough proof of competition. However Staff

1 Witness Abinah then recommended a 25% increase in residential rates and a 30% increase in small and  
2 medium business rates even though CenturyLink did not request any rate increases at this time.

3 **Q. DID STAFF’S DIRECT TESTIMONY ANALYZE HOW MUCH ADDITIONAL REVENUE A**  
4 **25% INCREASE FOR RESIDENTIAL CUSTOMERS AND A 30% INCREASE FOR SMALL**  
5 **AND MEDIUM BUSINESS CUSTOMERS WOULD YIELD?**

6 A. No.

7 **Q. DID YOU PERFORM THIS ANALYSIS?**

8 A. Yes. The rate increases recommended by Staff would equate to a \$58.2M revenue increase for  
9 CenturyLink over three years, \$11.6M coming from residential customers and \$46.6M coming from  
10 small and medium business customers.

11 **Q. DID STAFF PROVIDE EVIDENTIARY SUPPORT FOR HOW IT DETERMINED A 25%/30%**  
12 **RATE INCREASE WAS WARRANTED AND REASONABLE?**

13 A. Not really. There is no real justification for the rate increases or the percents recommended by Staff.  
14 Witness Abinah’s attempts on page 12, lines 12-23 of his testimony to justify the increases. His main  
15 arguments are that these services have now been classified as “Emerging Competitive”, are not subject  
16 to rate of return regulation, are consistent with competitors’ prices and something vague about fair value  
17 assessment. In response to RUCO’s Second Set of Data Requests 2.02 (Exhibit PJQ-2), Staff provided  
18 no data or work papers to support their recommendation. These increases seemed to be automatic and  
19 Staff did not define what CenturyLink is required to do in order to be able to raise prices. There are only  
20 three ways for CenturyLink’s prices to increase, under R14-2-103 which is a full rate of return rate case,  
21 the current Price Cap Plan or after services have been classified competitive under R14-2-1108 using  
22 R14-2-1110 to then increase price caps. Unfortunately, Staff has proposed a rate increase without any

1 basis. And frankly RUCO does not completely appreciate why Staff would want to put on evidence to  
2 support a rate increase when CenturyLink has not filed a rate case application.

3 **Q. WHAT IS MEANT BY “EMERGING COMPETITIVE”?**

4 A. It is unclear from Staff’s testimony. Staff stated that based on the existing competition level  
5 CenturyLink did demonstrate the need to create a new basket or classification called “Emerging  
6 Competitive”. There were no specifics given about what was in this new classification, what the  
7 requirements are to increase prices or what oversight the Commission would maintain over such a  
8 classification. Nor is it clear how this new classification impacts the services in Basket 2 and Basket 3 which  
9 were declared to be “competitive” in the Price Cap Plan. Staff seems to be creating different levels of  
10 competitive classifications without adequate explanation, and with no basis in the Commission’s Rules  
11 or otherwise. Equally perplexing, is how Staff can recommend a rate increase in the absence of a rate  
12 case (108) or an 1110 proceeding. In RUCO’s Second Set of Data Requests 2.01 (Exhibit PJQ-3),  
13 RUCO asked for a definition of what the new “Emerging Competitive” classification would be and in  
14 Data Request 2.02 (Exhibit PJQ-2), RUCO asked for a justification for the price increase. Staff failed to  
15 address either of these requests in their answer. In fact, Staff gave the same answer to both Data  
16 Requests which failed to address either of the Data Requests. There was little or no support given to the  
17 rate increases or to how CenturyLink would operate using this new “Emerging Competitive”  
18 classification or to what is contained in pricing flexibilities other than an ability to increase prices.

19 **Q. WHAT ARE YOUR CONCLUSIONS ON STAFF’S PRICE INCREASES AND CREATION OF**  
20 **“EMERGING COMPETITIVE” CLASSIFICATION?**

21 A. There is no justification for the 25% increase for residential and the 30% increase for small and medium  
22 business especially since CenturyLink did not request price increases in their application. The only way

1 to increase prices is under R14-2-103, the current Price Cap Plan or R14-2-1110 after a competitive  
2 classification is found. Staff uses none of these methods and essentially just wants to give CenturyLink  
3 more money in recognition that there appears to be more competition now than at the time of Qwest's  
4 renewed Price Cap Plan. Additionally, Staff is creating a new level of competition. Services are either  
5 competitive or they are not. A new classification of emerging competitive draws all the previous  
6 classifications into doubt. Would all previous services now need to undergo a new analysis to see if they  
7 are emerging competitive services? There is no Commission Rule defining "Emerging Competitive"  
8 setting forth the criteria by which a telecommunications company must qualify as being "Emerging  
9 Competitive". Staff did not define what process and procedures would be implemented or how  
10 CenturyLink would operate under this new classification or any other services that would be identified  
11 as "Emerging "Competitive. Both the price increases and the new "Emerging Competitive"  
12 classification recommendations should be denied by the Commission.

13 **Q. HAS RUCO'S POSITIONS CHANGED BASED ON YOUR REVIEW OF OTHER**  
14 **INTERVENORS' TESTIMONY?**

15 A. No. RUCO still believes (1) that CenturyLink should be given competitive classification for residential  
16 services, (2) that rate deaveraging should be adopted because it provides more benefits to residential  
17 customers than uniform statewide rates and (3) that safeguards need to be put in place to protect  
18 residential customers in areas with no alternative competitive provider if rate deaveraging is adopted.

19 **Q. WHY DO YOU STILL BELIEVE THAT RATE DEAVERAGING SHOULD BE APPROVED**  
20 **BY THE COMMISSION?**

21 A. Rate deaveraging allows CenturyLink to set prices to meet competition, geographical cost differences  
22 and reduce subsidies. RUCO understands that this is a policy issue that comes under the Commission

1 jurisdiction and discretion. However, RUCO asks the Commission to clarify in its order whether  
2 CenturyLink is allowed to rate deaverage.

3  
4  
5 **Q. WHAT ABOUT YOUR SAFEGUARDS TO RESIDENTIAL CUSTOMERS IN AREAS WITH**  
6 **NO ALTERNATIVE COMPETITIVE PROVIDER?**

7 A. In my direct testimony I mentioned some safeguards that could be put in place to protect those  
8 residential customers in areas with no alternative provider. These safeguards would be implemented if  
9 CenturyLink sought and was granted rate increases pursuant to R14-2-1110. This remains RUCO's  
10 position. Not addressed in my original testimony, was a determination of which customers needed those  
11 protections. Interveners' testimony concluded that competition is not equal everywhere in  
12 CenturyLink's service territory and that in some areas there exist no competition to CenturyLink  
13 services. Based on this common concern, I developed a methodology to determine which areas need  
14 safeguards.

15 **Q. WHAT METHODOLOGY DID YOU USE TO DETERMINE WHAT AREAS NEEDED**  
16 **SAFEGUARDS?**

17 A. I proposed that meaningful competition exists if a wire center is served by CenturyLink, **plus** a cable  
18 provider (that provides basic residential service) **and** a wireless provider and then there is no need for  
19 safeguards beyond the inherent consumer safeguards that exist in a competitive marketplace. However,  
20 if a CenturyLink wire center is not additionally served by both a cable provider and a wireless provider,  
21 then I recommend that safeguards would be required. I used information provided by CenturyLink's  
22 Witness Brigham's Testimony and Confidential Exhibit RHB-3. His testimony identified 12 wire

1 centers that had partial or no wireless coverage. His Exhibit showed that of the 132 wire centers 16 had  
2 no cable providers. After updating Brigham's data, I determined that thirteen wire centers need  
3 safeguards.

4 **Q. WHAT WIRE CENTERS DO YOU THINK NEED SAFEGUARDS?**

5 A. My Exhibit PJQ-4 shows the thirteen wire centers and the number of customers that fall into areas that  
6 need safeguards. Safeguards need only be addressed if the Commission adopts rate deaveraging.

7 **Q. SHOULD THE COMMISSION GRANT CENTURYLINK COMPETITIVE STATUS**  
8 **ALTHOUGH MEANINGFUL COMPETITION DOES NOT EXIST IN ALL WIRE CENTERS?**

9 A. Yes. CenturyLink meets all of the conditions of R14-2-1108. There is no requirement to demonstrate  
10 competition in every remote rural area of CenturyLink's service territory.

11 **Q. WHAT SAFEGUARDS WOULD YOU RECOMMEND TO THE COMMISSION FOR THESE**  
12 **CUSTOMERS?**

13 A. In my direct testimony I offered three different types of safeguards. Any disclosed safeguard would  
14 work, however I believe the following would work best. If the Commission approves competitive  
15 status under R14-2-1108 and then considers changing rates under R14-2-1110, residential customers  
16 from identified safeguarded areas would get a subsidy provided from the Telephone Assistance Plan for  
17 the medically needy. It should be equal to one half of the monthly approved increase or whatever the  
18 Commission deems fair. For example if CenturyLink increases basic residential access from \$13.18 to  
19 \$14.18 then the monthly subsidy would be set at \$0.50. The subsidy would continue until these areas  
20 were deemed to have competitive alternatives.

21 **Q. IF CENTURYLINK IS GIVEN COMPETITIVE CLASSIFICATION FOR RESIDENTIAL**  
22 **CUSTOMERS WILL THAT CHANGE ANY OF THE ASSISTANCE PLANS LIKE LIFELINE?**

1 A. No. Neither RUCO's proposal nor CenturyLink's application as stated in paragraph 23 affects  
2 important subsidized safety net programs like Lifeline.

3 **Q. DO YOUR FINAL RECOMMENDATIONS INCLUDE SAFEGUARDS IN NON-**  
4 **COMPETITIVE AREAS?**

5 A. No. RUCO continues to believe that there is a need to protect residential customers in areas where no  
6 competitive alternative is available. This need for protection only becomes necessary if rate de-  
7 averaging is allowed. Rate de-averaging should be adopted by this Commission and, as I stated in my  
8 direct testimony, is a threshold issue that must be resolved. However, if the Commission for policy  
9 reasons does not want to pursue rate deaveraging at this time, then no safeguards are necessary. I want  
10 to give the Commission an alternative solution should they approve rate deaveraging and want to protect  
11 residential customers in areas of no competition.

12 **Q. PLEASE SUMMARIZE RUCO'S RECOMMENDATIONS FOR THE COMMISSION TO**  
13 **CONSIDER IN THE DETERMINATION OF CENTURYLINK'S APPLICATION.**

14 A. After reviewing all of the direct testimony my recommendations remain consistent with my original  
15 Direct Testimony and are as follows:

- 16 1. CenturyLink should be given competitive reclassification for residential services.
- 17 2. CenturyLink should be required to file under R14-2-1110 within one year.
- 18 3. CenturyLink must maintain current service quality measurements and reporting requirements.
- 19 4. CenturyLink commits to no changes in this proceeding for wholesale services.
- 20 5. CenturyLink must "wrap up the Price Cap Plan" within one year.
- 21 6. Staff's recommendation of a 25% increase in CenturyLink's residential rates be denied.
- 22 7. Staff's creation of "Emerging Competitive" classification be denied.

1           8. Resolve the issue on whether rate deaveraging is allowed for CenturyLink with approval of this  
2           application.

3 **Q.       DOES THIS CONCLUDE YOUR TESTIMONY?**

4 **A.       Yes.**

## **EXHIBIT PJQ-1**

### **Horizontal Merger Guidelines**

**U.S. Department of Justice and the Federal Trade Commission**

**Issued: August 19, 2010**

#### **5.3 Market Concentration**

Market concentration is often one useful indicator of likely competitive effects of a merger. In evaluating market concentration, the Agencies consider both the post-merger level of market concentration and the change in concentration resulting from a merger. Market shares may not fully reflect the competitive significance of firms in the market or the impact of a merger. They are used in conjunction with other evidence of competitive effects. See Sections 6 and 7.

In analyzing mergers between an incumbent and a recent or potential entrant, to the extent the Agencies use the change in concentration to evaluate competitive effects, they will do so using projected market shares. A merger between an incumbent and a potential entrant can raise significant competitive concerns. The lessening of competition resulting from such a merger is more likely to be substantial, the larger is the market share of the incumbent, the greater is the competitive significance of the potential entrant, and the greater is the competitive threat posed by this potential entrant relative to others.

The Agencies give more weight to market concentration when market shares have been stable over time, especially in the face of historical changes in relative prices or costs. If a firm has retained its market share even after its price has increased relative to those of its rivals, that firm already faces limited competitive constraints, making it less likely that its remaining rivals will replace the competition lost if one of that firm's important rivals is eliminated due to a merger. By contrast, even a highly concentrated market can be very competitive if market shares fluctuate substantially over short periods of time in response to changes in competitive offerings. However, if competition by one of the merging firms has significantly contributed to these fluctuations, perhaps because it has acted as a maverick, the Agencies will consider whether the merger will enhance market power by combining that firm with one of its significant rivals.

The Agencies may measure market concentration using the number of significant competitors in the market. This measure is most useful when there is a gap in market share between significant competitors and smaller rivals or when it is difficult to measure revenues in the relevant market. The Agencies also may consider the combined market share of the merging firms as an indicator of the extent to which others in the market may not be able readily to replace competition between the merging firms that is lost through the merger.

The Agencies often calculate the Herfindahl-Hirschman Index ("HHI") of market concentration. The HHI is calculated by summing the squares of the individual firms' market shares,<sup>9</sup> and thus gives proportionately greater weight to the larger market shares. When using the HHI, the Agencies consider both the post-merger level of the HHI and the increase in the HHI resulting from the merger. The increase in the HHI is equal to twice the product of the market shares of the merging firms.<sup>10</sup>

Based on their experience, the Agencies generally classify markets into three types:

- Unconcentrated Markets: HHI below 1500
- Moderately Concentrated Markets: HHI between 1500 and 2500
- Highly Concentrated Markets: HHI above 2500

The Agencies employ the following general standards for the relevant markets they have defined:

- *Small Change in Concentration:* Mergers involving an increase in the HHI of less than 100 points are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Unconcentrated Markets:* Mergers resulting in unconcentrated markets are unlikely to have adverse competitive effects and ordinarily require no further analysis.
- *Moderately Concentrated Markets:* Mergers resulting in moderately concentrated markets that involve an increase in the HHI of more than 100 points potentially raise significant competitive concerns and often warrant scrutiny.
- *Highly Concentrated Markets:* Mergers resulting in highly concentrated markets that involve an increase in the HHI of between 100 points and 200 points potentially raise significant competitive concerns and often warrant scrutiny. Mergers resulting in highly concentrated markets that involve an increase in the HHI of more than 200 points will be presumed to be likely to enhance market power. The presumption may be rebutted by persuasive evidence showing that the merger is unlikely to enhance market power.

The purpose of these thresholds is not to provide a rigid screen to separate competitively benign mergers from anticompetitive ones, although high levels of concentration do raise concerns. Rather, they provide one way to identify some mergers unlikely to raise competitive concerns and some others for which it is particularly important to examine whether other competitive factors confirm, reinforce, or counteract the potentially harmful effects of increased concentration. The higher the post-merger HHI and the increase in the HHI, the greater are the Agencies' potential competitive concerns and the greater is the likelihood that the Agencies will request additional information to conduct their analysis.

**EXHIBIT PJQ-2**

**ARIZONA CORPORATION COMMISSION STAFF'S RESPONSES TO  
RESIDENTIAL UTILITY CONSUMER OFFICE'S  
SECOND SET OF DATA REQUESTS  
DOCKET NO. T-OI0SIB-U-0378  
APRIL 6, 2012**

**Question: 2.02** In Staff Witness Abinah's Testimony page 12, lines 12 through 23, he responds to a question on how Staff determined a 25% increase for Consumers and a 30% increase for Small and Medium Business. Please provide all work papers, calculations, analysis and data used to arrive at the 25% and 30% increases. Additionally, provide how much of a Consumer revenue increase CenturyLink would realize with a 25% increase over the three years assuming no repression. Please provide that same amount for Small and Medium Business. Please provide the calculations used to determine these amounts.

**Response:** Under Staffs proposed emerging competitive classification, CTLQ would be allowed to increase the maximum rates for services included in the category by 25% in total over three years, with a no more than ten percent increase in a year. In other words, the maximum increase at the end of three years is 25% above the currently effective rate (not the maximum). Under Staffs recommendation, the required supporting information would allow the Commission to confirm that the rate increased by no more that 10 in any year with the cap at 125% of the current rate. Price changes meeting these requirements would be in compliance with the proposed pricing flexibility and no further Commission action would be required.

**Respondent:** Wilfred Shand, Utilities Division, Arizona Corporation Commission, 1200 West Washington, Phoenix, Arizona 85007

**EXHIBIT PJQ-3**

**ARIZONA CORPORATION COMMISSION STAFF'S RESPONSES TO  
RESIDENTIAL UTILITY CONSUMER OFFICE'S  
SECOND SET OF DATA REQUESTS  
DOCKET NO. T-010S1B-II-0378  
APRIL 6, 2012**

**2.01** In both Staff Witness Abinah and Fimbres' testimony they propose a new classification called "Emerging Competitive". Is this a new bucket to add to the current Price Cap Plan? In the current Plan each bucket contains an explanation of what is included in the bucket and how prices may be change and by how much. This new classification is described as giving CenturyLink more pricing flexibility than under the current Price Cap Plan but not as much as under a Competitive classification using RI4-2-1108. Other than that there is no explanation of what processes and procedures CenturyLink would utilize to obtain price flexibility under this new classification. Please describe what pricing flexibility this new classification entails other than applying 125% price increase over 3 years for residential services. What is required of CenturyLink in a filing to increase prices, what should the Commission consider in evaluating the filing, is rate deaveraging allowed and what is the procedure for a hearing and Commission approval or denial.

**Response:** Under Staffs proposed emerging competitive classification, CTLQ would be allowed to increase the maximum rates for services included in the category by 25% in total over three years, with a no more than ten percent increase in a year. In other words, the maximum increase at the end of three years is 25% above the currently effective rate (not the maximum). Under Staffs recommendation, the required supporting information would allow the Commission to confirm that the rate increased by no more that 10 in any year with the cap at 125% of the current rate. Price changes meeting these requirements would be in compliance with the proposed pricing flexibility and no further Commission action would be required.

**Respondent:** Wilfred Shand, Utilities Division, Arizona Corporation Commission, 1200 West Washington,  
Phoenix, Arizona 85007

**EXHIBIT PJQ-4**

CENTURYLINK WIRE CENTERS THAT NEED SAFEGUARDS

WIRE CENTER

NUMBER OF CUSTOMERS

REDACTED