

# PROFILE OF QWEST COMMUNICATIONS (QWEST)<sup>1</sup>

Ian Duff  
JETS  
University of Edinburgh

## Introduction

In the business press over the last few years various labels have been used to describe the new generation of telecom companies which have burst onto the scene. These companies have come to the market with new networks and new attitudes: “Unencumbered by legacy systems or legacy mentality”.<sup>2</sup> Perhaps the most frequent label used for the new entrants is “upstarts”. Another is “newbies”.<sup>3</sup> A more dramatic image was preferred by McKinsey which talked of “attacker telecommunication companies”.<sup>4</sup> A similar image was evoked by the FT which, in a discussion of the industry, stated that, “And now strange, fierce creatures, previously unknown in these parts, are darting about”.<sup>5</sup> Whatever terminology is used, however, most accounts of the development of a new breed of communication companies identify the single key player as Qwest Communications.

The FT, for example, implied that for most of the last few years Qwest has been “the most talked-of company in the industry”, and that it represents the “self-styled leader of the ‘bandwidth barons’”.<sup>6</sup> The Economist adopted a similar stance referring to Qwest as the “next WorldCom”<sup>7</sup> - the company which had been at the forefront of change prior to the arrival of the most recent wave of innovators. On another occasion it stated simply that “Qwest is a phenomenon”.<sup>8</sup>

In the profile which follows it will be seen that the rise of Qwest is attributable to a number of disparate factors. This was the view taken by the New York Times, which argued that: “In some ways the rise of Qwest represents an ideal confluence of ability, personality and opportunity”.<sup>9</sup> The third of these conditions was assisted by the US Telecommunications Act of 1996 which helped nurture the demand for Internet communications. The first two it put down to two individuals, Philip Anschutz and Joseph Nacchio, respectively. This profile starts by looking at the two men.

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<sup>2</sup> Upside (July, 1998)

<sup>3</sup> FT (30/9/98)

<sup>4</sup> McKinsey Quarterly (Spring 1999)

<sup>5</sup> FT (4/4/98)

<sup>6</sup> FT (9/6/99, 14/6/99)

<sup>7</sup> The Economist (4/4/98)

<sup>8</sup> The Economist (14/3/99)

<sup>9</sup> The New York Times (15/6/99)

## 1/Origins and Development

### Philip Anschutz

Reviewing the company in 1998 Forbes suggested that, “Qwest’s own story is a probably-only-in-America one, starting with a gleam in the eye of Philip Anschutz”.<sup>10</sup> This image of an “all American story” was heightened by the FT which suggested that, “Anschutz displays all the trappings of the modern western maverick”, and that he has “cattle, oil and railroads in his blood”.<sup>11</sup>

Anschutz started his business career with the purchase of a cattle ranch in the late 1960s which proved to be the source of considerable oil reserves. He later sold his interest in the oil-rich ranch for \$500 million.<sup>12</sup> In 1982 he bought the Denver and Rio Grande Western railroad for \$500 million - with \$90 million cash up front. Four years later he leveraged this investment into the purchase of Southern Pacific Rail Corp. Qwest was spun off from the railroad operation in 1988.<sup>13</sup> In 1995 this railroad was sold to Union Pacific for \$3.9 billion, netting him a profit of around \$1.6 billion.<sup>14</sup> The New York Times pointed out that the Southern Pacific Railroad had already given birth to Sprint (hence the first two letters of its name) and, “through Mr Anschutz, Qwest has become the Southern Pacific Railroad’s second great communications progeny”.<sup>15</sup>

After selling the Southern Pacific Railroad to Union Pacific Anschutz retained the right to lay fibre-optic cable along the tracks of both railways - a strategy which he had started through an arrangement between Southern Pacific and Qwest in 1992.<sup>16</sup> This move, suggested the Economist, was no less than “a stroke of genius”.<sup>17</sup> Business Week was equally enthusiastic describing the rights of way contract as a “gem”.<sup>18</sup> In addition to his agreement with Southern Pacific and then Union Pacific, Anschutz also secured the rights of way along CSX Corp’s 19,000 miles of track.<sup>19</sup>

In examining his business record most commentators agree that he has a tremendous ability to identify cash-generating opportunities which have been overlooked or declined by his competitors. Business Week took this view, arguing that, “For Philip F. Anschutz, life has been one long adventure in ferreting out hidden treasures in unexpected places”.<sup>20</sup> Fortune focused on his tendency to go against the grain, painting him as something of a “contrarian” who was inclined to “bet against the conventional wisdom”.<sup>21</sup> As well as being known as unconventional he is also widely

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<sup>10</sup> Forbes (30/11/98)

<sup>11</sup> FT (15/6/99)

<sup>12</sup> Ibid

<sup>13</sup> FT (9/6/99)

<sup>14</sup> Forbes (26/2/96)

<sup>15</sup> The New York Times (15/6/99)

<sup>16</sup> Forbes (26/2/96)

<sup>17</sup> The Economist (19/6/99)

<sup>18</sup> Business Week (8/12/97)

<sup>19</sup> Fortune (26/2/96)

<sup>20</sup> Business Week (8/12/97)

<sup>21</sup> Fortune (26/2/96)

portrayed as being something of a recluse. The New York Times, for example, referred to him as “the reclusive Denver billionaire”,<sup>22</sup> while the FT painted him as “media shy” claiming that, “This is a man so keen on privacy that almost no photographs of him exist”.<sup>23</sup>

Looking at the extent of his personal fortune: in 1995 he was worth around \$2 billion.<sup>24</sup> By 1999 his worth was put at \$16.5 billion - much of the increase attributable to Qwest’s strong market performance.<sup>25</sup> In late 1998 he was reported to be one of the richest 10 men in the U.S.<sup>26</sup> In keeping with such riches he is occasionally involved in philanthropy. He has given money to Bob Dole, the 1996 Republican presidential candidate, and to the arts.

While making the usual references to Anschutz being “press-shy”, the New York Times pointed out that it was only due to his “stealthy manoeuvrings” that a face-saving deal was finally agreed between Qwest and Global Crossing in the merger battle involving Frontier and US West (see Mergers section).<sup>27</sup> The implication was that when it came to the crunch his business ability was far stronger than his reclusive nature. There is also evidence to suggest that he keeps his head in a crisis. Even with “the ferocious merger battle” between Qwest and Global Crossing in full swing Anschutz, it seems, was busy doing other deals. Forbes revealed that he paid \$106 million for a video transmission and storage business called Slingshot at the same time as the merger talks.<sup>28</sup>

In addition to this deal he has also been involved in a number of recent ventures which are not directly related to Qwest. In 1995 he was part of a \$113 million deal to buy the Los Angeles King’s hockey team. In England, he has an interest in another ice hockey outfit, the London Knights. Other sporting interests include his involvement of three of Major League Soccer’s 12 teams (the Colorado Rapids, Los Angeles Galaxy and Chicago Fire). He also has a stake in the basketball team the LA Lakers.<sup>29</sup> The FT suggested that far from being a “sports nut”, Anschutz got so heavily involved in sports clubs in the LA area due to a plan to construct a giant complex in the city to house most of its sports teams.<sup>30</sup> His partner in this enterprise was media magnate Rupert Murdoch, who owns baseball’s LA Dodgers.

## **Joseph Nacchio**

As stated above Nacchio has been characterised as having the “personality” which compliments the business ability exhibited by Anschutz. Again, Forbes profiled him under the by-line: “An only in America story”.<sup>31</sup> It stated that he was the grandson of

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<sup>22</sup> The New York Times (6/7/99)

<sup>23</sup> FT (15/6/99, 30/10/98)

<sup>24</sup> Fortune (26/2/96)

<sup>25</sup> Forbes (26/7/99)

<sup>26</sup> FT (30/10/98)

<sup>27</sup> The New York Times (25/7/99)

<sup>28</sup> Forbes (26/7/99)

<sup>29</sup> FT (30/10/98)

<sup>30</sup> FT (30/10/98)

<sup>31</sup> Forbes (30/11/98)

a rag picker who emigrated from Italy and the first in his family to attend college. He “grew up in a scrappy Italian neighbourhood on Staten Island”.<sup>32</sup> Contrasting his background and upbringing with his present position at Qwest, Nacchio has commented that “My grandparents wouldn’t even understand what I do”.<sup>33</sup>

The “personality” of which so much has been made seems to be in keeping with the typical Italian immigrant upbringing which he experienced. That this left its mark is shown by the comments of the Economist which stated that: “At times Joe Nacchio looks and sounds as if he has walked straight off the set of a Martin Scorsese film”.<sup>34</sup> Less controversially, it has been said that, “Joe Nacchio is a dynamic guy” and that he is “self assured - cocky even”.<sup>35</sup> It has also been claimed that Nacchio’s personal qualities have been responsible for the development of something of a “machismo culture” within Qwest.<sup>36</sup>

He spent 25 years at AT&T, rising to run both the consumer and business long distance units. In 1996 he was a loser in the battle to succeed Robert Allen as the firm’s CEO by which time he claims to already have been “disincentivised” by the bureaucratic ways of the company and its failure to react to the opportunities presented by the explosion of the Internet.<sup>37</sup> He left the company “on not very pleasant terms”.<sup>38</sup> Upon the departure of Nacchio from AT&T, its new President, John Walter, wrote a letter to the staff stating that Mr Nacchio, “has always wanted to lead his own company, and it has become clear to him that won’t happen here at AT&T”.<sup>39</sup>

He arrived at Qwest in January 1997. His starting salary was \$600,000 with a \$300,000 annual bonus. In addition he received 6.3 million share options (worth around \$227 million at August 1998) plus an “equalization payment “ of \$10.7 million payable over three years as compensation for any benefits lost upon leaving AT&T.<sup>40</sup> In February 1999 he was named Chairman of Qwest, in addition to his two other posts of President and CEO.

## **H. Brian Thompson**

H. Brian Thompson joined Qwest as vice chairman in June 1998 with the take-over of LCI where he was Chairman and CEO. He resigned from this position in December 1998. He was then chosen to head the market floatation of Ireland’s state owned Telecom Eireann.<sup>41</sup> In March 1999 he was elected Chairman and CEO of Global TeleSystems - one of Qwest’s main competitors, particularly in the European carriers’ carrier market.

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<sup>32</sup> The New York Times (25/7/99)

<sup>33</sup> Quoted in Forbes (30/11/98)

<sup>34</sup> The Economist (US - 19/6/99)

<sup>35</sup> Fortune (16/8/99)

<sup>36</sup> The New York Times (15/6/99)

<sup>37</sup> The Economist (US - 19/6/99)

<sup>38</sup> Fortune (16/8/99)

<sup>39</sup> FT (24/12/96)

<sup>40</sup> Forbes (5/10/98)

<sup>41</sup> Telecommunications (March 1999)

## **Solomon Trujillo**

Following the merger between Qwest and US West (see Mergers section, below) Solomon Trujillo, the CEO and Chairman at US West since 1998, has emerged as a key individual. At times it has been commented that he is entirely different from Nacchio (and indeed from another assertive New Yorker, Robert Annunziata of Global Crossing, who also tried to do a deal with Trujillo's company in 1999). The New York Times, for example, described him as, "humble, soft-spoken, and earnest".<sup>42</sup>

He came from a Mexican-American background and is open about attributing his success, in part, to the programme of affirmative action. He started with AT&T in 1974 and recalls that "the only Hispanics there swept floors and cleaned bathrooms".<sup>43</sup> Due to affirmative action, however, he secured a white-collar position as a business forecaster with Mountain Bell in 1974. This was only a year after AT&T, in a settlement with the Equal Employment Opportunity Commission, had agreed to take on more members of minority groups. His official biography contains a comment from Henry Cisneros, the former Secretary of Housing and Urban Development, claiming that Mr Trujillo is "the most important Hispanic in corporate America today".<sup>44</sup>

Despite the poor image which has at times surrounded US West, Mr Trujillo has been widely credited with improving the company. In discussing his qualities the New York Times suggested that, "Mr Trujillo's ability to shift his stance may be his strongest asset, as he tries to change US West...into a global communications force".<sup>45</sup> This comment which was in reference to the company's strategic direction took on a rather different meaning when Trujillo found himself in close negotiations with Global Crossing (which led to an agreed merger) and then immediately afterwards with Qwest (which led to the original merger agreement being scrapped – see Mergers section, below).

## **Jack Grubman**

Another personality who crops up in the early years of Qwest (and also Global Crossing) is analyst Jack Grubman of Salomon Smith Barney. The FT described him as "the most prominent of Wall Street's new band of superstar analysts."<sup>46</sup> He had been instrumental in bringing together MCI and WorldCom and also played a key role in the proposed mergers between Global Crossing and both Frontier and US West (see Mergers section, below).

Things got rather complicated when Qwest entered the fray, since Grubman had been central in bringing both this company and Global Crossing to market and was an

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<sup>42</sup> The New York Times (23/5/99)

<sup>43</sup> Quoted in Fortune (21/6/99)

<sup>44</sup> Quoted in The New York Times (23/5/99)

<sup>45</sup> The New York Times (23/5/99)

<sup>46</sup> FT (23/6/99)

“unabashed bull” of both outfits.<sup>47</sup> In other words he had a close involvement with both of the “two darlings” of the telecom world.<sup>48</sup> In the case of Qwest the links went further since he had worked with its CEO, Joe Nacchio, at AT&T and had been instrumental in getting him recruited in that position at Qwest. During the protracted and often highly personalised battle between Global Crossing and Qwest, Grubman had to walk something of a diplomatic tightrope, although given that Salomon Smith Barney were acting on behalf of Global Crossing he had little choice but to come down on their side.

Mr Nacchio of Qwest denied that there was anything “personal” in the take-over battle and pointed out to reporters that Grubman had recently attended his son’s graduation party. Nacchio went on to claim that “the punch line is we’ll still be friends after this is over”.<sup>49</sup> In the course of the take-over battle, though, Nacchio admits that he informed Grubman and his fellow Global Crossing advisors that, “I’m going to drop a ton of bricks on your heads”.<sup>50</sup> He was, of course, speaking metaphorically.

## **2/Investors**

Qwest was wholly owned by the Anschutz Company until June 27, 1997 when the company issued common stock in an IPO. Anschutz’s initial investment in Qwest was reported to have been \$55 million.<sup>51</sup> As of late 1997 he had a 84.8 percent stake in the company - worth around \$2.9 billion at the time.<sup>52</sup> By late 1998 his stake had dropped to 52 percent.<sup>53</sup> Qwest’s 1998 Annual Report put his stake at 46.2 percent as at 31<sup>st</sup> December 1998.<sup>54</sup> In mid 1999 it was reported that even after selling \$1.5 billion of his stake to Bell South (see below), Anschutz retained around \$10 billion worth of shares.<sup>55</sup> As of March 2000 Anschutz’s stake was just under 38 per cent percent.<sup>56</sup> At this time Directors and Executives as a group (excluding Anschutz) accounted for less than one percent of the stock.<sup>57</sup>

In April 1999, Bell South paid around \$3.5 billion for a 10 percent share in Qwest. This gave the Baby-Bell its maximum allowable equity stake in the company until it wins long distance relief.<sup>58</sup> The Baby-Bell later lodged an SEC filing indicating that it could possibly take a controlling interest in the company at some point in the future.<sup>59</sup>

As part of a joint-venture arrangement in December 1998, Microsoft agreed to take \$200 million worth of Qwest’s equity at \$45 a share - given Bill Gates’ corporation a

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<sup>47</sup> Ibid

<sup>48</sup> Forbes (5/7/99)

<sup>49</sup> The New York Times (22/6/99)

<sup>50</sup> Quoted in The New York Times (25/7/99)

<sup>51</sup> Forbes (8/10/97)

<sup>52</sup> Ibid

<sup>53</sup> Forbes (30/11/98)

<sup>54</sup> 1998 Annual Report, p32

<sup>55</sup> FT (15/6/99)

<sup>56</sup> SEC Form DEF 14A, Definitive Proxy Statement (17/3/2000, p2)

<sup>57</sup> Ibid

<sup>58</sup> Telephony (26/4/99)

<sup>59</sup> The New York Times (10/6/99)

1.4 percent stake in the company.<sup>60</sup> According to Business Week the First Capital Group also had a significant stake in Qwest.<sup>61</sup>

### **3/Mergers, Acquisitions and Joint Ventures**

In the company's Fact Sheet, provided with its Investors' Pack, one of its stated strategies is to "Expand quickly through acquisitions, alliances and internal growth". The following account of mergers, acquisitions and joint ventures shows that Qwest has been true to its word with an intense level of activity over the last few years. In particular Qwest has been busy forging strategic alliances with key names in the computing and Internet world. The extent of this activity is demonstrated by the fact that Qwest has established relationships with both Netscape and Microsoft - two companies which are conventionally portrayed as mutually hostile. In the Fact Sheet Qwest emphasises the importance of these alliances and claims that:

"Through strategic relationships Qwest is leading the move toward convergence of telecommunications and computing".

#### **Acquisitions**

In October 1997 Qwest purchased SuperNet for \$20 million in cash. This Colorado-based ISP offered a "quality service record and extensive customer base".<sup>62</sup>

In March 1998 Qwest acquired Phoenix Network Inc., a non-facilities-based reseller of long distance services. The price was \$27.2 million worth of Qwest's common stock.<sup>63</sup>

In April 1998 Qwest paid \$150 million in cash and stock for Eunet International, a European Internet Service Provider based in Holland with 60,000 business customers and operations in 13 countries in Europe.<sup>64</sup> Telecommunications greeted the news with the headline, "Operators and ISPs begin symbiotic relationship", arguing that increasingly companies such as Qwest were choosing to buy, rather than build, their ISP expertise.<sup>65</sup> The Dutch company, it suggested, would be used as a foothold for Qwest's planned introduction of IP telephony into Europe. Writing in the 1998 Annual Report Nacchio stated that the company made Qwest a "major player in Europe's exploding data market".<sup>66</sup> Commenting upon the purchase the FT stated that:

"The deal underlines Qwest's determination to build its international operations and signals a further consolidation in the fragmented European ISP

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<sup>60</sup> The New York Times (15/12/98)

<sup>61</sup> Business Week (10/8/98)

<sup>62</sup> Annual Report, 1998, p19

<sup>63</sup> Ibid

<sup>64</sup> Forbes (30/11/98, FT 27/3/98)

<sup>65</sup> Telecommunications (May 1998)

<sup>66</sup> 1998 Annual Report, p5

market”<sup>67</sup>

In March 1998 Qwest made a \$4.4 billion all-paper bid for LCI International, a 15 year old company known for the sophistication of its marketing.<sup>68</sup> The logic behind the acquisition was obvious, claimed Richard Klugman of Goldman Sachs:

“Qwest has the network and is working on getting a customer base. LCI has the customer base and is working on growing its network”<sup>69</sup>

This purchase “vaulted” Qwest to become the fourth largest long-distance carrier in the U.S. - and was seen as something of “a slap in the face” for the “Big Three” operators, AT&T, MCI WorldCom and Sprint.<sup>70</sup> By gaining access to LCI’s customer-base, the deal would, according to Nacchio, allow Qwest to accelerate its plans by about three years”.<sup>71</sup>

In September 1998 Qwest paid \$185 million in stock for Icon CMT Corp which provides Web and network services to companies such as Bear, Stearns & Co., CBS and Pfizer.<sup>72</sup> Telephony reported that the deal would give Qwest immediate leadership in the Internet service market.<sup>73</sup> The company subsequently changed its name to Qwest Internet solutions and started deploying Qwest Cyber Centers across the U.S. to provide Web hosting and IP-based Internet solutions.<sup>74</sup> In a press release relating to the announcement Qwest suggested that the “merger” would also boost its relationship with Microsoft (see joint-ventures, below) in that Icon’s sales channels, data centres and IT staff would contribute to that alliance’s provision of advanced hosting services.<sup>75</sup>

## **Mergers**

### **The Battle with Global Crossing for Frontier and US West**

In early 1999 the “upstart” telecom companies Qwest and Global Crossing were little known outside of specialist circles. By the middle of that year they were seldom out of the business news. Much could be written about the tussle between the two for control of Frontier and US West. Here, only a brief account is given but suffice to say that the episode was in keeping with the comments by Telephony that the telecommunications industry was becoming “a virtual soap opera”.<sup>76</sup>

In March 1999 Global Crossing announced that it had reached a merger agreement with Frontier Corporation, one of the country’s leading providers of facilities-based integrated communications and Internet services and owner of GlobalCenter, one of

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<sup>67</sup> FT (27/3/98)

<sup>68</sup> Economist (14/3/98), FT (10/3/98)

<sup>69</sup> Quoted in Economist (14/3/98)

<sup>70</sup> FT (9/6/99)

<sup>71</sup> FT (10/3/98)

<sup>72</sup> Forbes (30/11/98)

<sup>73</sup> Telephony (21/9/98)

<sup>74</sup> Annual Report, 1998, p5

<sup>75</sup> Press Release (4/1/99)

<sup>76</sup> Telephony (5/4/99)

the biggest web hosting concerns. The deal was worth \$11.2 billion.<sup>77</sup> Frontier, once known as Rochester Telecom, had been one of the first companies to buy capacity from Qwest as a way of branching out into the long distance business.<sup>78</sup> This early business relationship provided the first link with Qwest which would in time make its own counter bid.

In May 1999 Global Crossing indicated that it was also to merge with US West, the smallest and most rural remaining “Baby Bell” in an agreement valued at \$37 billion.<sup>79</sup> As Forbes put it US West was “nobody’s idea of a glamour stock”<sup>80</sup>: indeed it was often referred to as “US Worst” due to its “horrible customer service”.<sup>81</sup> The New York Times called the company the “slow growing runt of the Baby Bell local phone family”.<sup>82</sup> But with almost 55,000 employees it was still a big fish for a minnow like Global Crossing (with a workforce of under 200) to consider. The Economist referred to the move as “a piece of social climbing which would make Cinderella gasp”.<sup>83</sup> The FT, for its part, implied it was an audacious step for a mere “paper company” such as Global Crossing.<sup>84</sup>

Many commentators were impressed with the assertiveness shown by Global Crossing in its strategic manoeuvring. Utility Business suggested that the company “at two years considered just a toddler in the telecommunications industry, is hitting the terrible twos in grand style”.<sup>85</sup> But then came along an older child, in the form of Joseph Nacchio, who had its sights set on the toddler’s new toys.

On June 12 1999 Qwest announced simultaneous hostile bids for both Frontier and US West. Together the bids represented the largest ever unsolicited take-over offer.<sup>86</sup> Clearly such a move would “scuttle the plans of Global Crossing Ltd”.<sup>87</sup> As the FT observed, Qwest seemed to be attempting “to take over Global Crossing’s strategy lock, stock and barrel”.<sup>88</sup> The initial offers were rejected by both Frontier and US West. In assessing the bids Lex was quite scathing, suggesting that Qwest was “more-or-less a virtual company”, although admittedly it was not simply “a paper company” like Global Crossing.<sup>89</sup>

While rumours had been flying around Wall Street that a counter bid might be made for US West by Qwest, few analysts expected the double-barrelled attack which materialised. The Economist focused upon Qwest’s CEO, suggesting that, “Some of Nacchio’s admirers feared that this time he may have let his natural aggression get the

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<sup>77</sup> Global Crossing Web site

<sup>78</sup> FT (18/3/99)

<sup>79</sup> The New York Times (17/5/99)

<sup>80</sup> Forbes (5/7/99)

<sup>81</sup> Internet Week (21/6/99)

<sup>82</sup> The New York Times (23/5/99)

<sup>83</sup> The Economist (22/5/99)

<sup>84</sup> FT (15/6/99)

<sup>85</sup> Utility Business (June, 1999)

<sup>86</sup> FT (14/6/99)

<sup>87</sup> Pensions and Investments (28/6/99)

<sup>88</sup> FT (15/6/99)

<sup>89</sup> FT (15/6/99)

better of his business sense”.<sup>90</sup> The FT, followed a similar line, referring to Mr Nacchio’s “chagrin” when “Mr Winnick’s Global Crossing emerged from nowhere to unseat Qwest as the most talked-of company in the industry”.<sup>91</sup> It went on to imply that US West merging with Global Crossing would have been all the more painful given that both Qwest and US West were based in Denver and had previously enjoyed a close marketing agreement (see Joint-venture section, below).

Immediately after the bid Qwest’s shares fell by around 25 percent in record trading, removing most of the premium over Global Crossing’s original offers.<sup>92</sup> As the New York Times put it, investors had “panned” the offer.<sup>93</sup> The publication, Telephony agreed, suggesting that Qwest’s stock had experienced “a staggering fall”.<sup>94</sup> As Pensions & Investments put it, Qwest “was a growth stock when the market closed June 11. Portfolio managers were treating it as a laggard 3 days later.”<sup>95</sup> By June 23 its stock was 30 percent down on its pre-bid levels.<sup>96</sup>

Before long a war of words had erupted between Global Crossing and Qwest. On balance, though, it is probably fair to say that most of the verbal barrage came from Qwest and from Nacchio in particular. Part of this was attributable to the gagging order which was effectively placed upon CEO Annunziata until Global Crossing could file the necessary documentation with the regulators.<sup>97</sup> When Nacchio of Qwest was asked if he would consider a take-over of Global Crossing itself, he replied, “let’s face it, all Global Crossing has is one cable under the sea”.<sup>98</sup> This was not the first time Nacchio had homed in on this side of Global Crossing. In another interview he had stated that:

“Global Crossing have described themselves as the wet Qwest - Qwest under the ocean. They have aspirations to be like us but they’re not. We’ve completed our nation-wide network. They have one cable under the Atlantic”<sup>99</sup>

Neither of the initial bids were accepted, not least due to the fall in Qwest’s share price which had reduced the value of their all-paper offers. Business Week, speaking of Nacchio, argued that, “With the current offer, he’s not going to get US West and he’s not going to get Frontier. He’s just going to get embarrassed”.<sup>100</sup> Its advice was presented under the headline “Qwest, pull the plug on this deal.”

But the plug was not pulled and on June 23 Qwest made an improved bid for the two companies containing various “sweeteners”. The response of the two target companies was less than enthusiastic. Lex was not impressed either, asking, “What is

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<sup>90</sup> The Economist (19/6/99)

<sup>91</sup> FT (14/6/99)

<sup>92</sup> The Economist (19/6/99)

<sup>93</sup> The New York Times ((24/6/99)

<sup>94</sup> Telephony (21/6/99)

<sup>95</sup> Pensions & Investments (28/6/99)

<sup>96</sup> FT (24/6/99)

<sup>97</sup> The New York Times (25/7/99)

<sup>98</sup> Quoted in The New York Times (24/6/99)

<sup>99</sup> Quoted in The New York Times (14/6/99)

<sup>100</sup> Business Week (28/6/99)

worse than launching a hostile bid that fails to impress? Raising it and still not delivering a killer blow". Lex went on to suggest that Qwest could finally prove victorious but that it has "hardly looked smart so far".<sup>101</sup> After Qwest had struggled to impress for the second time the New York Times repeated the comments of a Wall Street banker who had suggested after the original hostile bids that, "This will be a Harvard Business School case study someday on how not to launch a hostile takeover".<sup>102</sup> The New York Times also suggested that the company's subsequent "road show" in which it tried to sell the deal to investors was "equally disastrous".<sup>103</sup> One analyst, Robert Gensler, of the mutual fund company T. Rowe Rice, expressed the views of many commentators when he commented that, "I think the whole strategy is absurd".<sup>104</sup> Luckily for Qwest, however, the stock-price of Global Crossing had also been getting weaker during the battle - making its own increased offers look more attractive.<sup>105</sup>

On June 18 the New York Times implied that Qwest was much more interested in US West than in Frontier. This view was supported by Brian Hayward, manager at Invesco Worldwide Communications fund, who stated that "if I were guessing, I could see Global Crossing getting Frontier and US West going with Qwest".<sup>106</sup> He guessed correctly. On July 19 it was announced that Global Crossing and Qwest had reached a "gentleman's agreement" whereby Global Crossing was to go ahead with its merger with Frontier and Qwest was to get US West in a \$36.5 billion deal.<sup>107</sup>

Commenting upon the original agreement between Global Crossing and US West, Annunziata, in keeping with his dynamic reputation, indicated that the joint outfit would be a thorn in the side of the major players since "the good news is we know how to move quick".<sup>108</sup> Unfortunately, on this occasion Global Crossing did not move quickly enough to prevent this deal being scuppered by Qwest. Annunziata and Global Crossing did, however, have the consolation of a break-up fee of \$420 million from US West to help restore their wounded pride. This comprised of three equal \$140 million increments, namely:

- \* cash, to be paid immediately;
- \* returned Global Crossing stock from the tender offer (valued at the same \$62.75 per share at which US West acquired it); and
- \* capacity purchase on the Global Crossing network, to be purchased over two years at Global Crossing's published Tier 3 prices.<sup>109</sup>

Interestingly, this final break up fee represented less than half the agreed sum of \$850 million which had been written into the original agreement. The lesser penalty to US West is likely to have formed part of the merger compromise reached between Global

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<sup>101</sup> FT (24/6/99)

<sup>102</sup> Quoted in The New York Times (6/7/99, 25/7/99)

<sup>103</sup> The New York Times (25/7/99)

<sup>104</sup> Quoted in Ibid

<sup>105</sup> FT (9/7/99)

<sup>106</sup> Quoted in The New York Times (20/6/99)

<sup>107</sup> The New York Times (19/7/99)

<sup>108</sup> Quoted in Fortune (21/6/99)

<sup>109</sup> GC Letter to Shareholders, 18/7/99

Crossing and Qwest - the result of what the New York Times called “weeks of almost Machiavellian manoeuvring”.<sup>110</sup>

While Global Crossing and Qwest were fighting it out in these take-over battles it could have been easy to overlook just how similar the aims of the two companies were. Both had reached a critical time in their development whereby they needed to acquire customers and attempt to join the big-league players. This was recognised by the FT which stated that:

"By providing customers, an instant sales force and direct access to customers through local networks, those acquisitions would help to turn both companies from construction projects into rounded telephone companies"<sup>111</sup>

The New York Times made a similar point:

“Both Global Crossing and Qwest need customers, and they need to get them before investors realize how great the need really is”.<sup>112</sup>

Earlier, this newspaper had helped to add some historical perspective to the episode arguing that:

“The Global Crossing - Qwest showdown is just the latest bombshell in the telecommunications industry which has come to resemble the railroad and steel industries of a century ago in its ruthless dashes for assets and market share”<sup>113</sup>

Reading the post-merger comments by both Global Crossing and Qwest it is easy to accept the theory than the outcome represented a “win-win” compromise with both companies getting what they truly coveted. Mark Bruneau, of Renaissance Worldwide, was less inclined to accept this “victimless” assessment, suggesting that:

“This is a big win for Qwest because it’s proving that you can acquire your way into local access...and it’s a big loss for Global Crossing because it has limited time to convert its lofty market valuation into a real, sustainable revenue engine and operation”<sup>114</sup>

While Qwest can be presented as victorious, however, the reputation of Nacchio was not enhanced during the episode, with the business press frequently questioning his motives and temperament. Rather than a “win-win” outcome, then, it seems just as valid to argue that to some extent both companies emerged as losers from the affair.

### **Qwest’s Post-Merger Relationship with US West**

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<sup>110</sup> The New York Times (25/6/99, 21/7/99)

<sup>111</sup> FT (30/6/99)

<sup>112</sup> The New York Times (19/6/99)

<sup>113</sup> The New York Times (14/6/99)

<sup>114</sup> Quoted in The New York Times (17/7/99)

The post-merger company would have a market capitalisation of around \$65 billion, sales of \$18.5 billion and 29 million customers.<sup>115</sup> A company press release indicated that the newly merged entity would qualify as a Fortune 100 company which would:

“bring together the world's most advanced network providing broadband Internet communications with the most innovative local communications and the nation's leader in providing high-speed Internet access through advanced DSL technology”<sup>116</sup>

Even after Qwest succeeded in having talks with US West, however, the negotiations were far from straight forward. The New York Times quoted their ubiquitous person “close to the talks” who informed them that, “US West was concerned about Qwest slashing and burning its management team”.<sup>117</sup> In the end Qwest conceded a significant role for US West’s management in the new company and agreed to Sol Trujillo becoming Co-Chairman and taking charge of the company’s local and wireless operations. This formed part of an agreement whereby the new Qwest would have three Co-Chairmen: Mr Trujillo, Mr Nacchio and Mr Anschutz.<sup>118</sup> Mr Nacchio would also serve as CEO of the new company. Such a “*menage a trois* management plan” was described by the FT as “unconventional” and “bizarre”.<sup>119</sup>

Qwest did not, however, waste any time in exploiting the greater opportunities which the inclusion of US West within the corporation presented. In August 1999 Qwest announced that it was offering high speed Internet access in 13 US cities, with the intention of increasing that to 30 by the end of the year. According to the New York Times this plan had been assisted by its merger with US West which “has been the most aggressive of the regional Bells in selling digital subscriber line services”.<sup>120</sup> It was expected that other announcements would follow as Qwest acted to maximise the potential of its newly enlarged customer base.

### **Deutsche Telekom’s Involvement**

By the Spring of 2000 the merger between Qwest and US West was well on its way to winning regulatory approval. This complicated and convoluted deal, it appeared, was nearing its conclusion. Then in March the whole merger process was thrown into confusion by Deutsche Telekom’s attempt to merge with both US companies. Clearly, though, the German incumbent was far more interested in Qwest’s digital network than in US West’s local business. Earlier it had been seen as a prime candidate to take over Global Crossing in order to secure its network assets. For this reason it intended to offer a higher premium for Qwest’s shares than for US West’s. This prompted US West to block the deal unless its share holders were treated on an equal basis. Failing this it insisted that the original merger with Qwest proceed as scheduled. Any delay or backtracking on the part of Qwest would be met by a substantial claim for damages.<sup>121</sup> Finally, faced with the prospect of paying almost

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<sup>115</sup> PC Week (26/7/99)

<sup>116</sup> press release (27/7/99)

<sup>117</sup> Quoted in The New York Times (25/7/99)

<sup>118</sup> FT (19/7/99)

<sup>119</sup> FT (20/7/99)

<sup>120</sup> The New York Times (5/8/99)

<sup>121</sup> FT.com, 6/3/2000

\$100 billion for two companies, one of which it did not want, Deutsche Telekom withdrew from negotiations.<sup>122</sup>

The episode undoubtedly did further harm to Qwest's reputation and to its ongoing relationship with US West. In particular, the relationship between Nacchio and Trujillo was tested. Speaking after the collapse of the merger talks Qwest's CEO stated that:

“We regret that US West apparently wouldn't even consider an alternative transaction...despite the possibility of greater value for US West shareholders”<sup>123</sup>

Meanwhile Trujillo undoubtedly felt marginalized during Qwest's attempts to align itself with Deutsche Telekom. Speaking of Nacchio he stated that, “Joe and I really don't have the same style and beliefs”.<sup>124</sup> Given that the two men would be Co-Chairmen of their combined companies this did not bode well for the future.

### **Joint Ventures**

In May 1996 GTE announced plans to buy a quarter of the Internet capacity of the Qwest network. The price put on the deal was around \$450 million. While the deal was more a supplier/customer arrangement than a joint-venture, the two companies are often discussed in a way which would suggest they have an on-going collaborative arrangement.<sup>125</sup>

In 1998 Qwest was selected to provide the Internet backbone to connect 130 universities across the US as part of the Internet 2 project. The plan had originally been announced by President Clinton in 1996.<sup>126</sup> As part of the deal Qwest agreed to donate 16,000 route fibre miles of its OC-192 network to help build “Abilene”, the network backbone for Internet 2, a project which had originally been initiated by the University Corp. For Advanced Internet Development. The donation announcement was made by Vice President, Al Gore, with Nacchio at his side - something of a coup for the young company.<sup>127</sup> Commenting upon the new system, thought to be 1000 times faster than today's Internet, Al Gore stated that:

“In coming years this investment may enable the best medical specialists to give advice to patients in rural hospitals, scientists to use remote supercomputers to predict tornadoes, and adults to get new skills through distance learning”<sup>128</sup>

In February 1998 Qwest formed a joint marketing agreement with Hughes Network Systems for ATM and frame relay products. Qwest agreed to deploy Hughes' Radiant multiservice edge switches on its network and designated the company as first

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<sup>122</sup> FT (10/3/2000).

<sup>123</sup> Quoted on FT.com, 10/3/2000

<sup>124</sup> Quoted in FT.com, 3/3/2000

<sup>125</sup> FT (21/5/97,16/10/97, 18/10/97)

<sup>126</sup> FT (18/3/99)

<sup>127</sup> Network World (20/4/98)

<sup>128</sup> Quoted in FT (15/4/98)

technology partner.<sup>129</sup> It also announced a deal with Northern Telecom whereby it would utilise its Transport Node OC-192 technology, designed for traditional voice networks. This was interpreted as a sign that Qwest was not abandoning older technologies altogether (something which separated it from “purist” digital network builders such as Level 3).

In February 1998 Qwest finalised a marketing deal with !nterprise (a division of US West). The arrangement was described as an “unusual partnership” which allowed the companies to take advantage of a loophole in the 1996 Telecom Act which allowed a Bell company to market an unaffiliated carrier’s services.<sup>130</sup> The deal was quickly followed up by another one with Ameritech. Just as quickly, though, five of Qwest’s competitors filed law suits against it claiming a breach of the 1996 legislation.<sup>131</sup> A few months later Network World reported that Qwest’s lawyers were “pulling out all the stops” to salvage the deals.<sup>132</sup> The attempt was unsuccessful, however, and in September 1998 it was reported that the attempt to “side-step” the long distance regulatory restrictions had been blocked by the FCC.<sup>133</sup> David Goodtree of Forrester Research had seen the type of alliance between Qwest and US West as a natural way forward, commenting that:

“It’s good for customers and both companies get to do what they’re best at. It shows you don’t have to own all the assets to keep ahead”<sup>134</sup>

As just stated, though, the companies were ultimately prevented by the FCC from doing what they were best at in a collaborative arrangement. As a result, it seems that Qwest concluded that the only way forward was indeed to own the assets - a change of stance which would lead to their takeover bid for US West a little over a year later.

Around July 1998 speculation was growing that BT was on the verge of announcing a major alliance with a U.S. operator, following the collapse of its relationship with MCI. In the end it was to link up with AT&T but the short-list was also thought to include Qwest.<sup>135</sup> As part of this ongoing speculation the Economist had previously suggested that Qwest could be an out right takeover target for BT. Exercising caution, however, it reminded its readers that, “Qwest’s eye-watering rating gives it a phenomenal market value of nearly \$12 billion, and it comes with a gung-ho culture that BT might find impossibly alien”.<sup>136</sup>

In August 1998 it was reported that BCE, the Canadian telecoms group, was actively seeking a partner in order to move into the U.S. market.<sup>137</sup> Qwest was seen as one of the most likely candidates. The FT later indicated that talks had had taken place between the two companies although nothing definite was announced.<sup>138</sup>

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<sup>129</sup> Telephony (16/2/98)

<sup>130</sup> Telephony (11/5/98)

<sup>131</sup> The New York Times (15/5/98)

<sup>132</sup> Network World (20/7/98)

<sup>133</sup> The New York Times (29/9/98)

<sup>134</sup> Quoted in The Economist (16/5/98)

<sup>135</sup> FT (16/7/98)

<sup>136</sup> The Economist (4/4/98)

<sup>137</sup> The FT (13/8/98)

<sup>138</sup> FT (5/3/99)

In September 1998 it was announced that Qwest was teaming up with Netscape in a venture called Netscape Contact which would allow consumers to manage voice mail, E-mail and fax communications through a single site on the Web.<sup>139</sup> The three year agreement would also see the companies focusing upon corporate communication management. Information Week commented that, “The future demand for these combined services for corporate customers looks strong”.<sup>140</sup> The most visible affect of this alliance would be that Qwest would, in the future, have a button on the tool bar Netscape’s Communicator web browser. Commenting upon Netscape’s move into the corporate service sector the FT suggested that it was a “lucrative, but uninspiring activity”. It concluded that “Netscape, the pioneer of the Internet, has gone mainstream”.<sup>141</sup>

In November 1998 a \$1.2 billion joint-venture between Qwest and KPN, the dominant phone company in the Netherlands, was announced. The deal involved the provision of high-speed data services to European businesses, with the operation going under the name KPN Qwest. The deal, suggested the FT would create Europe’s biggest network for Internet traffic and may lead to joint activities in other areas of the telecoms market.<sup>142</sup> The venture was designed to serve multinational companies and also other telecoms carriers and Internet service providers. Nacchio stated that, “This will allow our customers to manage their data, video and voice networks as these converge”. Part of the deal involved the incorporation of Qwest’s recent purchase EUNET into the joint-venture.<sup>143</sup>

KPN had previously been involved in a tie-up with AT&T in the form of the Unisource Communications Service - an arrangement which was being “unwound” after AT&T’s new alliance with BT.<sup>144</sup>

In early 1999 the joint-venture company announced that it had won a \$50 million contract to provide an advanced high-speed fibre optic network linking European research centres.<sup>145</sup> In April 1999, the FT announced that the joint operation was considering a stock market listing in order to help finance future acquisitions across Europe. Qwest executive Jack McMaster (later appointed Chief Operating Officer of the joint-venture) was quoted as saying that such a move would give the operation “a currency to expand”.<sup>146</sup> The IPO for the company duly took place in November 1999, with around 10 percent of its shares being floated. At the time the operation was valued at around \$8.4 billion.<sup>147</sup> The offering was designed to raise about \$1 billion of the \$2.1 billion that that the company needed to complete its pan-European network.<sup>148</sup>

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<sup>139</sup> The New York Times (17/9/98)

<sup>140</sup> Information Week (28/9/98)

<sup>141</sup> FT (3/1/98)

<sup>142</sup> FT (20/11/98)

<sup>143</sup> FT (9/6/99)

<sup>144</sup> FT (20/11/98)

<sup>145</sup> FT (12/2/99)

<sup>146</sup> Quoted in FT (15/4/99)

<sup>147</sup> FT (5/11/99)

<sup>148</sup> FT (10/11/2000)

In December 1998 Qwest announced an exclusive multi-year agreement with OfficeMax to provide prepaid calling cards for the chain's private label brand, OfficeMax Prepaid Phone Cards.<sup>149</sup>

In December 1998 a deal was announced between Qwest and Microsoft whereby the former company would host electronic commerce Web applications and virtual private networks as part of the increasing outsourcing of applications to external networks. The applications used for these services would be based upon Windows NT. Qwest indicated that it would create a new business unit focusing upon the new services early in 1999.<sup>150</sup>

As part of the joint-venture, Microsoft agreed to take \$200 million worth of Qwest's equity at \$45 a share - given Bill Gates' corporation a 1.4 percent stake in the company.<sup>151</sup> Commenting upon the increasing interest being shown in the outsourcing of applications, the FT stated that "Even Microsoft is dipping a fairly fat toe in the water".<sup>152</sup> The Economist described Internet-based outsourcing as a "huge and fast growing business" and distinguished it from the more traditional "end-to-end" variant whereby the likes of IBM would offer a complete package of solutions to large corporations. To clarify:

"If end-to-end outsourcing is the computer equivalent of limousines with chauffeurs, the new version is a fleet of taxis - less luxurious, but much cheaper and for hire to businesses anywhere"<sup>153</sup>

Commenting further upon the trend, the Economist stated that:

"Some companies will feel uneasy about giving their most valuable data to hired guns half a continent away. But for others, leaving the management of the network, systems, data and applications to contracted professionals is an idea whose time has come"<sup>154</sup>

Other industry sources continued to feel "uneasy" about the rapid development of applications outsourcing with Information Week warning that:

"Businesses would be wise to approach this new market with a degree of scepticism. The promises - cheaper, faster, more effective computing architectures - resemble those in the infancy of client-server computing"<sup>155</sup>

Discussing the deal in more detail the FT suggested that the alliance could represent a "significant link" with Qwest and was a step beyond Microsoft's previous investments in telecom firms (such as UUNET) which were "passive" in nature.<sup>156</sup> One immediate

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<sup>149</sup> Discount Merchandiser (Dec, 1998)

<sup>150</sup> Computer weekly (17/12/98)

<sup>151</sup> The New York Times (15/12/98)

<sup>152</sup> FT (9/1/99)

<sup>153</sup> The Economist (9/1/99)

<sup>154</sup> Ibid

<sup>155</sup> Information Week (21/12/98)

<sup>156</sup> FT (15/12/98)

goal for Microsoft, it argued, was to prove that Windows NT was suitable for large scale systems - something which competitors such as Sun Microsystems had frequently questioned.

Referring to the alliance in the 1998 Annual Report Nacchio pointed out that the deal would give Qwest access to 88,000 sales distribution points that provide Microsoft products. He estimated the revenue potential at \$3 billion over the next five years and drew attention to the launch in March 1999 of the alliance's first product: Q. Commerce-Retail, a turnkey solution for the retail industry to create Web-based store-fronts.<sup>157</sup>

In early 1999 Qwest moved further into application outsourcing by teaming up with Hewlett-Packard Co., Siebel Systems Inc and SAP AG to offer hosted business automation applications. These planned hosted applications ranged from Enterprise Resource Planning (ERP) to Virtual Private Network (VPN) services. Speaking of the move, Vab Goel, Vice President of engineering and advanced technologies at Qwest, stated that, "We can go to IT managers and basically help them amalgamate all of their systems and move to a single uniform solution".<sup>158</sup> Talking about the explosion of data traffic Network World had previously predicted a significant role for the new telecom providers suggesting that, "From a network manager's perspective, now is the time to get to know the new carriers, such as Qwest, Level 3, IXC and Williams Telecommunications..."<sup>159</sup>

Also in early 1999 Qwest made an investment of \$15 million in cash in Covad Communications, a packet-based CLEC which provides Digital Subscriber Lines (DSLs) to Internet Service Providers and enterprise customers. Nacchio described this investment as a "pivotal step" in that it would enhance Qwest's local connectivity capacity.<sup>160</sup> Referring to the DSL service he indicated that it would be in use within 22 local markets by the end of 1999 and would be complimented by Qwest's own construction of local networks in key cities across the U.S. In the press release (which accompanied the announcement he stated that:

"With the explosive growth of the Internet, including e-commerce and web-hosting, it is critically important that Qwest has direct, unrestricted high-speed broadband access to its customers"<sup>161</sup>

Qwest later followed up the Covad deal with an investment in Rhythms, another local access provider focussing on DSL services.<sup>162</sup>

In April 1999 Qwest announced a link-up with Bell South to promote a number of joint marketing initiatives. The Baby-Bell, which was seen by many analysts as a future buyer of the company, agreed to buy a 10 percent stake in Qwest for around

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<sup>157</sup> 1998 Annual Report, p5

<sup>158</sup> Quoted in PC Week (7/6/99)

<sup>159</sup> Network World (25/5/98)

<sup>160</sup> 1998 Annual Report, p6

<sup>161</sup> press release (19/1/99)

<sup>162</sup> 1999 Annual Report

\$3.5 billion.<sup>163</sup> Initially, the broad partnership agreement would give Bell South access to Qwest's nation-wide network, while Qwest, in turn, would be given better access to Bell South's client base in the South East of the US. The tie-up was seen by some analysts as a means by which Bell South could compensate for its lack of a strategic merger - the chosen path for most of the Baby Bells. The FT commented that it was an "investment aimed at plugging the gaps caused by its independent strategy."<sup>164</sup>

In June 1999 an SEC filing by Bell South indicated that it was actively discussing the possibility of a merger with Qwest as a follow up to its 10 percent equity purchase. It also revealed, however, that for the time being it would not be given any seats upon the Qwest board. This would change once it won long-distance authority from state and federal regulators in four of the nine states in its region.<sup>165</sup>

Also in June 1999 Qwest moved further into applications outsourcing by teaming up with Oracle, an arrangement through which business customers would be able to use Qwest's network to access a full suite of Oracle applications. The new service, to be called Business Online, would be marketed by both companies although only Oracle would deal with sales.<sup>166</sup>

Reviewing the outsourcing sector the Economist suggested that, "The most determined firm is Oracle", which led the market for corporate databases and was the number two firm in "enterprise resource planning".<sup>167</sup> Other big names in the venture included Sun Microsystems and Hewlett-Packard. Commenting upon the rising importance of outsourcing, the Economist went on to argue that, "Rented applications fit beautifully with Oracle's vision of a simpler and more reliable form of computing based on the open standards of the Internet".<sup>168</sup> Referring to alliances such as this, Information Week commented that "the need for IT skills and for a network infrastructure with high availability, reliability, and security is leading to new types of partnerships between IT organizations and service providers...".<sup>169</sup>

Again in June 1999 Qwest announced it had teamed up with KPMG, the accounting and consulting firm, to launch Qwest Cyber Solutions, an Internet-based end-to-end Application Service Provider (ASP) that will offer application hosting and application management services. Qwest, which would have a 51 percent stake in the venture would contribute international access to its network and access to the 7 Cybercenter hosting facilities that it planned to have in operation by the end of the year. Internet Week saw this as an attempt by Qwest "to ease its way into application outsourcing", in particular in relation to midsize companies without the resources to manage complex collaborative applications.<sup>170</sup>

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<sup>163</sup> Telephony (26/4/99)

<sup>164</sup> FT (20/4/99)

<sup>165</sup> Network World (14/6/99)

<sup>166</sup> Network World (7/6/99), Computer Reseller (7/6/99)

<sup>167</sup> The Economist (9/1/99)

<sup>168</sup> Ibid

<sup>169</sup> Information Week (7/6/99)

<sup>170</sup> Internet Week (28/6/99)

Also in June 1999 Qwest announced that, along with other investors, it intended to take a 48 percent stake in fixed-wireless operator Advanced Radio Telecom (ART) for a price of \$251 million. Commenting upon the deal the New York Times pointed to the tremendous growth potential in the fixed-wireless industry which was forecast to increase from \$103 million in 1998 to an estimated \$8.5 billion in 2007. The “payoff”, it suggested, “could be big”.<sup>171</sup> Referring to the deal, Telephony put Qwest’s level of investment at \$90 million and indicated that there would be an attempt to incorporate the company within Qwest’s brand. ART, it said, were planning to build out in 40 of the top 50 US markets over the following two years.<sup>172</sup>

Also in June 1999 it was reported that Qwest was partnering the company, US Clearing, in providing customised Web services for a range of its clients in the US clearing sector.<sup>173</sup>

Yet again, in June 1999 Qwest announced a “partnership” with Cisco Systems Inc, worth around \$1 billion, to jointly develop advanced communications services based on Internet technology. Lewis O. Wilks, President of Qwest’s Internet unit, said that the deal “gives us a partner that can help us on the technology side”. He continued to explain that as Qwest moved from standard telephone networks to systems based on Internet technology that “Cisco is helping us architect it so that transition is seamless”.<sup>174</sup> Unlike companies such as Level 3, however, Qwest was not prepared to commit itself to an all-Internet-based network and indicated that it would continue to use a range of protocols.

In September 1999 Qwest and Anschutz Digital Media formed a joint venture called Slingshot Networks to provide advanced digital production and transmission facilities together with digital media storage and distribution services. Qwest’s contribution was put at \$85 million.<sup>175</sup>

In early 2000 Qwest announced that it would be collaborating with IBM in the construction of 28 new Web-hosting centres in the US. This was followed by a similar agreement with KPN Qwest for the construction of 18 such centres in Europe. As part of the deal IBM would lease 25 per cent of the space in the centres to handle its own customers’ Internet needs.<sup>176</sup> The moves were seen as part of Qwest’s attempts to establish itself as a leading company in the expanding Web-hosting market.

## **Suppliers**

In August 2000 the shares of Next Level Communications fell by over 55 percent in a single session when a report by Lehman Brothers suggested that US West would not represent such a big customer now that it formed part of Qwest. US West had relied

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<sup>171</sup> The New York Times (13/6/99)

<sup>172</sup> Telephony (7/6/99)

<sup>173</sup> Wall Street and Technology (June, 1999)

<sup>174</sup> Quoted in The New York Times (17/6/99)

<sup>175</sup> 1999 Annual Report

<sup>176</sup> FT (5/4/2000)

on the company for VDSL equipment as part of its Internet strategy. As of June 2000 US West accounted for 67 per cent of the company's turnover.<sup>177</sup> The fear was that Qwest would take US West in a new strategic direction, thereby cutting Next Level's earnings. While the episode did not reflect badly upon Qwest, it indicated how susceptible company's within the telecoms sector were to changing attitudes to particular technologies.

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<sup>177</sup> FT (8/9/2000)

#### 4/Network

A key element in Qwest's strategy has been to develop its own independent network. This is in keeping with the comments of the Economist which argued that "Owning your own network is becoming the holy grail of the industry".<sup>178</sup> In constructing its network across the U.S. Qwest lay two conduits: one got filled with fibre optic cable, the other stayed empty, to provide space for any new upgrades. This makes the network virtually "future proof" and means that Qwest is unlikely to be burdened with the "legacy technology" which is presently the plight of many of the older operators. Commenting on the issue, Mark Bruneau at Renaissance Worldwide stated that "Qwest's network is the one everyone would love to build if they started with a clean slate".<sup>179</sup>

An indication of the value of running an independent network was given in 1999 with Upside reporting that in switching more than 80 percent of its traffic onto its own network by the end of the year, Qwest would be saving over \$10 million in leasing equipment from other operators.<sup>180</sup>

The progress of Qwest's network up until 1998 is shown below.

<b>Table 1 - Qwest's Network 1996-1998</b>			
	1998	1997	1996
Route miles of conduit installed	17,000	9,500	3,650
Route miles of fibre activated	12,500	3,400	900
Minutes of use (millions)	10,800	669	382
Annual Report (1998, p16)			

Qwest's 1998 Annual Report also drew attention to its Pacific Network which will serve Japan and the Asia Pacific region. Initially this region would be served by capacity on an undersea cable which Qwest was constructing as part of a consortium. This link would consist of a 13,125-route-mile, four fibre pair cable system. The connection to Japan was due for completion in the year 2000.<sup>181</sup>

As of 1999 the Qwest Macro Capacity fibre network, designed with the newest optical networking, spanned more than 18,500 route miles in the United States, with an additional 315-mile network route to be completed by the end of that year. In

<sup>178</sup> The Economist (1/8/98)

<sup>179</sup> Quoted in Fortune (8/6/98)

<sup>180</sup> Upside (June, 1999)

<sup>181</sup> 1998 Annual Report (notes between p12-13, p39)

addition, Qwest and KPN, the Dutch telecommunications company, formed a venture to build and operate a high-capacity European fibre optic, Internet Protocol-based network that has 2,100 miles and will span 8,100 miles when it is completed in 2001. Qwest had also completed a 1,400-mile network in Mexico.<sup>182</sup>

In mid-1999 PC Week indicated that Qwest's 18,500 mile advanced fibre-optic network (operating at 2.5 G bps) was essentially finished.<sup>183</sup> Complementing this would be US West's 40,400 mile local telephone network and its DSL services, which are available to 5.5 million customers in 40 cities.

In the 1998 Annual Report the Qwest network was described in the following technical terms: "10 gigabits, OC-192 speed, "self-healing", SONET ring architecture; 2.4 gigabit (OC-48) Internet Protocol architecture". For those shareholders who were not so technically minded Nacchio summed up its qualities by stating that the network "will move more information faster, more securely and more reliably than any other network on earth". He went on to suggest that "Our network is the enabler and the customer magnet".<sup>184</sup>

In Qwest's 1999 Annual Report it stated that its North American network now extended to 25,500 miles. It also reported that Digital Subscriber Line (DSL) services had been introduced in a number of US cities, with 25 cities to be covered by the end of 2001.

## **5/Addressable Market**

### **Market Size**

Breaking up the market into component parts can be awkward, a fact shown by the different accounts of market size which are apparent in the literature. This inconsistency becomes particularly apparent when projections are made for the size of individual market segments into the future. A more rough and ready approach was adopted by the FT which calculated that the global market for all telecom activities was worth a figure getting on for \$1,000 billion.<sup>185</sup> A figure of this magnitude adds credence to the view expressed by the Business Communications Review which suggested that, "Next-Generation Telcos are pursuing a potentially huge market".<sup>186</sup> In his introduction to the 1998 Annual Report Nacchio described the scale of this market as "amazing".<sup>187</sup>

### **The U.S Market**

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<sup>182</sup> Press Release (27/7/99)

<sup>183</sup> PC Week (26/7/99)

<sup>184</sup> 1998 Annual Report (p4-5)

<sup>185</sup> FT (9/10/98)

<sup>186</sup> Business Communications Review (April, 1999)

<sup>187</sup> 1998 Annual Report, p4

One market size which seems to be widely agreed upon is that for the local services market in the U.S.. Communications of the ACM valued this market at \$100 billion.<sup>188</sup> The FT also uses this figure.<sup>189</sup>

The long distance market in the U.S. is estimated by The FT at \$80 billion.<sup>190</sup> According to America's Network the figure is around \$87 billion, although it argued that Qwest was aiming to turn it into one of \$40 billion by slashing prices.<sup>191</sup> The FT concurred with these sentiments, stating that "lean companies, such as Qwest, promise to push prices ever lower".<sup>192</sup>

Once we turn to the markets for data the rapidity of change within the sector makes for some divergent figures. Research from Forrester puts the global value of Internet-related services as a whole at \$327 billion by 2002. The Yankee Group suggests that in the US customers will spend \$56 billion on Internet access over the next five years.<sup>193</sup>

The bandwidth market in the US has been estimated at \$50 billion by 2001.<sup>194</sup> The data communications component of the US telecommunications industry has been put at around \$25 billion annually.<sup>195</sup> The market for IP telephony was put at \$30 million in 1998. By 2004 it is expected to increase to \$2 billion.<sup>196</sup> Estimates from Forrester Research indicate that the Web-based applications outsourcing market in the US could be worth \$21 billion by 2001.<sup>197</sup>

## **Outside the U.S.**

Credit Suisse First Boston suggested that the European telecoms market was growing at around 11 percent a year (comprising of volume growth of 17 to 18 percent and price deflation of 6 to 7 percent). It calculated that the market would grow from \$194 billion in 1999 to \$413 billion by 2005.<sup>198</sup> Virtually all of this growth was projected to come from data and mobile traffic with voice traffic growing just enough to offset predicted price declines. The carrier segment of the European market is put at around \$30 billion.<sup>199</sup>

According to Bear, Stearns and Co, the European market for voice, data and Internet services is worth more than \$175 billion a year.<sup>200</sup> As the number of European connecting to the Internet increases this figure will grow substantially. Dataquest estimate that the number of European PCs going on line will rise from 13 million at

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<sup>188</sup> Communications of the ACM (July 1999)

<sup>189</sup> FT (6/2/99)

<sup>190</sup> Ibid

<sup>191</sup> America's Network (1/6/98)

<sup>192</sup> FT (6/2/99)

<sup>193</sup> FT (10/6/98)

<sup>194</sup> Forbes (9/2/98)

<sup>195</sup> The McKinsey Quarterly (Spring, 1999)

<sup>196</sup> FT (6/5/98)

<sup>197</sup> Information Week (21/12/98)

<sup>198</sup> Credit Suisse First Boston, Viatel Research Note (21/9/99)

<sup>199</sup> GTS Annual Report, 1998

<sup>200</sup> dowjones.com (13/5/99)

the start of 1997 to 69 million by the end of 2002.<sup>201</sup>

Commerzbank has estimated that the telecoms sector in Europe is growing at eight percent a year. It predicts that the value of the top 6 territories: the UK, Germany, France, Italy, Spain and the Netherlands will grow from \$129 billion in 1997 to \$246 billion in 2005. Much of this growth will come from mobile services (from 19 percent in 1997 to 34 percent in 2005) and from the Internet.<sup>202</sup>

The European data market was expected to be worth \$55 billion by the year 2000.<sup>203</sup> It is this market which Qwest hopes to tap through its purchase of Eunet and its joint-venture with KPN. The international telecoms market for multi-national companies looking for “one-stop-shopping” facilities is estimated at \$40 billion with the potential to grow by a factor of five over the next decade.<sup>204</sup> The global market for Web-hosting, another key area for Qwest, has been estimated at up to \$20 billion by 2003.<sup>205</sup>

## **Target Market**

In its early years Qwest was focused on the wholesale, long distance market and as a side-line upon the market which existed in laying cable for other operators. As Qwest’s strategy changed with the recruitment of Nacchio in 1997, so to do its perceived target market.

In fact, three discrete stages in the company’s development have been identified, each stage accompanied by a separate target market (see Strategy section).<sup>206</sup> Firstly came the carriers’ carrier market, as just indicated. Then Qwest started to focus upon the business market, with the emphasis upon the convergence of voice and data. During this period the company attempted to facilitate entry into new markets via alliances (e.g. Microsoft and Netscape) and acquisitions (e.g. LCI and Icon CMT). This expansion of the company’s operations also took it into Europe (via the purchase of Eunet and the alliance with KPN). Then Qwest redefined itself as a complete telecoms retailer as it moved its sights onto the “last mile” (a move facilitated by the merger with US West).

## **6/Stock Market History**

### **Fund Raising**

During 1997/98 Qwest issued Senior Notes and Senior Discount Notes on five separate occasions, raising a total of approximately \$2.3 billion.<sup>207</sup> This level of

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<sup>201</sup> Ibid

<sup>202</sup> FT (18/3/99)

<sup>203</sup> FT (27/3/98)

<sup>204</sup> The Economist (1/8/98), FT (28/7/98)

<sup>205</sup> FT (17/3/2000)

<sup>206</sup> Fortune (16/8/99)

<sup>207</sup> Annual Report, 1998, p26

indebtedness remained stable throughout 1999 indicating by then the company had already financed its network roll out.<sup>208</sup> This distinguished it from a number of its competitors which were still borrowing heavily during 1999. Qwest's frequent use of the debt markets adds credence to the statement by the FT that, "Leveraged finance and high-yield debt could have been invented for today's emerging telecommunications and cable television industries."<sup>209</sup>

In late 1998 The Investment Dealers' Digest reported that Anschutz Co., the main stockholder in Qwest, would be placing a highly unusual \$400 million mandatory 144A convertible security.<sup>210</sup> This, it suggested, was down to a "loophole in the securities law definition of an investment company" which allowed the company to issue "the creative but highly illiquid - and typically illegal" security.

In May 1999 KPN Qwest announced a 10 year high yield bond offering, split into \$450 million and 340 million Euros tranches. It was commented that the pricing was less expensive than previous telecoms issues, reflecting the stronger business outlook for the two well established companies.<sup>211</sup>

In September 2000 Qwest indicated that it would be raising \$1 billion through the sale of its investments in 15 companies, including an interest in Global Crossing which it had inherited through its merger with US West.<sup>212</sup>

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<sup>208</sup> Annual Report 1999

<sup>209</sup> FT (9/10/98)

<sup>210</sup> The Investment Dealers' Digest (7/12/98)

<sup>211</sup> FT (26/5/99)

<sup>212</sup> FT (8/9/2000)

## Share Performance

Qwest held its IPO in June 1997 at \$22 a share (\$5.50 split adjusted). It raised \$320 million. The FT described the reception on Wall Street as both “warm” and “enthusiastic”, with the shares finishing at \$27.50 on the first day of trading.<sup>213</sup>

During 1998 the shares made steady progress, but really took off in the first half of 1999 when they reached a high of over \$47 (split adjusted). Part of this surge was due to the perception that Bell South was preparing to buy out the company. With the company’s double barreled bids for Frontier and US West, however, the momentum was lost and the shares tumbled back to around \$25. Since then the shares have made fairly steady progress, with a peak of around \$60 in early 2000 when the company looked as though it may be taken over by Deutsche Telekom. In general the company has resisted the selling pressure which has affected the telecoms sector in general throughout 2000. As of the beginning of November 2000 the shares stood at around \$49.<sup>214</sup> Part of the share’s resilience is undoubtedly attributable to the perception that Deutsche Telekom may make a second attempt at a merger.

Looking at the company’s share performance since its IPO it has increased in value by around 540 per cent.<sup>215</sup> In attempting to explain the strong stock market performance of telecom companies such as Qwest in the first half of 1999 the FT offered the following comments:

“The stock market has already decided that these newcomers - along with the fast-growing wireless industry - will win a big slice of the communications pie, according them valuations more familiar in the realms of the technology industry than the utility-style telecommunications world”<sup>216</sup>

At the beginning of 2000 Qwest shifted from NASDAQ to the New York Stock Exchange. The move was seen as in keeping with the more mature stage which the company had reached. It now trades under the highly recognisable stock symbol, “Q”.

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<sup>213</sup> FT (25/6/97)

<sup>214</sup> Interactive Investor Web site

<sup>215</sup> Bloomberg.com (2/11/2000)

<sup>216</sup> FT (26/4/99)

## 7/Company Data

<b>Table 2 - Revenues and Earnings (Losses)</b>						
(\$million)						
	1999	1998	1997	1996	1995	1994
Total Revenue	3,927.6	2,242.7	696.7	231.0	125.1	70.9
Net earnings (loss)	458.5	(844.0)	14.5	(6.9)	(25.1)	(6.9)
Annual Reports (1998, 1999)						

Table 2 shows the strong increase in Qwest's revenues between 1994-1999. With the completion of the merger with US West these revenues are set to increase considerably. In September 2000 Nacchio announced that the company had increased its revenues forecasts for the next two years. The increased estimates stood at \$18.8-\$19.1 billion for 2000 and \$21.3- \$21.7 billion for 2001.<sup>217</sup>

The above table also shows that Qwest made a significant net profit in 1999, something which distinguishes it from most of the other new entrants (e.g. Global Crossing and Level 3) which are still at the loss making stage as they roll out their networks.

In 1998 69 percent of Qwest's revenues came from communications services - with the remaining 31 percent coming from construction services. In the previous year only 17 percent had come from the communications division.<sup>218</sup> In the 1999 Annual Report the company was talking about the complete phasing out of its construction services and relying purely on the communications side of the business. In that year construction revenues made up less than 6 per cent of its revenues.

In 1998 the company's European operations contributed \$60 million to revenues, the first year that Qwest received a contribution from this area. In the 1999 Annual Report its stake in KPN Quest was valued at \$16 billion.

In the 1999 financial year IP and data revenues increased by 200 percent over the previous year, representing 25 per cent of total revenue.<sup>219</sup> Nacchio has referred to this side of the business as the company's "growth engine".<sup>220</sup>

### Employees

After its acquisition of LCI in 1998 Qwest had 1,800 employees.<sup>221</sup> Prior to the

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<sup>217</sup> FT (8/9/2000)

<sup>218</sup> Annual Report, 1998, p42

<sup>219</sup> 1999 Annual Report

<sup>220</sup> Ibid

<sup>221</sup> Telecommunications (Apr, 1998)

merger with US West in 1999 Qwest claimed to have 8,000 employees.<sup>222</sup> After the merger with US West, it was estimated that Qwest now had 64,000 employees.<sup>223</sup>

In September 2000 Qwest announced that it would be cutting 12,800 jobs over the next two years. The job losses represented part of a restructuring programme following the merger with US West.<sup>224</sup>

## **8/Strategy**

### **Early days**

In the early 1990s Qwest was essentially a cable laying company. The Economist suggested that when Nacchio arrived at Qwest in January 1997 it was still “more of a construction company than a telecoms firm”.<sup>225</sup>

Following up on the right of way agreements which Qwest secured from 1992, the company engaged upon a construction programme to lay 6,000 miles of fibre in 15 states. It followed this up in 1995 with a \$250 million investment to lay 5,000 miles of fibre to link Mexico City, Monterey, Guadalajara and other cities, and to hook up to US long distance carriers at the US border.<sup>226</sup>

Fortune suggested that there were many people who thought Anschutz was foolhardy in attempting to create another nation-wide network (there were already four in existence) which would “set him head-to-head with four very well capitalized competitors: AT&T, MCI Communications, LDDS WorldCom and Sprint”.<sup>227</sup> But it was a gamble which was to pay off.

One of Qwest’s early strategic platforms was to build excess capacity into its network which it then sold to companies such as Frontier, GTE and WorldCom, which helped to subsidise the operation to the tune of \$1 billion.<sup>228</sup> Forbes put the figure at \$1.8 billion, leaving Qwest itself to meet a “scant” \$300 million in construction costs.<sup>229</sup> In mentioning these figures, the publication paid tribute to Anschutz’s “farsightedness” in building the bulk of his infrastructure with his competitors’ money.

In summary, the first component in the Qwest strategy was simply to exploit its extensive rights of way to quickly construct an advanced network - something it managed to do on the cheap.

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<sup>222</sup> Company Fact Sheet

<sup>223</sup> Fortune (16/8/99)

<sup>224</sup> FT (8/9/2000)

<sup>225</sup> The Economist (US - 19/6/99)

<sup>226</sup> Fortune (26/2/96)

<sup>227</sup> Ibid

<sup>228</sup> Fortune (8/6/98)

<sup>229</sup> Forbes (30/11/98)

## Post Nacchio

With Nacchio's arrival in 1997 he shifted the strategic emphasis from constructing a network to formulating ideas as to how it could be exploited. This was a step which the company had to take since with the network nearing completion it had no choice but to look to the next stage of its development. As the publication *Upside* was to suggest a little later, "This is the time when Qwest Communications Inc., a company built on promises, needs to start delivering on them".<sup>230</sup>

This shift in the company's development has been formalised through the creation of two business segments: construction services and communications, each of which have a :

"separate management team and infrastructure, offering different products and services, and utilising different marketing strategies to target different types of customers".<sup>231</sup>

Accompanying this change of strategic direction was a new outlook for the future. As the *Economist* put it, upon taking over at Qwest, Nacchio proceeded to "throw himself into building a business and - no less important - selling a vision".<sup>232</sup> This "vision thing" was quick to take off with The Forrester consultancy referring to the company as a "visionary rule-breaker".<sup>233</sup> This seemed a new direction indeed for a cable laying outfit or even a telecoms company. Certainly the aura surrounding Qwest had little in common with the image associated with "Ma Bell" and her off spring. In short, Qwest had quickly become "the epitome of telecoms cool".<sup>234</sup>

By 1998 with its IPO successfully completed Qwest was enjoying an image and a stock market rating normally reserved for Internet operations. Distancing the company from the stuffy utilities it was competing with, Nacchio commented that, "People ask me if we're telecom guys or Silicon Valley guys...I like to say we are a Silicon Valley company on the other side of the Rockies".<sup>235</sup>

In presenting its vision Qwest claimed to have "the bandwidth to change everything" and offered its investors and customers the chance to "ride the light".<sup>236</sup> The idea of "riding the light" has underpinned much of Qwest's advertising and was a notion which caught on in Wall Street and beyond.<sup>237</sup> The *Economist* was cautious, however, and warned its readers that Qwest "may still be more of an idea than a business". Despite the hyperbole, though, there is no doubt that Nacchio's arrival led to the company's great leap forward. This was the view of *Fortune* which argued that:

"In his two years as CEO of Qwest Communications in Denver, Joe Nacchio

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<sup>230</sup> *Upside* (July, 1998)

<sup>231</sup> Annual Report, 1998, p42

<sup>232</sup> *The Economist* (US, 19/6/99)

<sup>233</sup> Quoted in the *Economist* (14/3/98)

<sup>234</sup> *The Economist* (US - 19/6/99)

<sup>235</sup> Quoted in *Fortune* (8/6/98)

<sup>236</sup> Annual Report, 1998, front cover

<sup>237</sup> *The Economist* (14/3/98)

has transformed it from a tiny telecom outfit to a budding global powerhouse.”<sup>238</sup>

When not looking into the future Nacchio began to argue that Qwest found itself in a “sweet spot” around the time of his arrival; that is to say it was first to the new Internet-driven bandwidth supply market, ahead of rivals such as Level 3 and far superior than the aged incumbents.<sup>239</sup> The extent of its bandwidth meant that it could embark upon the introduction of IP telephony - a system which while conceivable had proved erratic and unreliable in the past. Such a radical shift in voice communication brought the Qwest vision from the future into the present. No sooner had Nacchio arrived and Qwest announced that it would be the first nation-wide provider of non-compressed Internet Protocol telephony and fax services over its own network. Not surprisingly given the potential ramifications of the move, it was accompanied by a “blaze of publicity”.<sup>240</sup>

The service which was to become known as Q.talk was initially aimed at small business and consumers with a promise to extend it to larger business in 1998. Qwest was able to offer this service at 7.5 cents a minute, dramatically undercutting AT&T while matching its 17 to 20 percent profit margin. Business Week commented that it heralded “the coming of age of Internet telephony”.<sup>241</sup> Telephony suggested that the IP telephony move by Qwest represented one of two “bombs” dropped upon the traditional telecom industry during 1997.<sup>242</sup> Interestingly, the other bomb was the introduction of one-second exact billing by LCI - a company which Qwest was soon to take over (see Mergers section, above).

The move into IP telephony assured Qwest of pride of place among the new breed of “data centric” network operators. The FT recognised the significance of the emergence of “voice over IP” suggesting that “there is little doubt that the migration of voice to the Internet will transform the economics of telecoms services”.<sup>243</sup> It also made the point that it would play a key role in facilitating the convergence of voice and data. Companies such as Qwest, it implied, were well placed to ride the new “data wave” which would account for 99 percent of telecoms traffic within four years.<sup>244</sup> The FT quoted John Beaumont, Managing Director of Planet Online, who believed that, “The Telco world will become an IP world and there will be an increased blurring between telecoms and computing”.<sup>245</sup> The reality of this convergence was beginning to underpin much of Qwest’s strategy and would continue to do so in the form of its hectic acquisition, merger and joint venture activity (see Mergers section, above).

The Economist also noticed the rise of IP telephony. In the past, it suggested, “The call quality was dreadful and the whole business had the user-friendliness of camel-

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<sup>238</sup> Fortune (26/4/99)

<sup>239</sup> The Economist (US - 19/6/99)

<sup>240</sup> The Economist (14/3/98)

<sup>241</sup> Business Week (29/12/97)

<sup>242</sup> Telephony (5/1/98)

<sup>243</sup> The FT (6/5/98)

<sup>244</sup> FT (10/6/98, 5/5/99)

<sup>245</sup> Quoted in FT (5/5/99)

riding”. As quality improved, however, it recognised that the Internet represented a “time-bomb under the carefully worked out framework of charges which underpins the telephone companies’ most lucrative business”. In conclusion, it admitted that with the efforts of companies such as Qwest, “Internet Protocol telephony is growing up, and incumbent telecoms companies have some unpleasant choices to make”.<sup>246</sup> For its part Telephony believed simply that, “The potential profits from IP are too compelling to ignore”.<sup>247</sup>

While voice over the Internet was still being refined, the Economist pointed out that faxes could already be sent reliably and remarkably cheaply. It quoted WorldCom which saw fax as the “low-hanging fruit” for Internet telephony.<sup>248</sup> The FT painted a similar picture, and echoed the comments of Telephony, above, by stating that, “The economics of fax transmission over the internet are compelling.”<sup>249</sup>

While IP telephony has formed a consistent plank in Qwest’s strategy since the arrival of Nacchio, the ambitions of the company go much further than simply offering a new means by which to deliver voice traffic. An early indication of the wider remit which Qwest had set itself was given by Nacchio who stated quite plainly upon joining the company that, “I want to create a full-service communication provider”.<sup>250</sup> This implied that acquisitions would not be far off - a strategic option facilitated by Qwest’s soaring market valuation following its IPO. The inevitability of this route was recognised by Fortune which claimed that “...if Nacchio wants to turn Qwest into a full-service telco, he’ll need to buy or merge his way into the local market”.<sup>251</sup> This is exactly what he did with through a “slew of acquisitions” during 1998/99.<sup>252</sup>

While various deals were done during 1998 the one which created most interest was the purchase of LCI International (see Mergers section, above). As stated earlier the acquisition elevated Qwest to 4<sup>th</sup> position among US long-distance carriers, behind only AT&T, Sprint and WorldCom. For many commentators within the industry Qwest had officially arrived. The New York Times, for example, argued that the purchase “signalled that the company was serious about serving callers in addition to serving other carriers”.<sup>253</sup> Qwest’s desire to expand its market was also commented upon by Internet Week which claimed that, “While they are selling wholesale capacity to other providers, they also have set their sights on business customers”.<sup>254</sup> The purchase of LCI, with its national sales force and advanced marketing techniques made this ambition much more achievable.

A significant proportion of the coverage relating to the purchase, however, was critical in nature. The Economist, for example, described LCI as “a quirky long-distance outfit”.<sup>255</sup> Similar sentiments were expressed by Fortune which saw the company as

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<sup>246</sup> The Economist (2/5/98)

<sup>247</sup> Telephony (17/8/98)

<sup>248</sup> The Economist (2/5/98)

<sup>249</sup> FT (14/1/98)

<sup>250</sup> Quoted in The New York Times (15/6/99)

<sup>251</sup> Fortune (8/6/98)

<sup>252</sup> Business Week (28/6/99)

<sup>253</sup> The New York Times (15/6/99)

<sup>254</sup> Internet Week (27/4/98)

<sup>255</sup> The Economist (US - 19/6/99)

“a juggernaut” and “as one of telecom’s quirkiest companies”, not least because of its reliance upon Amway style marketing techniques.<sup>256</sup> It later suggested that the industry was “stunned” by Qwest’s purchase of LCI.<sup>257</sup> Forbes was not impressed either suggesting that “LCI is a leap into telecom’s past, technologically. It’s as if Henry Ford had bought a carriage maker as he introduced the Model T.”<sup>258</sup>

The negative coverage of the LCI episode was nothing, however, compared with the reception which Qwest received upon its announcement of its intention to merge with Frontier and US West in June 1999 (see Mergers section, above). Prior to this move Qwest had explored the possibility of reaching operational agreements with companies which could provide it with local access (see joint-venture section, above). Around 1998, for example, Nacchio initiated marketing agreements with US West and Ameritech, succeeding in getting 40,000 customers to switch phone companies in a single week. AT&T and MCI reacted by suing, claiming that the agreements violated the 1996 Telecoms Act. The Federal Communications Commission (FCC) later ruled against Qwest on the matter. With this strategy ruled out it seems that Qwest felt it had no option but to contemplate a merger with US West and Frontier (although the latter company was seen by many as a mere bargaining chip for Qwest in its battle with Global Crossing). With Global Crossing moving first the resultant struggle for control did little to enhance Qwest’s corporate reputation. But Qwest got what it wanted and succeeded in wresting US West away from the clutches of Global Crossing.

The reaction of both the markets (see Share section, above) and industry commentators was harsh. Business Week saw the acquisition as “a colossal mistake”<sup>259</sup>, while Christopher Mines, an analyst at Forrester Research, suggested that the deal “trashes” Qwest’s distinctive approach to telecoms.<sup>260</sup> The FT implied that Qwest might have to pay dearly in the long run, commenting, “Whether this proves a Faustian bargain remains to be seen”.<sup>261</sup> The Economist contribution was to suggest that of late, “Mr Nacchio’s vision has become murkier”.<sup>262</sup> Mr Nacchio himself later seemed to admit that things had changed. Speaking of the US West deal he commented that, “Qwest can never be the same...Once we started, we knew that we could never go back to what we were before”.<sup>263</sup>

For many analysts Qwest’s merger with US West was a retrograde step - a case of a rash decision to secure a local network rather than allowing it to fall into the hands of a rival. Suddenly people seemed to remember that Nacchio for all his talk of a vision had spent decades within AT&T. This was the line of attack used by the Economist which suggested that, “You can take the boy out of AT&T, but you can’t take AT&T out of the boy”.<sup>264</sup> Business Week took a similar line, accusing Nacchio of being “a

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<sup>256</sup> Fortune (8/6/98)

<sup>257</sup> Fortune (16/8/99)

<sup>258</sup> Forbes (30/11/98)

<sup>259</sup> Business Week (28/6/99)

<sup>260</sup> Quoted in The Economist (US - 19/6/99)

<sup>261</sup> FT (20/7/99)

<sup>262</sup> The Economist (US - 19/6/99)

<sup>263</sup> Quoted in The New York Times (25/7/99)

<sup>264</sup> The Economist (US, 19/6/99)

telecom bureaucrat dressed up in Internet clothes”.<sup>265</sup> Following the episode Nacchio’s comments on the future of Qwest have been more open to alternative interpretations. In 1999, for example, he argued that “AT&T was a great company for the 20<sup>th</sup> century...but Qwest will replace it in the 21<sup>st</sup> century”.<sup>266</sup> Some analysts were now more inclined to suggest that this may simply be a matter of replacing like with like. This view seemed to be expressed by Boyd Peterson, Vice President of the Yankee Group, who, in reviewing Nacchio’s contribution, commented that:

“Qwest has done a good job of keeping the image of a next-generation telco...But in the background he has created a fairly classic telecom company. And US West will contribute to that”<sup>267</sup>

Whatever the strategic sense of the merger most commentators seem to agree that Qwest had to do something fairly quickly in order to achieve the critical mass which would secure its long term survival. This was the stance taken by Mark Bruneau of Renaissance Worldwide who argued that:

“A marginally profitable company without too many customers can’t have the market valuation that Qwest has for too long...it has to use (that valuation) quick to buy some more sustainable revenue”<sup>268</sup>

The sense of urgency was also conveyed by the New York Times which claimed that:

“Qwest’s lusty pursuit of US West was about trying to win a spot at the head table of telecommunications”<sup>269</sup>

Fortune took a similar view, arguing that:

“this acquisition was necessary to ensure Qwest’s place in an industry that’s becoming an oligopoly dominated by a few super megaglobal carriers”<sup>270</sup>

This idea that it was all about getting bigger, quickly, seemed to be supported by Nacchio himself when he commented that:

“There will be supercarriers emerging over the next few years...we will be one of them”<sup>271</sup>

A more refined form of the above argument rests on the notion that in the future the key value added sector within the market will be found in delivering sophisticated end products to individual telecom customers, rather than merely providing bandwidth. It is for this reason that over the last few years, “Qwest has repositioned itself as...a

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<sup>265</sup> Business Week (28/6/99)

<sup>266</sup> Quoted in The New York Times (6/7/99)

<sup>267</sup> Quoted in Fortune (16/8/99)

<sup>268</sup> Quoted in Ibid

<sup>269</sup> The New York Times (20/7/99)

<sup>270</sup> Fortune (16/8/99)

<sup>271</sup> Quoted in Ibid

provider of advanced communications services for end users”.<sup>272</sup> Explaining this process in more detail, the New York Times went on to suggest that,

“At Qwest the shift in focus toward the top of the food chain has happened in fast -forward, and some investors have found it unsettling”<sup>273</sup>

While Qwest may have emerged as a powerful force within the industry there is some debate as to whether its present position is a result of a clearly defined strategy or whether it is just where it happens to find itself having been tossed around within a turbulent environment. Telephony seemed to argue that it has had a coherent strategy, claiming that:

“Qwest was most frequently identified in its formative years as a carriers’ carrier, but its master plan called for a mix of wholesale and retail services all along, with retail taking a prominent role”<sup>274</sup>

Other accounts cast doubt upon the idea of any “master strategy”. With the US West merger and attempted merger with Frontier, for example, it appeared as if Qwest was outsourcing its strategic planning to Global Crossing. With Deutsche Telekom then showing a strong interest in Qwest the deal making was undermined by the existing merger agreement with US West. Unwittingly Qwest seemed to have acquired its own “poison pill”, which reduced its strategic options.

For many commentators Qwest was showing itself to be reactive rather than proactive even before the failed Deutsche Telekom merger highlighted the point. There were also those who questioned the coherence of Qwest’s strategic plays. Commenting upon the diverse range of acquisitions and alliances initiated by the company during 1998, for example, Fortune claimed that such deals “raise questions about the consistency of Qwest’s consumer strategy”.<sup>275</sup> It went on to talk of Qwest’s “scattershot load of services to consumers” leading to “a brand-identity headache”. Later Fortune continued with this theme, suggesting of Nacchio that “in his two and a half years at Qwest, he’s changed his company’s long-term strategic course no fewer than three times”.<sup>276</sup> It listed the following three stages:

- 1/A carriers’ carrier
- 2/An operator focused upon the business market via an emphasis upon digital offerings
- 3/A telecoms retailer - much like AT&T

Whether or not Qwest will be the AT&T of the 21<sup>st</sup> century there is no doubt that it is spreading itself across the whole data and telecommunications spectrum. Whether in committing resources to network construction, cyber centres and outsourcing, it is spreading itself too thinly, is a matter of some debate. Likewise, its virtual simultaneous link-up with, of all companies, Netscape and Microsoft, is viewed by

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<sup>272</sup> The New York Times (11/7/99)

<sup>273</sup> Ibid

<sup>274</sup> Telephony (11/5/98)

<sup>275</sup> Fortune (8/6/98)

<sup>276</sup> Fortune (16/8/99)

some commentators as inspired while others regard it as scatter brained. What is not in doubt, however, is that over the last few years Qwest's has totally re-assessed its strategy. This much was made clear within the company's 1998 Form 10k submission to the SEC in which it stated that:

“While Qwest's main source of revenue in 1998 was traditional voice communications services, our strategy for the future is to focus on providing video, data and voice services using Internet communications protocols that can be more effectively provided over our high-capacity network than over more traditional telecommunications networks”<sup>277</sup>

## 9/Competition

Looking at Qwest firstly as a modern network provider its principal competitors can be seen as the other major data networks within the U.S. This is the approach adopted by Upside which suggested that its “main rivals” were Level 3 which plans 20,000 miles of fibre by 2001, Williams Network (using natural gas pipelines) and IXC Communications Inc..<sup>278</sup>

According to Network World, “Nacchio does not see Level 3 as a competitor”,<sup>279</sup> although given Nacchio's tendency to malign fellow operators this comment should perhaps be treated with some caution. Fortune argued that it was indeed companies such as Level 3; i.e. those “following in the footsteps” of Qwest which represented its “most daunting challenge”, not least because Level 3's network would have a local, as well as a national, reach.<sup>280</sup> Certainly Level 3 is included within Qwest's list of competitors as outlined in its annual SEC submission, reproduced below:

“In addition to Qwest, there are currently three other principal facilities-based long distance fiber optic networks (AT&T, Sprint and MCI WorldCom). Others are building or planning additional networks that, if constructed, could employ advanced technology similar to Qwest's network. Frontier, GTE, IXC Communications and Williams Communications each may have a fiber network smaller in geographic scope and similar in potential operating capability to Qwest's network. Level 3 Communications may have a fiber network similar in geographic scope and potential operating capability to Qwest's network”<sup>281</sup>

In early 2000 a new network competitor emerged in the US in the form of America's Fiber Network (AFN). The new company represented an alliance between three of the US's biggest power companies who intended to combine their networks to offer broadband services to small and medium sized town and cities, many of which have been by-passed by the existing networks. By pooling their existing networks the

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<sup>277</sup> 1998 SEC Form 10k, p14

<sup>278</sup> Upside (July, 1998)

<sup>279</sup> Network World (12/10/98)

<sup>280</sup> Fortune (8/6/98)

<sup>281</sup> 1998 SEC Form 10k, p12

power companies claimed that they would start with a 7,000 mile network within the US.<sup>282</sup>

At an international level Qwest is also competing with other carriers' carriers such as GTS and Global Crossing. Commenting upon the KPN Qwest alliance, Nacchio indicated that the new venture would put the companies "neck and neck" with MCI WorldCom which was also embarking upon the creation of an extensive European network.<sup>283</sup> Then there is the alliance between AT&T and BT which includes the development of an international IP network based on terabit routers and open application programmer interfaces over which the two companies intend to offer IP telephony and other data services.<sup>284</sup> As stated earlier Qwest itself was heavily tipped as a potential partner for BT. Once BT chose to link up with AT&T instead it ensured that Qwest would have to take it seriously as a competitor rather than as a potential partner.

With the take-over of LCI Qwest moved into fourth position in the U.S. long-distance league, behind AT&T, Sprint and MCI WorldCom. All these companies are now competitors together with the other long distance participants in the U.S.. According to Multex.com its "peer group companies" within the category of "large long distance telecommunications companies" are: AT&T, MCI Worldcom, Sprint and Teleglobe.<sup>285</sup> This long distance market is likely to be opened up soon to the Baby Bells, with Bell Atlantic already making moves in this direction.<sup>286</sup> On this subject Forbes made the point that companies such as Qwest "like to snicker at the idea of competition from local phone companies. But the Bell companies are not asleep".<sup>287</sup> The lurking danger posed by the Baby Bells was given tacit recognition by Qwest which stated that it "cannot predict when any of the original local exchange carriers will obtain long distance authority or predict the impact on the long distance market".<sup>288</sup>

With the merger with U.S West Qwest must now also defend its access to the "last mile" within its new partner's operating area. This expands its list of competitors to include cable companies (now including AT&T), fixed wireless companies (also including AT&T) and the satellite operators.

As Qwest moves further into Internet access and other Internet protocol products it considers its "significant competitors" to be: IBM, GTE, UUNet (a subsidiary of MCI WorldCom), Digex and Exodus and many other smaller, specialist companies.<sup>289</sup> Furthermore, as Qwest concentrates more upon the applications outsourcing market it will have to compete with the leading ISP's such as UUNet, ANS and Exodus which already run firms' Internet sites for them.<sup>290</sup>

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<sup>282</sup> FT (21/3/2000)

<sup>283</sup> Quoted in FT (20/11/98)

<sup>284</sup> Telecommunications (Nov 1998)

<sup>285</sup> Multex.com (4/9/99)

<sup>286</sup> Forbes (4/5/98)

<sup>287</sup> Ibid

<sup>288</sup> SEC Form 10k, 1998, p15

<sup>289</sup> Ibid p11

<sup>290</sup> The Economist (9/1/99)

## 10/Other Threats

### Over capacity

As with the other providers of fibre optic networks in the U.S and internationally, Qwest is vulnerable to any development of over-capacity. Already the influence of the new arrivals has been to slash the cost of national calls within the U.S, with international charges following suit. As early as 1997 the Economist, in a discussion of Qwest, noted that, "Such companies will turn long-distance traffic into a commodity."<sup>291</sup> McKinsey made a similar analysis, pointing to increasing commoditisation of the long haul "backbone" routes, with a spot market in this commodity already developing. With such future developments, it suggested, "Digital communications will probably sell on the cheap".<sup>292</sup> If too many companies are trading in this same commodity there are bound to be casualties. Referring to Nacchio's "sweet spot" comments (see Strategy section), Fortune responded by suggesting that "...sweet spots can turn sour when competition closes in".<sup>293</sup>

Expanding upon the capacity issue, Mark Bruneau, President of the Consultants, Renaissance Worldwide, has suggested that by 2001 the capacity on US telephone networks will be 400 times what it was in 1998. This, he suggests, will lead to a "bandwidth glut", an experience which will also afflict Europe around 2004.<sup>294</sup> This potential has also been recognised by Forbes which talks of the present "fiber-building frenzy" and maintains that "if and when a glut arrives, the new comers might slash prices to frightfully low levels."<sup>295</sup> With the proliferation of new entrants laying their own network the prospect of over supply has become a reality. This was recognised by the FT which stated that:

"if the growth in data fails to match the growth in capacity, further consolidation will leave a few large groups fighting over distinctly thin pickings"<sup>296</sup>

In early 1999 one of Qwest's main European rivals, GTS, pointed out that it had sunk enough fibre cabling across Europe to carry 20 times the total current traffic across the continent. The FT picked up on the inherent danger within this emphasis upon capacity, pointing out that GTS was only one of a dozen operations constructing state of the art pan-European networks. The consultancy, Analysys, put the number of telecom firms across Europe which intend to create their own facilities at around 140.<sup>297</sup> Such a proliferation, suggested the FT, "will see the death or withdrawal of some of the weaker operators, particularly among the later entrants".<sup>298</sup> In September 2000 this prediction proved correct with UK-based Iaxis going into receivership with

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<sup>291</sup> The Economist (13/9/97)

<sup>292</sup> The McKinsey Quarterly (Spring, 1999)

<sup>293</sup> Fortune (8/6/98)

<sup>294</sup> FT (30/6/99)

<sup>295</sup> Forbes (19/4/99)

<sup>296</sup> FT (9/12/98)

<sup>297</sup> FT (17/3/98)

<sup>298</sup> FT (18/3/99)

debts of \$200 million.<sup>299</sup> The company was widely seen as the first victim of the capacity glut in bandwidth and the resultant fall in prices.

### **Filling the Qwest Network**

Writing in late 1998 Forbes suggested that with Qwest's network due to "light up" in full in June 1999, the company would put into operation only one percent of its 31-million-simultaneous-call capacity. At the time of the article, Forbes maintained that Qwest had signed up customers to use four percent of that that percent.<sup>300</sup> The urgent need to fill the network was also recognised by the Economist which argued that:

"Increasingly Mr Nacchio looks like a man racing against time to light up all of Qwest's fibres before his competitors enter the field and create a glut of bandwidth"<sup>301</sup>

The Economist's comments were precipitated by Qwest's attempts to wrestle control of Frontier and U.S. West away from its rival Global Crossing. For some observers this was clearly a desperate move to secure customers before it was too late.

### **Technological Change**

Related to the problem of over capacity is the speed of technological change within the telecoms industry. Until now new wave companies such as Qwest have used the technological advances of the past few years to undercut the incumbent carriers burdened as they are with antiquated networks. As time passes, however, innovators such as Qwest might see themselves being overtaken by technical advances (e.g. by satellite-based systems). This danger has been recognised by the FT which in a discussion of COLT indicated that:

"what is becoming rapidly apparent... is that even sophisticated new operators are being caught out by the speed of technological progress"<sup>302</sup>

Companies also face the danger of becoming over-reliant upon one particular technology. This was shown in the case of Next Level whose shares collapsed when it was realised that Qwest would have less use for its services than US West (see Suppliers, above). On this occasion Qwest was the culprit rather than the victim in this case of technological over reliance. Qwest would do well, however, to take on board the message that a company's share price can be severely affected by unpredictable developments in telecoms technology.

### **Risk of Take-over**

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<sup>299</sup> FT (10/9/2000)

<sup>300</sup> Forbes (30/11/98)

<sup>301</sup> The Economist (US, 19/6/99)

<sup>302</sup> FT (18/3/99)

Another “threat” often associated with Qwest is that of a take-over. Paying tribute to the rapid progress made by Qwest the Economist warned that Qwest might “be just too dangerous for its own long term independence”.<sup>303</sup> Expanding upon the same argument it raised the possibility that, “Qwest itself will fall victim to America’s telecom-merger frenzy - perhaps to a Baby Bell in a hurry to enter the long-distance market”.<sup>304</sup> The long term favourite amongst the possible contenders to take over Qwest is indeed a Baby Bell - Bell South, the only one of the original seven Baby Bells still in its original form.<sup>305</sup> Already Bell South has bought a 10 percent stake in the company and has made filings with the SEC indicating a take-over interest (see Stock market and Joint-ventures sections). Bell South’s involvement with Qwest has been increased through its links with KPN with whom it has a wireless agreement.

Of course a take-over might be seen, not as a threat, but as Qwest’s ultimate strategic ambition. The idea that the company is being fattened up ready for a trade sale has certainly contributed to its high rating on Wall Street. Anschutz’s business history has, after all, involved developing and then selling commercial assets. Nacchio would not seem adverse to such a plan either, allegedly stating in private that “if I haven’t sold this company in 24 months, I’ll consider it a failure”.<sup>306</sup>

There are those who believe that Qwest under Nacchio has been developing itself with the express purpose of being purchased by Bell South. Interestingly, in July 1999, Qwest announced that it would be moving into 25 new US markets, but avoided any overlap with Bell South. Such a strategy, it was suggested would minimise the antitrust concerns in the event of a merger of the two companies.<sup>307</sup>

Other potential buyers of Qwest have been identified as SBC and Bell Atlantic.<sup>308</sup> Forbes agreed that both these companies could be potential buyers and added that foreign outfits such as Cable and Wireless of the UK or Japan’s Nippon Telegraph and Telephone could also be interested. It suggested that the price would be around \$56 a share - valuing the whole company at around \$19 billion.<sup>309</sup>

More recently Deutsche Telekom has emerged as the clear front runner to takeover Qwest. With the full integration of US West into the company then the obstacles which stood in the way of a friendly merger in early 2000 will no longer exist. The fact that these obstacles had been created by Qwest itself cast doubt upon the coherence of its own long term strategy.

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<sup>303</sup> The Economist (14/3/98)

<sup>304</sup> Ibid

<sup>305</sup> Business Week (2/8/99)

<sup>306</sup> Quoted in Forbes (30/11/98)

<sup>307</sup> The New York Times (20/7/99)

<sup>308</sup> Fortune (8/6/98)

<sup>309</sup> Forbes (30/11/98)

## Slow Liberalisation and Powerful Incumbents

As a new operator in a newly deregulated US and European market Qwest is vulnerable to both national regulators who are dragging their feet and incumbents who are surreptitiously engaging in rear guard defensive action. Rival company Viatel has acknowledged this danger in the European arena, indicating that while EU members have been obliged to enact legislation to open up their telecommunications markets, certain obstacles remain. In relation to the removal of national restrictive practises, for example, it has stated that, "in certain cases this has been done on an inconsistent, and sometimes unclear basis".<sup>310</sup> The incumbents, of course, are only too quick to shelter their businesses behind any barriers which remain. As Michael Mahoney, CEO of Viatel has put it:

"Liberalization and deregulation do not necessarily mean that the incumbents are going to throw the door open to new entrant carriers"<sup>311</sup>

This tendency has also been commented upon by Price Waterhouse Coopers who stated that:

"...a shrewd telco will use what remaining degree of regulatory freedoms it still possesses to buy time while it sets about reshaping itself"<sup>312</sup>

So it is no surprise when Lehman Brothers remind us that:

"International Long Distance (ILD) operators continually complain about PTT's intentionally delaying the provisioning of interconnect capacity as it is one of the last remaining mitigants to open competition"<sup>313</sup>

Business Communications Review offered a comparison of the European and American experiences and concluded that:

"...while regulatory structures differ, the attitude of incumbent carriers is similar no matter where they're found around the globe. The European PTTs are using the same delaying tactics seen in the U.S. during the early 1980s"<sup>314</sup>

In the UK it was reported in September 2000 that both Global Crossing and WorldCom had abandoned their plans to offer high-speed Internet access in homes and offices throughout the country. The decision was put down to frustration at the "unbundling" process in the UK, with BT showing itself to be skilful in restricting access to its local exchanges. On this occasion OFTEL was widely criticised by alternative operators for not exerting enough pressure on the British incumbent.<sup>315</sup>

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<sup>310</sup> Viatel SEC 10k Report, 1998, p35

<sup>311</sup> Quoted in Global Telecoms Business (Feb/Mar 1999)

<sup>312</sup> Quoted in Global Telecom Business (October 1999)

<sup>313</sup> Lehman Brothers, European High Yield Research (27/9/99), p14

<sup>314</sup> Business Communications Review (July 1999)

<sup>315</sup> FT (21/9/2000)

This experience would seem to vindicate the Economist's observation that even when pressured by regulators to open up their markets the incumbent "will use every trick in the book to make life miserable for its rival".<sup>316</sup>

### **Changing Mood on Wall Street**

While Qwest has managed to resist much of the market pressure affecting the telecoms sector in general during 2000, its experience in its attempt to take over Frontier and US West showed that its stock price was highly susceptible to market jitters. Further attempts at acquisitions could paradoxically, reduce its total market capitalisation. Commenting upon this theme the FT stated that, "some of the new wonder-stocks of the telecommunications industry may not carry as much weight as their champions had hoped".<sup>317</sup>

### **Accountancy Matters**

Another source of uncertainty for companies such as Qwest is the accountancy treatment of capacity sales through IRU ownership agreements. In 1999 the Federal Accounting Standards Board (FASB) was looking at the possibility of ruling that revenues from such agreements should be spread over its 20 year life span rather than treated as a one off payment (known as FASB66). This would naturally lead to a reduction in reported current year capacity sales and might lead to a negative market reaction. The actual cash flow of the company would not, however, be affected. The first company to comply with the alternative interpretation was Williams which subsequently issued an earnings warning on 2/9/99.<sup>318</sup> In the case of Global Crossing it announced slower revenue growth in early 2000 due to the new accountancy treatment of deferred revenues. While the company emphasised that the change was purely technical it still suffered an 8.6 percent fall in share price immediately after the announcement.<sup>319</sup>

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<sup>316</sup> The Economist (13/9/97)

<sup>317</sup> FT (15/6/99)

<sup>318</sup> Lehman Brothers, op cit

<sup>319</sup> FT (19/2/2000)