BEFORE THE WASHINGTON 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 UT-100820 POST-HEARING BRIEF OF PUBLIC COUNSEL AND COMMISSION STAFF ON COMMISSION-IDENTIFIED BRIEFING ISSUES

1 Staff of the Washington Utilities and Transportation Commission (Staff) and the Public Counsel Section of the Attorney General's Office (Public Counsel) jointly submit this post-hearing brief on the four issues identified by the Commission in Appendix A to its Order 13 issued January 7, 2011.

COMMISSION ISSUE NO. 1: AFOR

2 As it currently stands, both CenturyLink and Qwest are required to participate in alternative form of regulation (AFOR) proceedings in the near future. CenturyLink is required to petition for an AFOR by July 1, 2014, pursuant to its agreement in the CenturyTel/Embarq merger proceeding, which was adopted by the Commission.[1] Qwest

[1] *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 UT-082119, Order 05, Final Order Approving and Adopting Settlement Agreement; Authorizing Transaction Subject to Conditions; Rescinding Order 03; Approving and Rejecting Side-Agreements; Granting and Denying Pending Requests for Leave to Withdraw; Dismissing Party (*Embarq Merger Order*) at pp. 29–30, ¶ 98, and Appendix 1 Settlement Agreement at p. 6 (May 28, 2009) ("CenturyTel and Embarq agree that the Merged Company ILECs will petition for an AFOR(s) pursuant to RCW 80.36.135, or the then current

currently operates under an AFOR that will expire in November 2011.[2] The company is required to file financial information in February 2011 in order to initiate the review of its AFOR.[3]

A. Settlement Agreement of the Joint Applicants, Staff and Public Counsel

3 The Settlement Agreement entered into by the Joint Applicants, Staff and Public Counsel (Agreement) requires CenturyLink to file an AFOR plan (or plans) covering all post-merger local operating companies no sooner than three or later than four years from when the merger closes.[4] The Agreement requires that the plan(s) comply with RCW 80.36.135, the AFOR statute. The Agreement provides the foundation for the Commission to analyze all of CenturyLink's post-merger local operations concurrently and, as appropriate, to apply consistent regulatory treatment and rate structures across local operating entities.

B. Statutory Framework

4 Under Washington law, incumbent local exchange carriers are subject to traditional rate of return, rate base regulation, chapters 80.04 and 80.36 RCW, unless the Commission has granted one of the alternatives to traditional regulation available under chapter 80.36 RCW. There are two primary alternatives: (1) a company or service can be classified as competitive under RCW 80.36.310–330; or (2) the Commission can approve an alternative form of regulation (AFOR) under RCW 80.36.135.

AFOR law or rule, no later than five (5) years from the close date of the merger").
The merger closing date was July 1, 2009.
http://www.centurytelembarqmerger.com/pdf/pressreleases/News_Release_Legal_Close_06-30-09_FINAL.pdf.

[2] *In the Matter of the Petition of Qwest Corporation For an Alternative Form of Regulation Pursuant to RCW 80.36.135*, Docket UT-061625, Order 06, Order Accepting Settlement and Approving Alternative Form of Regulation, on Conditions at p. 38, ¶ 140, and p. 46, provision 2 (July 24, 2007) (*Qwest AFOR Order),* and Order 14 at p. 1 (November 30, 2007).

[3] *See* Qwest AFOR Order at p. 33, ¶ 115.

[4] Appendix A to Settlement Agreement (Appendix A), Condition 3.

5 Under RCW 80.36.135(3), while a company may request an AFOR, the Commission has the authority to reject the company's AFOR plan. In addition, under RCW 80.36.135(4), even if an AFOR is approved in any form, the petitioning company can elect not to proceed with the AFOR. Under this statutory scheme, therefore, if a request to depart from traditional rate of return regulation is denied, the telecommunications provider simply remains regulated under that pre-existing regime. The statutory language reflects that traditional regulation is the default, providing that a telecommunications company "*subject to traditional rate of return, rate base regulation* may petition the Commission to establish an alternative[.]" RCW 80.36.135(3) (emphasis added). Elsewhere, the statute provides that "the Commission may regulate telecommunications companies *subject to traditional rate of return, rate base regulation* by authorizing an alternative form of regulation[.]" RCW 80.36.135(2) (emphasis added).[5]

C. Regulatory Status of Joint Applicants' Washington ILECs

6 CenturyLink: The CenturyLink ILECs are currently subject to traditional rate of return, rate base regulation, with several exceptions, such as bundled services.[6]

7 Qwest: As noted above, Qwest is currently subject to alternative regulation under an AFOR, with a set duration of four years (expiring November 2011) unless extended by the Commission. However, a number of services, including basic residential service (1FR) remain under tariff pursuant to the AFOR.[7] In addition, separately from the AFOR, Qwest

[5] The AFOR statute also requires that a proposed AFOR submitted by a company must include a "proposed duration." RCW 80.36.135(3). The statute thus contemplates that an approved AFOR will have an end date and will be subject to review at its expiration. It is implicit that the Commission would have the discretion to extend or terminate the AFOR as a result of that review.

[6] CenturyLink ILEC bundles and packages are subject to minimal regulation (see RCW 80.36.332). Docket UT-071575 (Embarq) and UT-071964 (remaining CenturyLink ILECs). In addition, in Docket UT-971689, Embarq was granted competitive telecommunications service classification for its intraLATA toll services.

[7] Qwest AFOR Order at p. 7, ¶ 19, at p. 35, ¶¶ 120–121, and at pp. 47–48.

has been granted competitive classification for its business services and directory assistance.[8]

D. Application of the Statutory Framework to This Case

8 The Commission issue statement assumes that Qwest's existing AFOR would be extended, as provided in the Agreement, until new AFOR plans are considered concurrently for Qwest and the CenturyLink ILECs. Under the Agreement, the AFOR filings would constitute new AFOR petitions under the statute for both the CenturyLink ILECs and for Qwest. The Commission's issue statement properly posits that the Commission could reject the filings under RCW 80.36.135(3), or that CenturyLink (or separate petitioning subsidiaries) could elect not to proceed with an AFOR if dissatisfied with the AFOR approved by the Commission, pursuant to RCW 80.36.135(4). Nothing in the settlement requires that these AFOR filings be treated any differently under the statute for these purposes than an AFOR filing by any other company. In other words, if the request to be regulated in an alternative manner is denied, or if the CenturyLink ILEC or Qwest elects not to proceed, the company continues to be "subject to traditional rate of return, rate base regulation."

9 In the case of the CenturyLink ILECs, the operating subsidiaries are currently subject to rate of return, rate base regulation and would remain so at least until the completion of the

[8] High-speed data services (DS-1, DS-3, and SONET) in specified geographic areas (Docket UT-990022);

Directory Assistance Services (Docket UT-990259);

Business services served via DS-1 or higher bandwidth circuits in 23 wire centers encompassed by the Seattle, Bellevue, Spokane, and Vancouver exchanges (Docket UT-030614);

Digital business services, including Digital Switched Service (DSS), ISDN Primary Rate Service, ISDN Basic Rate Service, Uniform Access Solution (UAS) Service, Integrated T-1 Service, Frame Relay Service, LAN Switching Service (LSS) and Digital Private Line Services (including DDS, DS1, and DS3) in the Seattle, Tacoma, Spokane, Olympia, Vancouver, Bellingham, Yakima, and Pasco exchanges encompassing 58 wire centers (Docket UT-050258).

new AFOR docket(s). These ILECs would be in the same situation as any company that had been subject to traditional regulation until 2014 or 2015 and then filed for an AFOR under the statute. If the AFOR is not approved, or is not accepted, the company remains under rate of return regulation. Any services competitively classified would remain so.

10 While Qwest is differently situated at present because of its AFOR, the statutory analysis and outcome are the same. In 2014 or 2015, Qwest would be making a new AFOR filing under the Agreement either as part of a consolidated CenturyLink filing, or as a separate CenturyLink subsidiary. The current AFOR had a set term and is in effect for only a four year term unless extended.[9] Thus, absent the merger, Qwest already faces a possible return to rate of return regulation, depending on the outcome of the AFOR review proceeding.[10] The settlement does not change the range of outcomes, it simply changes the timing. The review of Qwest's current AFOR is folded into and superseded by the new AFOR filings required by the Agreement. Nothing in the AFOR statute, the Agreement, the prior AFOR, or prior Commission orders, entitles Qwest to permanent continuation of its current AFOR. As with any company's AFOR proceeding, there is the possibility that, following consideration of a new AFOR plan or a review of the current AFOR, Qwest would return to rate of return regulation. This potential outcome is no different than the situation Qwest would face absent the merger. Finally, any Qwest service competitively classified would remain so.

E. Rates

11 The determination of the rates that would apply after rejection of an AFOR would be a relatively straightforward process. First, it is important to recall that the Agreement

[9] Qwest AFOR Order at p. 7, ¶ 18.
[10] As noted, a number of Qwest services, including 1FR, are still tariffed and traditionally regulated, and that status would continue.

contemplates that the Commission will have the information necessary to conduct a full earnings review akin to that in a general rate case.[11] On the basis of this record, the Commission would have the option to establish rates for the post-merger companies, either as a baseline for a new AFOR with pricing flexibility, or as a new set of tariffed rates for services returning to regulation. It could also, based on the earnings review, leave rates unchanged, based on a determination that the existing rates were fair, just, reasonable, and sufficient.

12 Again, this is particularly straightforward in the case of the CenturyLink ILECs, which will have primarily tariffed rates at the time of the new AFOR. After the full earnings review, if an AFOR were rejected for these companies, the CenturyLink ILECs would either retain their existing tariffed rates, or the Commission could modify them based on the record, if the existing rates were found not to be "fair, just, reasonable, and sufficient." With respect to services which already had been competitively classified prior to the AFOR, CenturyLink would retain pricing flexibility.

13 The same would apply to Qwest. The Commission could set rates for services that currently have pricing flexibility under the AFOR but had not been otherwise competitively classified. The rates which are currently under tariff, such as 1FR rates, would remain so, and could be reset or remain unaltered, depending on the record. Pricing for services which already had been competitively classified prior to the AFOR would remain flexible.

COMMISSION ISSUE NO. 2: TIMING OF THE CENTURYTEL/EMBARQ EARNINGS REVIEW

14 Pursuant to the Commission's order in the CenturyTel/Embarq merger proceeding,

[11] Appendix A, Subsection 3(b)(i). Section 3(d) of Appendix A already contemplates a review of a variety of rate issues as part of the AFOR/earnings review proceeding(s). Some additional procedural requirements might apply if the Commission initiated a general rate case.

as it currently stands, CenturyLink is required to file an earnings review on July 1, 2012.[12] The Agreement, however, provides that CenturyLink will seek an order relieving CenturyLink from the 2012 earnings review filing. The earnings review would be postponed, but broadened, and would be filed contemporaneously with the AFOR filing in 2014 or 2015. This postponement would be in the public interest given that an earnings review filed in mid-2012 would be less relevant and less useful than one that takes into full account the changed circumstances represented by the larger merger at issue here and given that the rate caps in the Agreement provide ratepayer protection until the earnings review is completed, to a much greater extent than the short-term rate cap in Embarq.

15 A postponement of the earnings review contemplated in the Embarq order would be consistent with the basis stated in that order for the three year earnings review. Significantly, the order stated that the "'public interest' requires the Commission be vigilant in review of the finances of the New CenturyTel companies *before they are relieved on[sic] any substantial rate oversight.*"[13] The Agreement in the CenturyLink/Qwest merger preserves the original purpose of the condition in the Embarq order, in that the Agreement postpones any consideration of relieving the CenturyLink ILECs, including Embarq, of any substantial rate oversight until after the Commission conducts a comprehensive earnings review.[14]

16 The Embarq order also noted that the merger created an "entirely new company from a financial perspective"[15] and that the financial picture was "dynamic and susceptible to a

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[12] *See* Embarq Merger Order at p. 30, ¶ 99, discussed at pp.13–15, ¶¶ 45–50; *supra* note 1 citing merger closing date.
[13] Embarq Merger Order at pp. 14-15, ¶ 48 (emphasis added).
[14] Note also that the Embarq settlement was unclear on the level of earnings review that would occur at the time of the required AFOR filing. The order created more specificity on that point by requiring the earnings review. This Agreement does not have that shortcoming.
[15] Embarq Merger Order at, p. 14, ¶ 48.

wide range of changes in the near term."[16] The overlay of the new merger and new merger synergies has again created an "entirely new company" with a "dynamic" financial picture. Postponing the earnings review allows the Commission to acquire a comprehensive picture of the entire company and all of its Washington operating subsidiaries' earnings as well as all synergies and merger costs, prior to making any decisions about future rates or regulation. Action by the Commission based on a partial picture created by a CenturyLink-only review in 2012 would necessarily be of an interim and partial nature. A comprehensive review of all of the Washington operations together is necessary and appropriate to consider rate issues such as retail rates and local and intrastate access rates.

17 An important reason for the earnings review in the Embarq order was the protection of ratepayers during the five year period prior to the contemplated AFOR. In this regard it was significant that the Embarq order contained only a limited rate freeze. The CenturyLink/Qwest merger, however, contains rate caps for residential and business customers, which protect customers until the completion of the new AFOR. This mitigates the need for the interim rate review required in Embarq.

18 Finally, the CenturyLink/Qwest Agreement preserves important elements of the Embarq order on the issue of earnings review. First, the Joint Applicants have agreed to the same level of earnings review as the Embarq order required: a full earnings review consistent with that required in a general rate case.[17] Second, the specific reporting obligations of the Embarq order are to remain in effect for CenturyLink.[18] Third, reporting requirements for merger synergies and costs parallel to those in the Embarq order will apply

[16] *Id.* at p. 15, ¶ 48.
[17] Appendix A, Subsection 3(b)(ii).
[18] Apendix A, Condition 4.

to Qwest also.[19]

19 If the Commission wished to conduct the earnings review required by the Embarq order it could of course do so. The review would not disrupt the fundamental framework of the settlement. The review could provide some interim information about the financial status of a part of the merged company and would not necessarily require any action by the Commission other than the review itself. Staff and Public Counsel, however, do not believe such a review is necessary.

COMMISSION ISSUE NO. 3: POST-MERGER STRUCTURE OF WASHINGTON OPERATING ENTITIES

20 On the one hand, there might be some advantages to be gained from consolidation of the Washington legal entities involved in the merger. The merger certainly anticipates synergies from consolidation of operations and systems. These potentially could be enhanced by greater consolidation of the legal entities. In addition, the regulatory burden on the Commission and other parties might well be reduced over time by such consolidation.

21 On the other hand, there are risks created by a "flash cut" consolidation of these different operating and legal entities, systems, work forces and cultures. Customers could well experience disruptions and degradations of service from a hasty cut over to consolidated service. Joint Applicants have represented that their plan is for a careful and deliberate integration process.[20] The CenturyTel/Embarq conversion integration must also be completed in the next few months and must be coordinated with the new merger activities.

22 The Agreement balances these two considerations. It is premised on the assumption that operational consolidation, conversions, and integrations will be occurring over the next

[19] *Id. Cf.* Embarq Merger Order at ¶ 50.
[20] Jones, Exh. No. JJ-4RT 10:14–15:4.

three to five years.[21] The need to generate the projected synergies over this timeframe will create an economic incentive for the companies to consolidate, at least on an operational basis. At the time of the new AFOR, the merged company has the option of making a consolidated AFOR filing, or filing a separate results of operations and a separate AFOR plan for each of the separate ILEC entities. If the local operating companies were to file separate results of operations under the Agreement, Staff believes it would be relatively straightforward to aggregate them. Whichever option is selected, the Commission retains the ability to require a consolidated filing if that appears preferable at the time.

23 The public interest standard in telecommunications mergers is a "no harm" standard.[22] The current status quo is that each corporate entity involved in the merger is already separately regulated. Unless the continuation of that structure creates harm, not mitigated by the conditions in the settlement, then the public interest standard has been met. Absent the merger, the status quo would continue. Ordinarily, the Commission does not dictate the specific form of corporate organization a regulated company must employ.

24 The Commission currently regulates the five separate entities in two main groups – Qwest, and the CenturyLink ILECs. With respect to the CenturyLink ILECs, the Commission currently is regulating multiple CenturyLink entities providing similar service through several different operating subsidiaries. It does not appear that the merger necessarily adds to the existing level of regulatory burden for this set of companies. Indeed, given the regulatory asymmetry between Qwest and the CenturyLink ILECs, it is prudent to retain separate operating companies after the merger closes, at least until the AFORs have

[21] *See, e.g.,* Bailey, Exh. No. GCB-1T 11:14–16; Bailey, TR. 375:14–17; Vasconi, TR. 252:13–24.
[22] *In the Matter of the Joint Application of Verizon Communications, Inc., and Frontier Communication Corporation For an Order Declining to Assert Jurisdiction Over, or, in the Alternative, Approving the Indirect Transfer of Control of Verizon Northwest, Inc.*, Docket UT-090842, Order 06, Final Order Approving and Adopting, subject to Conditions, Multiparty Settlement Agreements and Authorizing Transaction at p. 7, ¶ 9 (April 16, 2010).

concluded. As the Commission is well aware, Qwest currently operates under an AFOR and competitive classification for business services whereas CenturyLink's ILECs still conduct business primarily under traditional rate of return regulation. Under Qwest's AFOR a host of statutes and regulations were either waived in full or waived with modifications. These waived provisions are still in effect for the CenturyLink ILECs. Pricing of many services is handled differently for the two companies. Managing these differing regulatory requirements within a single corporate entity would be a significant challenge for both CenturyLink and the Commission.

25 There are additional requirements built in to the Settlement Agreement which mitigate the regulatory challenge of dealing with multiple entities and protect customers against cost increases that might result. These include:

- Condition 1 – Financial reporting requirements for the parent and all CenturyLink and Qwest ILECs.
- Condition 2 – Cost of Capital limitation on Qwest as well as on the CenturyLink ILECs.
- Condition 3 – Synergy Reporting. Reporting of synergy savings and costs company wide and for each CenturyLink ILEC and Qwest.
- Condition 5 – Bar to recovery of increased management costs.
- Condition 6 – Reaffirmation of affiliated interest requirements.
- Condition 11 – Accounting records. Sections 11(b), (c) and (d) in particular make clear that the merged company may not use the post merger corporate structure to restrict access to books and records.

26 Significantly, the provision for a combined new AFOR proceeding for all the companies gives the Commission an opportunity to revisit this question, after the Joint Applicants have had the opportunity to implement conversion and operational consolidation. While it is premature to reach conclusions at this stage, it may be feasible for the merged

company to consolidate all operations and systems in Washington in the three to five year timeframe.

27 The Agreement specifically leaves the door open for the Commission to treat the local operating companies as one entity for the purposes of analyzing results of operations and setting and designing retail and access rates in the new AFOR proceeding. This regulatory treatment would enable the Commission to establish consistent rate structures throughout the state in all of CenturyLink's post-merger local service areas, regardless of how CenturyLink chooses to legally separate its local operating entities. A single statewide rate design, for example, would appropriately reflect the post-merger consolidation of infrastructure and operations into the single company that will dwarf all other local exchange carrier operations in Washington. This is to say, the Commission could treat the merged companies as a single entity for regulatory purposes, including ratemaking purposes, even if some or all of the existing corporate structures remained in place.

COMMISSION ISSUE NO. 4: RURAL EXEMPTION[23]

28 Currently, CenturyTel of Washington, Inc., CenturyTel of Cowiche, Inc., and CenturyTel of Inter-Island, Inc. are eligible for the rural exemption under 47 U.S.C. § 251.[24] The merger would not change their exempt status. An ILEC that meets the definition of a rural telephone company can claim the rural exemption codified at 47 U.S.C. § 251(f)(1)(A). "Rural telephone company" is defined at 47 U.S.C. § 153(37). The definition covers a "local exchange carrier operating entity" that provides service generally to a smaller or rural population, to fewer access lines, or to a smaller percentage of access lines. The Federal Communications Commission has interpreted "local exchange carrier operating entity" to

[23] Public Counsel takes no position on this issue.
[24] Exh. No. BHP-9, CenturyLink's response to Charter's Information Request No. 38.

mean the legal entity that actually provides the service and to exclude a holding company parent.[25]

29 A state commission can terminate an ILEC's rural exemption under certain conditions. The merger does not affect these conditions and might not have any impact on the Commission's termination analysis. Before a state commission considers whether to terminate an ILEC's rural exemption, the ILEC must have received a "bona fide request for interconnection, services, or network elements" from another carrier.[26] Then the state commission must terminate the exemption if "the request is not unduly economically burdensome, is technically feasible, and is consistent with section 254" universal service provisions.[27] The Eighth Circuit has determined that the burden is on the requesting carrier to prove these elements.[28]

30 There does not appear to be controlling authority for what the Commission must consider to determine whether a request represents an undue economic burden. Recently, another state commission held "that an undue economic burden exists when competitive entry is likely to undermine an ILEC's revenue to such an extent that an ILEC is likely to be

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[25] *FCC Tenth Report and Order,* IN THE MATTER OF FEDERAL-STATE JOINT BOARD ON UNIVERSAL SERVICE, CC Docket No. 96-45, FORWARDLOOKING MECHANISM FOR HIGH COST SUPPORT FOR NON-RURAL LECS, CC Docket No. 97-160, FCC 99-304 (November 2, 1999) at p. 121, ¶¶ 452-53.

> In the *Inputs Further Notice*, we sought comment on the meaning of the term "local exchange operating entity." [...] AT&T and MCI argue that the term should mean the holding company within a state whose affiliates provide the local exchange services. The third interpretation has been proposed by RTC and Citizens Utilities, who argue that the most natural understanding of "local exchange operating entity" is the legal entity responsible for the provision of local exchange services, regardless of whether that entity serves a single or multiple study areas. We conclude that this interpretation is the most reasonable one. We believe that it is most logical to classify the carrier at the actual corporate level through which it offers its local exchange services. As RTC and Citizens Utilities point out, it is that entity that has legal responsibility for the provision of the local exchange services. The holding company interpretation proposed by MCI and AT&T seems to rest upon the concern that study area designations will be manipulated and, as a result, carriers will inappropriately be eligible for support as rural carriers, when they should not be. [footnotes omitted.]

[26] 47 U.S.C. § 251(f)(1)(A).
[27] 47 U.S.C. § 251(f)(1)(B).
[28] *Iowa Utilities Board v. Federal Communications Commission*, 219 F.3d 744, 762 (8th Cir. 2000).

hampered in its ability to offer quality telecommunications services, attract sufficient capital, and undertake prudent investments in infrastructure while maintaining its ability to fulfill its role as a carrier of last resort."[29] At least one state commission has declined to take into account the ILEC's parent company in evaluating whether a request was unduly economically burdensome for the ILEC, and the decision was upheld by the reviewing court.[30] In any event, a competitive carrier must actually desire and request Section 251(c) elements from a CenturyLink ILEC that claims the rural exemption before the issue of whether to terminate the rural exemption would come before the Commission. The merger with Qwest would not change this prerequisite.

DATED this 14th day of January, 2011.

Respectfully submitted,

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[29] *In Re CRC Communications of Maine, Inc.*, Docket No. 2009-40, Docket Nos. 2009-41–2009-44, 2010 WL 2787418, Order of the Maine Public Utilities Commission at p. 12 (July 9, 2010).

[30] *Midcontinent Communications v. North Dakota Public Service Commission*, No. 1-09-cv-17, at 20 (S.D.N.D. filed April 15, 2010) ("[t]he Court notes that nothing in the Telecommunications Act of 1996, or the applicable FCC regulations, requires the PSC to include a rural telephone company's parent or affiliate in determining whether the request for interconnection is unduly economically burdensome"), *available at* http://www.ndd.uscourts.gov/dndopinions/html/1-09-cv-17-54.pdf.