BEFORE THE WASHINGTON STATE UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of QWEST COMMUNICATIONS INTERNATIONAL INC. AND CENTURYTEL, INC. For Approval of Indirect Transfer of Control of Qwest Corporation, Qwest Communications Company LLC, and Qwest LD Corp.	DOCKET NO. UT-100820 QWEST'S AND CENTURYLINK'S OPENING BRIEF IN RESPONSE TO COMMISSION ISSUES – JANUARY 14, 2011

I. Introduction

1 The Joint Applicants respectfully submit this opening brief in response to the questions and issues posed by the Commission on January 7, 2011.

A. The "No Harm" Standard of Review

2 Under well-established Commission precedent, and as clarified in a recent amendment to RCW 80.12.020, review of telecommunications mergers is subject to the "no harm" standard. In other words, if, after reviewing the transaction, the Commission determines that no harm will result from the transaction, the merger must be approved. This is in contrast to the higher standard that has been established by the legislature for mergers of energy companies, where the transaction will not be approved unless a net benefit from the transaction is shown.[1] The no harm standard has been applied by the Commission in

[1] RCW 80.12.020(1) provides that "[n]o public service company shall sell, lease, assign or otherwise dispose of the whole or any part of its franchises, properties or facilities whatsoever, which are necessary or useful in the

two recent merger dockets[2], and is applicable here as well.

B. Closing Date – Early Commission Order Desired.

3 As discussed during the last day of hearing, the Joint Applicants have previously stated their intent and desire to close during the first half of 2011. However, it is to the benefit of all parties to close the merger as soon as practicable after the final regulatory approvals are obtained. As of the date of filing of this brief, approvals are necessary from only four remaining states and the FCC. The Joint Applicants ask the Commission to expeditiously approve this transaction, with an order before the end of February 2011.

C. The Settlements and the Transaction are in the Public Interest.

4 The Commission is presented with a total of four settlements in this case, including two

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performance of its duties to the public, and no public service company shall, by any means whatsoever, directly or indirectly, merge or consolidate any of its franchises, properties or facilities with any other public service company, without having secured from the commission an order authorizing it to do so. The commission shall not approve any transaction under this section that would result in a person, directly or indirectly, acquiring a controlling interest in a gas or electrical company without a finding that the transaction would provide a net benefit to the customers of the company.

[2] "WAC 480-143-170 governs the Commission's standard of review for a change of control transaction and requires finding that the transaction is consistent with the public interest. To be consistent with the public interest, the transaction must not harm the public interest." *In the Matter of the Joint Application of EMBARQ CORPORATION AND CENTURYTEL, INC. For Approval of Transfer of Control of United Telephone Company of the Northwest d/b/a Embarq and Embarq Communications, Inc.*, Docket No. UT-082119; Order 5, ¶ 92. ("CenturyTel/Embarq Order")

"The Commission's authority and responsibility regarding transfers of ownership and control of public services companies are found in RCW 80.12 and WAC 480-143. These statutes and rules require Commission approval whenever a public service company agrees to a change-of-control transaction. The standard governing our review is: If, upon the examination of any application and accompanying exhibits, or upon a hearing concerning the same, the commission finds the proposed transaction is not consistent with the public interest, it shall deny the application (internal footnotes omitted)." *In the Matter of the Joint Application of VERIZON COMMUNICATIONS, INC., and FRONTIER COMMUNICATIONS CORPORATION For an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest, Inc.*, Docket No. UT-090842; Order 06, ¶ 115

that cover a substantial number of issues – (the other two are related to the first two, but are more specific to the individual party's issues, 360networks and DOD/FEA). The settlements resolve all the contested issues between the parties to those agreements, and those parties are unanimous in asking the Commission to approve the agreements, and the transaction, with no further conditions.

5 Every other state that has decided this matter to date, including the January 11, 2011 recommended decision from the Minnesota ALJ, has rejected the CLEC pleas for additional conditions. These issues will be further addressed in the January 21, 2011 brief.

II. Responses to Commission Issues

6 The Joint Applicants hereby provide their responses to the Commission-identified issues in this docket.

7 **Commission Issue # 1: Assume, *arguendo,* that the Commission adopts a condition requiring the merged companies to file a petition for an Alternate Form of Regulation (AFOR) by a date certain. What would be the effect of either a Commission rejection of the AFOR petition or the failure of the merged companies to accept a Commission-conditioned AFOR? Specifically, what rate structure would be in effect in the various Qwest and CenturyLink territories? Would Qwest rates be set under the expired AFOR (the one currently in effect), revert to those in effect before the AFOR, or some other structure?**

8 **Response:** Assuming that the companies are required to file a petition for an AFOR on a date certain post-merger (for purposes of discussion, this response will use an assumed date of October 1, 2014), the Joint Applicants believe that the forms of regulation for each company, and the rate structures in existence at the time of filing, would continue until the conclusion of the AFOR proceeding.[3] Under RCW 80.36.135,[4] after a party

[3] This response assumes, without deciding, that the petition for AFOR could contain a plan for a single AFOR for all of the post-merger ILECs, or that the petition could contain separate plans for different AFORs for different

files a petition and plan for an AFOR, the Commission, "after notice and hearing, shall issue an order accepting, modifying, or rejecting the plan" and not later than 60 days from the Commission's order, "the company or companies affected by the order may file with the commission an election not to proceed with the alternative form of regulation as authorized by the commission."

9 In general, the Joint Applicants believe that there are only three basic forms of telecommunications regulation in the state of Washington. First, incumbent ILECs are generally regulated under rate base, rate of return regulation. This type of regulation is described in various provisions of Title 80 RCW, Title 480 WAC, and numerous Commission and court orders. Second, CLECs are afforded minimal regulation pursuant to RCW 80.36.320 and Chapter 480-121 WAC. Under these provisions, CLECs are not rate or earnings regulated, and are subject to only a subset of the regulations that ILECs

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companies. The Joint Applicants' response is the same under either assumption, but it should be noted that the Settlement Agreement between the Joint Applicants, Commission Staff, and Public Counsel leaves that issue open for decision at a point in time closer to the filing of the AFOR, when there will be more information to guide that decision.

[4] RCW 80.36.135 provides in part as follows:

> (3) A telecommunications company or companies subject to traditional rate of return, rate base regulation may petition the commission to establish an alternative form of regulation. The company or companies shall submit with the petition a plan for an alternative form of regulation. The plan shall contain a proposal for transition to the alternative form of regulation and the proposed duration of the plan. The plan must also contain a proposal for ensuring adequate carrier-to-carrier service quality, including service quality standards or performance measures for interconnection, and appropriate enforcement or remedial provisions in the event the company fails to meet service quality standards or performance measures. The commission also may initiate consideration of alternative forms of regulation for a company or companies on its own motion. The commission, after notice and hearing, shall issue an order accepting, modifying, or rejecting the plan within nine months after the petition or motion is filed, unless extended by the commission for good cause. The commission shall order implementation of the alternative plan of regulation unless it finds that, on balance, an alternative plan as proposed or modified fails to meet the considerations stated in subsection (2) of this section.
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> (4) Not later than sixty days from the entry of the commission's order, the company or companies affected by the order may file with the commission an election not to proceed with the alternative form of regulation as authorized by the commission.

are subject to. Third, an ILEC may petition the Commission under RCW 80.36.135 to be regulated under an AFOR. AFORs do not follow a set structure, but rather are based on the company's plan of AFOR, as approved or modified by the Commission, and tailored to the specific facts and circumstances in the case. The Commission is allowed to waive certain regulatory requirements in an AFOR such that an ILEC is regulated in the same limited way as a CLEC.

CenturyLink ILECs

10 The Joint Applicants believe that for the CenturyLink ILECs, who are currently regulated under rate of return regulation, and who are assumed to be regulated in that same manner on October 1, 2014, a Commission or company rejection of the AFOR would leave the CenturyLink ILECs regulated under rate of return regulation.

11 For the CenturyLink ILECs, the rate structure after the rejection of an AFOR would remain as it was on October 1, 2014. Any tariffed services would remain under tariff, at tariffed rates. Any services that are not in the tariff would be priced in accordance with the rates and terms in the catalog. Examples of these latter services are intraLATA toll, which is competitively classified and therefore not in the tariff, and packaged or bundled services that have been removed from the tariff after a petition pursuant to RCW 80.36.332.[5]

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[5] RCW 80.36.332 Noncompetitive telecommunications companies, services — Minimal regulation.

(1) A noncompetitive telecommunications company may petition to have packages or bundles of telecommunications services it offers be subject to minimal regulation. The commission shall grant the petition where:

(a) Each noncompetitive service in the packages or bundle is readily and separately available to customers at fair, just, and reasonable prices;

(b) The price of the package or bundle is equal to or greater than the cost for tariffed services plus the cost of any competitive services as determined in accordance with RCW 80.36.330(3); and

(c) The availability and price of the stand-alone noncompetitive services are displayed in the company's tariff and on its web site consistent with commission rules.

12 Rate changes would be handled as they are today – some tariffed services can be changed on one day's notice, others require 30 days. Changes in rates for catalog, or non-tariffed, services, are not subject to Commission filing or approval.

Qwest ILEC

13 For Qwest Corporation ("Qwest"), who is currently regulated under an AFOR that was approved in 2007, the Joint Applicants believe that a Commission or company rejection of the AFOR would return Qwest to rate of return regulation. Under Qwest's 2007 AFOR, Qwest is treated as a competitively classified company, and is not price or earnings regulated, except for certain services such as the 1FR that remained tariffed under the AFOR. In addition, prior to the AFOR, Qwest had obtained competitive classification under RCW 80.36.330 for a number of its services, including toll, business services (including the business line and features), directory assistance, and certain high capacity services in various markets. Given the three general choices for the manner of regulation described above, it seems that if an ILEC is not under an AFOR, the only other option, absent legislative changes, is rate of return regulation.

14 The rate structure for Qwest would be determined based on the competitive status of the various services outside of an AFOR. In other words, services that have been competitively classified under RCW 80.36.330 would remain competitively classified and not tariffed. Thus, they would not be price regulated. Services that were under tariff as of October 1, 2014 would remain under tariff, with the same pricing requirements as described above for the CenturyLink ILECs. Services that were treated as competitively

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(2) For purposes of this section, "minimal regulation" shall have the same meaning as under RCW 80.36.330.
(3) The commission may waive any regulatory requirement under this title with respect to packages or bundles of telecommunications services if it finds those requirements are no longer necessary to protect public interest.

classified under the 2007 AFOR and transferred from the tariff to the catalog would return to the tariff, subject of course to Qwest's right to petition to have those services competitively classified under RCW 80.36.330 or subject to minimal regulation under RCW 80.36.332.

15 Rates would not revert to any prior levels. For example, prior to the AFOR, Qwest's tariffed 1FR was $12.50 per month. During the AFOR proceeding, it was determined that a $1.00 per month increase to that rate would result in a rate that is fair, just, and reasonable. Qwest filed revised tariffs after the approval of the 2007 AFOR to change its 1FR rate from $12.50 to $13.50 per month, the rate it is today. Barring any other changes to the rate level or competitive status of the 1FR between now and the conclusion of the next AFOR proceeding, the 1FR would be priced at the tariffed rate of $13.50 per month at that time, even if the Commission or the company rejected the new AFOR plan.

16 **Commission Issue # 2: To what extent is it in the public interest to delay the earnings review required as a condition of the Commission's approval of the CenturyTel/Embarq merger in Docket UT-082119, as set forth in the Joint Applicant/Staff/Public Counsel Settlement Agreement in this proceeding? Should the Commission order an earnings review by a date earlier than that contained in the Staff/Public Counsel/Joint Applicant Settlement?**

17 **Response:** Circumstances have substantially changed since the CenturyTel/Embarq merger order where the Commission established the requirement for a scheduled earnings review. The public interest would be best served by rescheduling that earnings review, as set forth in the Staff/Public Counsel/Joint Applicant Settlement.

18 In the CenturyTel/Embarq merger Order the Commission directed the combined company to submit a normalized *pro forma* results of operations report for regulated services in Washington. The intent was that such a report would reflect merger synergy savings realized through the test year and *pro forma* year (see ordering paragraph (2) in

Order 05). Given that the CenturyTel/Embarq merger transaction closed on July 1, 2009, that filing would have been due on July 1, 2012 and would have reflected an historical test year consisting of calendar year 2011. As the Commission points out in framing the issues for this brief, the Settlement Agreement reached by Commission Staff, Public Counsel and Joint Applicants in this case would have the effect of delaying the earnings review contemplated in the CenturyTel/Embarq merger order. The terms of the Commission Staff/Public Counsel/Joint Applicants Settlement Agreement provide for the filing of results of operation and associated financial information to allow the Commission to conduct a full earnings review to be submitted no sooner than three years or later than four years after close of the CenturyLink/Qwest merger transaction. (Exhibit 6, Condition 3 b.)

19 The resulting delay in a full earnings review of the CenturyTel/Embarq combined operations is fully justified by the substantial change in circumstances since the CenturyTel/Embarq merger order was issued. A 2011 test year as originally contemplated by the Commission in the CenturyTel/Embarq merger order would have been a fairly clean representation of combined CenturyTel and Embarq operations at a point well into the progression towards full run rate synergies. However, the announcement of the CenturyLink/Qwest merger transaction changes all of that. A 2011 test year will now be anything but a "clean" look at combined CenturyTel and Embarq operations.

20 Calendar year 2011 will in fact contain several months that will reflect the operation of Qwest properties. The legacy CenturyTel ILECs (CenturyTel of Washington, Inc., CenturyTel of Inter-Island, Inc., and CenturyTel of Cowiche, Inc.) and the Embarq ILEC (United Telephone Company of the Northwest) will continue to exist as separate

regulated corporate entities with their own results of operations after the Qwest acquisition. However, a substantial portion of the costs driving their results of operation consist of an allocation of costs arising from centralized functions performed at the combined CenturyLink corporate level. In the year 2011 these cost allocations will (at least for several of the months) be impacted by the inclusion of Qwest properties in that process. In fact, on an access line basis, the Qwest properties will represent more than 85 percent of the combined operation in Washington (see Exhibit A to the Joint Application). As a result, an earnings review filing based upon a 2011 test year would be less a reflection of the CenturyLink/Embarq merger transaction and more a reflection of the very beginnings of the impacts of the CenturyLink/Qwest merger transaction.

21 The advent of the CenturyLink/Qwest merger transaction means that calendar year 2011 will have a multitude of moving parts when it comes to trying to evaluate the impacts of the Embarq and Qwest acquisitions. There is no practical way to make a report due on July 1, 2012, and relying on calendar year 2011 results into any kind of a "normalized" reflection of operations going forward. Because of all these moving parts, calendar year 2011 is not a viable candidate for any meaningful regulatory analysis of either the Embarq or Qwest transactions. It would not be a good use of Commission, Public Counsel or Joint Applicants' resources to attempt to conduct a full earnings review based upon 2011 results.

22 Commission Staff, Public Counsel and the Joint Applicants took all of this into consideration in crafting Condition 3 to their Settlement Agreement. They recognized that little purpose would be served in carrying through with a full earnings review on the schedule contemplated in the CenturyTel/Embarq merger order. This is not to say that the Parties were oblivious to any public interest consequences of such a delay. On the

contrary, the parties were and are fully cognizant that, as will be discussed below, there are many other provisions in both the Settlement Agreement in this case as well as the CenturyTel/Embarq merger order that will continue to protect consumers during the resulting delay. Taking all of these factors into consideration it is in the public interest to delay the full earnings review that was contemplated in the CenturyTel/Embarq merger order.

23 As discussed above, given the current circumstances, there is no practical way to conduct a meaningful earlier earnings review. Nor is there any guarantee that an earlier earnings review would work to the benefit of consumers. As witness G. Clay Bailey testified at the hearing, CenturyLink has faced and will continue to face significant reductions in access lines, access minutes and revenues.[6] Depending upon the timing of any earnings review, those negative factors could more than offset any synergies achieved to that point.

24 In any event, there are many other provisions in the Commission Staff/Public Counsel/Joint Applicants Settlement Agreement as well as the CenturyTel/Embarq merger order that serve to protect consumer interests in the absence of an earlier earnings review. First and foremost, the Settlement Agreement protects consumers during this period by capping rates for basic residence and business services in the legacy CenturyTel and Embarq service areas. (Exhibit 6, Condition No. 20). This provision would have the effect of re-instating the cap on rates for basic residential service that was a condition included by adoption in the CenturyTel/Embarq merger order[7], but that

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[6] TR 389:2; and TR 499: 9

[7] See Condition No. 4 b. in Appendix 1- Settlement Agreement among Commission Staff, Public Counsel and Joint Applicants, adopted into Docket No. UT-082119, Order No. 5, at paragraph 9.

expired one year after closing of that merger transaction (i.e. July 1, 2010).

25 The CenturyTel/Embarq merger order also adopted a provision that prohibits CenturyLink from recovering from intrastate regulated rates, any merger-related branding or transaction costs.[8] That condition remains intact and will help to protect legacy CenturyTel and Embarq regulated ratepayers during the delay period. Similar provisions were also incorporated into the Commission Staff/Public Counsel/Joint Applicants Settlement Agreement in this case (Exhibit 6, Condition Nos. 5 and 6). Therefore regulated ratepayers are similarly shielded from the same type of merger-related costs arising from this transaction.

26 Based upon a reading of the CenturyTel/Embarq merger order and listening to questions from the Bench at the hearing in this matter, it is clear that a primary concern of the Commission in proceedings such as these is the ability to track and identify synergy savings arising from the transaction. The Commission in the CenturyTel/Embarq merger order imposed a requirement that CenturyLink track and report annually the cost and synergy savings of the merger on a company-wide basis and a Washington basis.[9] This requirement will remain in place regardless of any delay in the filing of a full earnings review. This information will give the Commission, its Staff and the Public Counsel the ability to monitor the achievement of expected synergies. These reports will alert the Commission to any major deviations from either the expected pace at which the synergies are achieved, or the amount expected to be achieved. If any deviations are of such a magnitude that they raise concerns, the Commission would be in a position to act before

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[8] See Condition No. 5 in Appendix 1- Settlement Agreement among Commission Staff, Public Counsel and Joint Applicants, adopted into Docket No. UT-082119, Order No. 5, at paragraph 9.

[9] See Docket No. UT-082119, Order no. 5, at paragraph 50 and ordering paragraph (3)

the earnings review contemplated in the Commission Staff/Public Counsel/Joint Applicants Settlement Agreement in this case. Otherwise, as discussed above, it is not practical or particularly meaningful to conduct a full earnings review prior to that time.

27 It is also the case that the CenturyLink ILECs will continue to submit quarterly financials in the normal course of the Commission's oversight rules. Again this will allow the Commission's Staff and the Public Counsel to alert the Commission to any drastic deviations or anomalies, and the Commission has powers to address them accordingly without having to wait for the full earnings review contemplated in the Commission Staff/Public Counsel/Joint Applicants Settlement Agreement in this case.

28 Finally, it is not necessary that a full earnings review be conducted in order for consumers in the legacy CenturyTel and Embarq service territories to receive benefits from the merger synergies. Testimony in both merger transaction dockets pointed out that synergies generated by the transactions will benefit consumers by creating a stronger, more stable provider that will be able to compete more effectively and to continue to invest in and offer new and expanded services to consumers.[10] One area where this benefit occurs is the ability to continue investing in broadband deployment in new areas that become progressively less sustainable from a business case perspective. In order to assure that this kind of benefit does in fact occur as synergies are expected to be realized, the Settlement Agreements with Commission Staff and Public Counsel in both merger transaction dockets contained broadband deployment commitments.

29 In the CenturyTel/Embarq merger docket, there was a commitment to extend broadband

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[10] See e.g., Bailey direct testimony (Exh. GCB-1T) p. 11, ln 6 thru p. 12, ln 7

to 2,200 additional higher cost lines in the legacy Embarq service area.[11] That deployment commitment has been fulfilled by CenturyLink.[12] Therefore to the extent that synergies from the Embarq transaction have been achieved to date, consumers have benefited from them even without conduct of a full earnings review.

30 The Settlement Agreement in this docket contains a very large broadband deployment commitment of $80,000,000 over five years.[13] This is in fact the largest amount of broadband investment commitment in any of the states reviewing the merger transaction.[14] The ability to make a commitment of this magnitude stems from the financial strength gained from the expected realization of free cash flow before synergies and through synergy savings from both of these merger transactions. Consumers, including those in the legacy CenturyTel and Embarq service areas, will begin benefitting from this commitment almost immediately. These consumer benefits will not be tied to or dependent upon an earnings review.

31 Delay of the earnings review contemplated in the Commission's CenturyTel/Embarq merger order will be in the public interest as it will allow such review to be conducted in a meaningful manner that will not absorb Commission, Commission Staff, Public Counsel, and company resources in an exercise of questionable validity. At the same time, consumers will not be harmed or denied benefits created by any synergy savings achieved during the delay.

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[11] See Condition No. 8 in Appendix 1- Settlement Agreement among Commission Staff, Public Counsel and Joint Applicants, adopted into Docket No. UT-082119, Order No. 5, at paragraph 9.

[12] TR 329:23 – TR 330:4

[13] Exhibit 6, Condition No. 14

[14] Joint Testimony in Support of Settlement (Exh. JJ/MK/MV/SJ-7T) p. 24, ln 3

32 Consequently, the Commission should not order an earnings review by a date earlier than that contained in the Staff/Public Counsel/Joint Applicant Settlement. The reasons for this are threefold.

33 First, the parties settled on this timeline as a part of a comprehensive settlement, and believe that it reasonably balances the desires of various parties with regard to the timing of an earnings review. The amount of time is reasonably tailored to allow realization of and reporting on the merger synergies prior to a review. An earlier review, as described above, might simply be administratively more burdensome, requiring a filing relatively soon after the merger close, and might require multiple adjustments and/or amended filings as the net synergy benefits shift during the work associated with integrating the companies.

34 Second, the timeline for an earnings review by the Commission does not foreclose a complaint or an investigation regarding rates. Thus, no party is prejudiced by the timing.

35 Third, in addition to the considerations described above for the CenturyLink ILECs, Qwest's earnings were subject to a thorough review in 2006, in the AFOR docket. The AFOR, though scheduled at this time for review in 2011, does not include a specific requirement for a formal earnings review such as the Settlement Agreement calls for, so a review of Qwest's earnings is not necessarily delayed by the Settlement. Further, to the extent that the AFOR continues in effect, so do the Commission-ordered reporting requirements – reporting that the Commission found was sufficient to monitor the progress of the AFOR.

36 No party in this case has alleged, or even suggested, that Qwest is over earning under a rate of return analysis, and the manner in which Qwest is maintaining its books and

records under the terms of the AFOR preserves the Commission's ability to conduct a review three years from now in the same manner that it might conduct one this year if the 2007 AFOR came up for renewal or reconsideration. Further, as is clear from the level of participation in this docket by various competitors, Qwest's rates and earnings are subject to considerable market pressure, likely greater than in 2006. There are no regulatory reasons to conduct an earnings review on any schedule other than that established in the Settlement Agreement.

37 **Commission Issue # 3: To what extent is it in the public interest to retain separate regulated operating entities in Washington (i.e., the CenturyLink companies, Embarq, and Qwest) after closing of the merger? Should the Commission's order in this proceeding require that the companies be consolidated or otherwise treated as a single entity for Washington regulatory purposes?**

38 **Response:** The Joint Applicants believe that it is consistent with the public interest to maintain the separate regulated operating entities that operate in Washington today. The Commission's order should not require that the companies be treated as a single entity for regulatory purposes.

39 First, there is no request to consolidate the operating companies as a part of the transaction. The separate operating companies that exist today will exist as separate corporate entities post-merger. In essence, the Qwest operating companies will become affiliates of the CenturyLink ILECs, including Embarq. The CenturyLink ILECs and Embarq are also separate entities now – as they have been for many years in Washington, and as they were through the CenturyTel/Embarq transaction. Thus, other than creating affiliate relationships where they did not previously exist, the transaction does not change the status quo. And, while "no change to the status quo" is not necessarily equivalent to the "no harm" standard discussed above, in this particular case maintaining the status quo in fact does not cause harm, and is therefore in the public interest.

40 Consolidating operating entities would not be a simple or straight-forward process. Nor could it be accomplished entirely within the confines of this docket. The fundamental regulatory accounting basis for the CenturyLink ILECs and Qwest is based upon study areas established by 47 C.F.R. Part 36. Study areas mirror the historical service areas of the ILECs. Study area boundaries for the CenturyLink ILECs and all other ILECs were frozen by the FCC in 1984.[15] The FCC has historically considered waivers of the study area freeze in transactions where there is a transfer of only a portion of an ILEC's service territory and therefore a modification to the existing study area boundaries. In this transaction there is no transfer of any partial service territory or partial study area. However, the operating company "consolidation" contemplated by the Commission in its framing of issue Number 3, would involve a combining of existing study areas and likely would trigger the need for an FCC waiver of the study area freeze.

41 It is also the case that modifying study areas will impact the calculation of federal universal service funding. The impact can in some instances be dramatic. Quantification of any such impact would seem to be a prerequisite to directing any consolidation of ILECs.

42 Further, the testimony of Clay Bailey affirmatively shows that any requirement to consolidate entities could cause harm by triggering certain debt covenants on debt held by the various operating entities.[16] The existence of debt within the various operating entities is a result of those entities holding debt at the time of their acquisition by CenturyLink. In the future, the companies plan to consolidate and streamline the

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[15] See 47 C.F.R. Appendix to Part 36

[16] TR 329:9

issuance of debt by limiting it to either the CenturyLink parent, or the Qwest operating company if necessary to refinance Qwest debt.

43 Finally, Mr. Bailey's testimony shows that the merger synergies that are anticipated from this transaction (as well as those from the Embarq transaction), do not depend on consolidation of the operating companies. Rather, those synergies will be realized by the consolidation of the corporate parents, and the cost savings that result from that consolidation. Indeed, if the Joint Applicants thought that additional synergies could be produced from a combination of the regulated operating entities, they would likely be seeking approval for such a restructure. But, as demonstrated, the potential harm is too great to make this a viable option. Further, though the Joint Applicants do not believe that there is any basis in fact at this point in time to decide that the companies should be considered as a consolidated entity for regulatory purposes, the Settlement Agreement recognizes that certain parties or the Commission may want to explore that issue during the earnings review, and it does not preclude consideration of that issue.

44 As was discussed above in Issue No. 2, the Commission will be dealing with a lot of moving parts as it endeavors to monitor and track the impacts of the Embarq and Qwest merger transactions. Joint Applicants would question whether it would make sense to unnecessarily add more moving parts to the process. One of the things that would remain constant throughout the period before and after both transactions is the accounting, reporting and corporate identities of the individual operating companies. This stability would provide a valuable baseline to help the Commission gauge the impacts of the transactions. It would seem counter-productive to disrupt that stability and base line by changing the accounting, reporting or corporate identities.

45 **Commission Issue #4. If the Commission approves the transaction, together with the conditions included in the proposed Settlement Agreements, would the merged company (or its subsidiaries) operating in Washington be eligible for the rural exemption under 47 U.S.C. §251?**

46 **Response:** The rural exemption status of the operating companies in Washington is established by operation of law and would not change by virtue of the transaction or any conditions in the Settlement Agreements.

47 The provisions of 47 U.S.C. §251(f)(1) exempt rural telephone companies from a limited set of interconnection requirements (i.e. §251(c) requirements). This is what is commonly referred to as the "rural exemption." The 1996 Act bestows the rural exemption only on those companies that meet the definition of a "rural telephone company" 47 U.S.C. §251(f)(1). Section 47 U.S.C. 153 (37) provides the definition of a "rural telephone company" and does so in terms of a "local exchange carrier operating entity" that meets certain distinct criteria. Therefore the definition of a "rural telephone company" is applied at the operating company level and not at the holding company level. FCC Tenth Report and Order, CC Docket No. 96-45 and CC Docket No. 97-160, November 2, 1999.

48 Companies hold the rural exemption by operation of law. They either meet the definition of rural telephone company or they do not. There is no provision in the law for a company to "seek" a Section 251(f)(1) rural exemption.

49 There is however a provision in the 1996 Act for state commissions to terminate a section 251(f)(1) rural exemption if a precise process is followed and specific findings are made. Section 251(f)(1)(B) provides that a state commission can terminate a section 251(f)(1)

rural exemption only within the context of a section 251 proceeding and then only after reviewing and making findings concerning matters of economic burden, technical feasibility and consistency with universal service objectives.

50 Turning to the local operating companies covered by the proposed transaction, the following summarizes their rural exemption status. With respect to the legacy CenturyTel local operating companies: CenturyTel of Washington, Inc., CenturyTel of Inter-Island, Inc., and CenturyTel of Cowiche, Inc. all meet the definition of a rural telephone company and therefore hold a section 251(f)(1) rural exemption. Their rural exemptions have never been reviewed or terminated by this Commission.

51 United Telephone Company of the Northwest (the legacy Embarq local operating company now owned and operated by CenturyLink) also meets the definition of a rural telephone company. Its rural exemption was not reviewed or terminated by this Commission. However, prior to acquisition by CenturyLink, and while under Sprint ownership, United was deemed to have voluntarily waived its rights to the rural exemption. This Commission has previously ruled that rural telephone companies can waive such rights. *In the Matter of the Claim of GTE Northwest Incorporated for Rural Telephone Exemption Pursuant to 47 U.S.C. Section 251*, Docket No. UT-960324, Second Supplemental Order, December 11, 1996. Therefore United does not now, nor in the future could it assert the rural exemption.

52 Qwest Corporation, f/k/a U S WEST, has never met the definition of a rural telephone company, nor would it after the transaction. Therefore it has never held the rural exemption and never will. Condition No. 6 in the Integra Settlement Agreement (Exhibit 3) is consistent with and confirms this fact.

53 Each of the local exchange carrier operating entities listed above will retain their existence as such an entity after the transaction closes. There is nothing in the transaction or the Settlement Agreements that will change their qualification to hold the rural exemption.

54 The "suspension and modifications" provision of 47 U.S.C. §251(f)(2) is also not a factor in this proceeding. A section 251(f)(2) suspension or modification is available to only "a local exchange carrier with fewer than 2 percent of the Nation's subscriber lines." Unlike the section 251(f)(1) exemption provision, subsection (f)(2) applies to local exchange carriers and not a rural telephone company. Also the language refers to "local exchange carrier" and not "local exchange carrier operating entity" as was otherwise the case in the section 153 (37) definition of "rural telephone company." This means that the 2 percent restriction would apply at the holding company level and not the operating company level. Neither pre-merger nor post merger CenturyLink would meet that 2 percent restriction. No CenturyLink ILEC has petitioned for a section 251(f)(2) suspension or modification, nor could they in the future.

55 It is worth noting that the scope of the rural exemption is limited and does not preclude competition in the service area of the ILEC holding the exemption. The legacy CenturyTel ILECs in Washington, while holding the rural exemption, have none-the-less negotiated and executed interconnection agreements with CLECs, exchange traffic with those CLECs and port numbers to those CLECs when they capture a customer. The transaction would not change any of this. Retention of the status quo with regard to rural exemptions is entirely consistent with the "no harm" standard that is to be applied to review of this transaction.

56 The rural exemption held by CenturyTel of Washington, Inc., CenturyTel of Inter-Island, Inc., and CenturyTel of Cowiche, Inc. would, and should remain in place by operation of law. As stated earlier, a state commission can terminate a section 251(f)(1) rural exemption only within the context of a section 251 proceeding and then only after reviewing and making findings concerning matters of economic burden, technical feasibility and consistency with universal service objectives. It is also the case that in such a proceeding, it is the CLECs who would carry the burden of proof. *Iowa Utilities Board v. Federal Communications Commission*, 219 F.3d 744 at 759-763 (8th Cir. 2000).

57 No such section 251 proceeding has occurred here. The Commission is in no position to make findings regarding economic burden, technical feasibility and consistency with universal service objectives. CLECs have in no way carried their burden to support the necessary conclusions in these areas. The CLECs' proposal that approval of the merger should be conditioned upon termination of rural exemptions that would otherwise continue to exist by operation of law after the merger, should, and must be rejected.

58 Respectfully submitted this 14th day of January, 2011.

CENTURYLINK

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