

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

COMMISSION STAFF'S
RESPONSE TO CENTURYLINK'S
PETITION FOR WAIVER AND/OR
MODIFICATION OF MERGER-
RELATED CONDITIONS
REGARDING AFOR FILINGS

I. INTRODUCTION

1 Staff of the Washington Utilities and Transportation Commission (Staff) submits this response to CenturyLink, Inc.'s Petition for Waiver and/or Modification of Merger-Related Conditions Regarding AFOR Filings (Petition). Staff does not object to modifying its settlement and the Commission's Order 14 to allow CenturyLink, Inc. (CenturyLink) to petition for Alternative Form of Regulation (AFOR) sooner than the three-year stay out period.

II. STATEMENT OF FACTS

2 On December 23, 2010, Staff, the Public Counsel Division of the Washington State Attorney General's Office (Public Counsel) and the two merging companies, CenturyLink, Inc. (CenturyLink) and Qwest Communications International Inc. (QCII), filed a settlement agreement with the Washington Utilities and Transportation Commission (Commission) regarding the merger. The settlement agreement incorporates a list of conditions, some of

which reference the AFOR¹ plan CenturyLink committed to file with the Commission. Condition 3 obligates CenturyLink, no sooner than three years and no later than four years after the transaction closing date, to file pro forma results of operations and an AFOR plan (or plans).² Condition 3 also sets forth issues to be included in the AFOR proceeding: analysis and disposition of merger synergies, rate rebalancing, rate design for residential and business services, and intrastate access charges. The logic behind the condition requiring CenturyLink to file an AFOR plan between three and five years after the merger rested on the timeline projected for synergy savings.³ The expectation was that synergy savings would take some time to develop and would continue to develop over the first five years following the merger. Over a half dozen other conditions use the conclusion of the AFOR proceeding as a termination date.⁴

3 The Commission approved and adopted the settlement agreement in Order 14, served March 14, 2011. In Order 14, the Commission modified Condition 3 by ordering an “additional review of the combined company’s *pro forma* results-of-operations according to a filing to be submitted no later than two years from the date of closing or by June 30, 2013,

¹ See RCW 80.36.135.

² Condition 3.b.

³ Joint Testimony of CenturyLink, Inc., Qwest Corporation, Commission Staff and Public Counsel 10:17-20 (filed Dec. 29, 2010).

⁴ Other AFOR-related conditions of the Staff-Public Counsel-CenturyLink settlement:

- Condition 1 provides for semi-annual financial reporting until such time as the AFOR proceeding has concluded.
- Condition 13 obligates CenturyLink to annually report certain capital expenditures as well as projections for such expenditures until the AFOR proceeding has concluded.
- Condition 15 requires CenturyLink to continue offering stand-alone (or nearly stand-alone) DSL until an AFOR proceeding has concluded.
- Condition 16 provides for an out of service credit and certain modifications to the service guarantee program adopted in the CenturyTel/Embarq merger, which are to remain in effect until the AFOR proceeding concludes.
- Condition 17 obligates CenturyLink to continue certain monthly service quality reporting until the conclusion of the AFOR proceedings.
- Condition 20 prohibits CenturyLink from filing tariff revisions increasing the stand alone flat rated residential or business line rates until an AFOR has been approved.
- Condition 24 requires CenturyLink to provide Staff and Public Counsel advanced notice of the rearrangement of major network components up until the AFOR proceeding has concluded.

whichever comes later.”⁵ With this added condition, the Commission hoped to capture the synergies realized not only from the CenturyLink merger with QCII but also from CenturyLink’s 2009 acquisition of telecommunications subsidiaries from Embarq Corporation (the “Embarq merger”) “to share these benefits with customers sooner than the timeline proffered by Staff and Public Counsel.”⁶

4 In Order 14, the Commission added various other conditions over and above the conditions in settlement agreements filed by the parties. One of the conditions required CenturyLink to reduce the intrastate access charges of all of its local operating companies to the rates charged by Qwest Corporation (Qwest).⁷ This resulted in significant reductions. Sprint Nextel Corporation had projected a revenue decrease of \$12 million,⁸ and CenturyLink adopted this number in nonconfidential briefing in support of its appeal of Order 14.⁹ The CenturyLink merger closed April 1, 2011. The access reductions took effect on May 29, 2011.¹⁰

5 In the fall of 2011, the Federal Communications Commission (FCC) issued its landmark universal service fund (USF) and intercarrier compensation (ICC) reform order.¹¹ The USF-ICC Reform Order requires carriers to reduce access charge rates in steps. The first two steps involve bringing intrastate terminating access rates to parity with interstate

⁵ Order 14 at ¶ 266, p. 132.

⁶ Order 14 at ¶ 218, p. 110. Note that, by letter of October 19, 2012, CenturyLink reported to the Commission that it had realized all of the projected synergies and completed all substantive integration activities associated with the CenturyTel/Embarq merger and does not anticipate having further synergy information to report.

⁷ Order 14 at ¶ 266, p. 132.

⁸ Appleby, Exh. No. JAA-1CT 32:10-14; Exh. No. JAA-3C; Order 14 at Note 475, p. 116.

⁹ *CenturyLink v. WUTC*, U.S. District Court for the Western District of Washington No. 2:11-cv-00633, Plaintiff’s Opening Brief on the Merits 11:35-37 (“The effect of this ruling [in Order 14] is to eliminate revenues estimated at \$12 million annually”) (filed July 14, 2011).

¹⁰ The tariff sheets filed on April 29, 2011, in Advice Nos. 11-12A and 11-13A, were permitted to become effective as filed with an effective date of May 29, 2011, per the Commission’s May 26, 2011, open meeting and compliance letter.

¹¹ *In the Matter of Connect America Fund, et al*, FCC 11-161, Report and Order and Further Notice of Proposed Rulemaking (adopted Oct. 27, 2011, and released Nov. 18, 2011) (“USF and ICC Reform Order”).

access rates by July 1, 2013.¹² As of July 2012, carriers were required to have adjusted their access rates so that intrastate access rates were halfway to parity with interstate revenues.¹³ CenturyLink filed these further revised access rates (the first step of the FCC's transition) with the Commission on May 24, 2012.¹⁴ Its filings include the required calculations to achieve access charge revenue reductions associated with adjusting intrastate terminating access rates toward parity with interstate access rates.¹⁵

6 CenturyLink also has experienced access line loss. Over the four-year period from 2008 to 2011, CenturyLink operating companies appear to have lost approximately 28% of Washington access lines.¹⁶ CenturyLink, in its Petition, further asserts that it has suffered retail access line loss of 56% over the last 10 years.¹⁷ In addition, CenturyLink, along with local exchange carriers (LECs) throughout the state, has been subject to declining minutes of use.¹⁸ Over the period from 2008 to 2011, intrastate switched access (that is, instate long distance) minutes of use declined by approximately 20% statewide.¹⁹ CenturyLink's rate of decline has exceeded this statewide trend considerably.²⁰

¹² *Id.* at ¶ 35, p. 15; at ¶ 801, Figure 9, p. 271 (ICC Reform Timeline). Note that the companies are regulated as "price cap" companies at the federal level.

¹³ *Id.* at ¶ 801, Figure 9, p. 272.

¹⁴ Docket UT-120753 (Qwest), UT-120754 (United Telephone), and UT-120755 (CenturyTel of Washington, CenturyTel of Inter Island, and CenturyTel of Cowiche).

¹⁵ See redacted confidential worksheets (filed with the Records Center but not posted to the Records Management System online) reflecting access revenue decline over a one-year period as a result of step one access charge adjustments, as follows: Qwest: (\$3,856, 526); United Telephone: (\$219, 634); CTL of Washington: (\$298,081); CTL of Inter Island: (\$30,416); and CTL of Cowiche: (\$3,676).

¹⁶ See ETC Certification Reports, due annually by July 31, for 2009 through 2012 (e.g., United Telephone: UT-121268), using working loops from the relevant NECA-1 forms as a surrogate for access lines.

¹⁷ Petition at ¶ 11, p. 4 (Between December 2001 and December 2011, CenturyLink retail access lines in Washington declined 56%).

¹⁸ See WECA 2010 annual report at p. 8, filed August 6, 2012, in Docket UT-121117 (table showing statewide intrastate long distance minutes of use declined from 2001 to 2010 by 56.75%).

¹⁹ Comparison of 2008 USF (statewide) minutes of use from WECA 2010 annual report (*id.*) with the 2011 minutes of use from the July 2, 2012, redacted submission in the same docket (UT-121117), Attachment 4, at page 5, line 9.

²⁰ See annual Washington intrastate access charge reports (e.g., United Telephone: UT-121167), filed pursuant to WAC 480-120-399 (each Class A company must provide annually the actual demand units for the previous calendar year for each switched access tariff rate element it has on file with the commission).

7 In the initial merger filing, CenturyLink estimated that synergies from the merger would yield \$575 million in operating expense savings. Washington's share of these savings was calculated to equal approximately \$57.5 million.²¹ Condition 4 of the Staff-Public Counsel-CenturyLink settlement agreement provides for annual reporting of synergy savings. On August 24, 2012, consistent with Condition 4, CenturyLink filed the first synergy report. According to the report, it appears that CenturyLink is on schedule to realize the operating expense synergy savings it projected.

8 On November 8, 2012, CenturyLink filed the Petition that is the subject of this response. The petition seeks a waiver and/or modification of Condition 3 to allow CenturyLink to commence an AFOR proceeding immediately. Staff understands the petition to address only the first paragraph of Condition 3.b.; that is, the timing of filing the AFOR plan and the requirement obligating CenturyLink to concurrently file results of operations with the AFOR plan.

III. DISCUSSION

9 When Staff negotiated the settlement agreement providing for an AFOR in three to five years, Staff anticipated addressing access charges in that future AFOR. Little did Staff know that the Commission would order access charge reductions, let alone that the FCC would issue major access charge reform requiring further access charge reductions so soon after the conclusion of the merger proceeding. Staff recognizes that the CenturyLink operating companies have experienced significant revenue reductions in Washington. Line loss as well as reductions in access charge rates coupled with declining minutes of use, have the potential to eviscerate synergy savings. Given CenturyLink's track record in the CenturyTel-Embarq merger, Staff expects synergy savings to remain on track with respect to

²¹ Order 14 at note 476, pp. 116-17.

projections. The access charge revenue decline, however, is significant to the point that it calls into question whether synergy savings actually will be available for other uses.

10 It appears that, following Step 2 of the FCC's intercarrier compensation reform, intrastate access charge reductions will be costing the company approximately \$20 million annually in lost intrastate access revenue. This number is close to half of the operating expense synergies projected for Washington. Given that these circumstances were unforeseen at the time Staff negotiated Condition 3 and that they are financially significant, Staff believes it is reasonable to proceed with the AFOR process with an earlier starting date than the settlement agreement provides.

11 With regard to the results of operations filing described in subsection b.ii. of Condition 3, Staff does not object to removing the requirement that it be filed concurrently with the AFOR proposal. With the decline in revenue due to the access charge reductions and competitive environment, and the resulting reduction in value of the synergy savings, CenturyLink's intrastate results of operations may no longer prove as important an element in evaluating CenturyLink's forthcoming AFOR proposal. Staff does not, however, support relieving CenturyLink of the obligation at this point to file results of operations by June 30, 2013. Similarly, Staff does not waive its right to request that CenturyLink file results of operations, as contemplated in Condition 3.b.i., earlier than June 30, 2013, if the company files an AFOR plan before that date.

IV. CONCLUSION

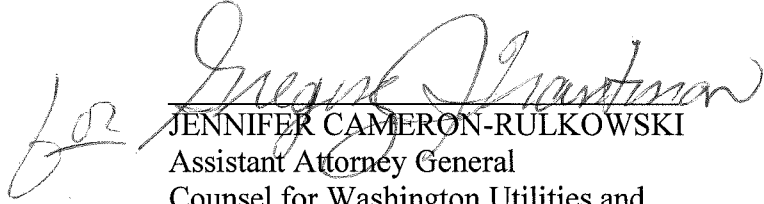
12 Staff does not object to modifying Condition 3 to allow CenturyLink to file an AFOR plan as set forth in Condition 3.b.ii. as soon as is practical but no later than April 1,

2015. In addition, Staff does not object to relieving CenturyLink of the obligation to file results of operations *concurrently* with the AFOR plan.

DATED this 16th day of November 2012.

Respectfully submitted,

ROBERT M. MCKENNA
Attorney General

A handwritten signature in cursive script, appearing to read "Jennifer Cameron-Rulkowski", is written over a horizontal line. To the left of the signature, the letters "for" are written in a similar cursive style.

JENNIFER CAMERON-RULKOWSKI
Assistant Attorney General
Counsel for Washington Utilities and
Transportation Commission Staff