CASE: UM 1484
WITNESS: Michael Dougherty

PUBLIC UTILITY COMMISSION
OF
OREGON

STAFF EXHIBIT 100

Reply Testimony

September 3, 2010

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Michael Dougherty. I am the Program Manager for the Corporate Analysis and Water Regulation Section of the Public Utility Commission of Oregon (Commission). My business address is 550 Capitol Street NE Suite 215, Salem, Oregon 97301-2551.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. My Witness Qualification Statement is found in Exhibit Staff/101.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is three-fold. First, I am the lead witness for the Commission Staff (Staff) in this proceeding. Accordingly, I am familiar with Staff sponsored testimony and recommended ordering conditions. Second, I will generally discuss the structure of this transaction, potential risks of the transaction, and mitigation of these risks. Third, I will list Staff's recommended ordering conditions proposed by Staff in this docket.

Q. WHAT IS STAFF'S RECOMMENDATION CONCERNING THIS DOCKET?

A. Staff recommends the Commission deny CenturyLink, Inc.'s (CenturyLink or Company) request to approve this transaction. There are significant risks posed by this transaction, which CenturyLink and Qwest Communications International, Inc. (QC II) have failed to adequately address.

Q. ARE THERE ANY CIRCUMSTANCES UNDER WHICH STAFF WOULD RECOMMEND THE COMMISSION APPROVE THE TRANSACTION?

A. Yes. The Commission could approve the transaction subject to the Applicants voluntarily offering or agreeing to conditions or commitments that either reduce the numerous risks of the transaction or offset the risks. Although Staff believes its recommended conditions (discussed later in testimony) reduce the risks of the transaction, Staff does not believe its conditions will completely mitigate the risks with the transaction, which include (and discussed later):

1. Maintaining a dividend of $2.90 per share;
2. CenturyLink taking on increased and substantial debt;
3. Increased debt leverage, Net Debt/EBITDA[1] (from approximately 2.0x to 2.4x (2.2x if synergies are achieved));
4. Potential for CenturyLink debt to fall below investment grade;
5. CenturyLink taking on steeper access line losses (Qwest currently has an 11 percent line loss as compared to CenturyLink's 6.6 percent);
6. Post-merger CenturyLink being less profitable than pre-merger CenturyLink. The decreased profitability may preempt or halt broadband expansion in legacy CenturyLink territories;
7. The inability to effectively ring fence the operating companies from the parent company;
8. CenturyLink is still in the process of integrating Embarq (a company that was approximately three times the size of CenturyTel when the

[1] Earnings Before Interest, Taxes, Depreciation, and Amortization

merger occurred) and the focus of rapid expansion in a short period may result in a lack of focus in Oregon;[2]

9. CenturyLink does not have experience as a BOC,[3] which may have an adverse effect on competition; and
10. Associated risks as presented by CenturyLink in its SEC Filing S-4 dated June 4, 2010.

As such, CenturyLink must offer conditions that will offset risks to ensure the legal standard for the transaction (in the public interest, no harm) is satisfied.

Q. PLEASE PROVIDE A LIST OF STAFF WITNESSES, EXHIBIT NUMBERS, AND THE SUBJECTS EACH ADDRESSES.

A. Staff witnesses who are providing direct testimony in this docket are as follows:

Table 1 – Staff Assignments

Witness	Exhibit	Subject(s)
Dougherty	100	Legal Standard; Summary of the Transaction; Risks and Risk Mitigation; Records, Access to Books; Ratemaking; Synergy Savings; Goodwill; Affiliated Interest Issues; and Recommended Approval Conditions
Ordonez	200	Financial Analysis; Financial Leverage; Profitability; and Credit Ratings Aspects of the Merger
Reynolds	300	Broadband Issues and Customer Support and Billing Systems

[2] Per Staff's UM 1416 memo, dated March 18, 2009: "As of December 31, 2008, Embarq served approximately 6.5 million local access lines including approximately 60,000 total access lines in Oregon. CenturyTel served approximately 2.1 million local access lines, including approximately 62,000 access lines in Oregon."
[3] Bell Operating Company.

Witness	Exhibit	Subject(s)
Emmons	400	Service Quality, Engineering and Service Assurance
Marinos	500	Long Distance and Competitive Issues
Cray	600	OTAP/Lifeline

Q. DID YOU PREPARE EXHIBITS FOR THIS DOCKET?

A. Yes. I prepared Exhibit Staff 102, consisting of 31 separately numbered pages.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. My testimony is organized as follows:

Issue 1, Legal Standard 4
Issue 2, Structure of Transaction, Potential Risks of the Transaction, and Mitigation of these Risks........ 5
Issue 3, Recommended Conditions Proposed by Staff........ 41

ISSUE 1 - LEGAL STANDARD

Q. WHAT IS THE LEGAL STANDARD THAT THE COMMISSION SHOULD APPLY TO THIS TRANSACTION?

A. According to advice given by the Oregon Department of Justice, the Commission should apply an “in the public interest, no harm” standard when considering whether to approve this transaction. This is the standard the Commission used in its Order No. 10-067, involving the indirect transfer of control of Verizon Northwest Inc. to Frontier Communications Corporation; Order No. 09-169 involving the merger between CenturyTel and Embarq; and Order No. 95-526 involving a transaction pursuant to ORS 759.375(1)(c) and

759.380 (sale of 23 exchanges). This is a ***lesser*** standard than the "net benefits" standard employed under ORS 757.511 for energy utility acquisitions. Additionally, the Commission has used the "in the public interest, no harm" standard for property sales including telecommunication utility property sales (Commission Order No. 08-617 (UP 247) and Commission Order No. 02-466 (UP 195)).

ISSUE 2 - STRUCTURE OF TRANSACTION, POTENTIAL RISKS OF THE TRANSACTION, AND MITIGATION OF THESE RISKS

Q. PLEASE PROVIDE A BRIEF CHRONOLOGY OF THIS DOCKET.

A. On May 24, 2010, CenturyLink submitted an application (Application) requesting a Commission order approving the indirect merger of CenturyLink's and Qwest's regulated incumbent local exchange subsidiaries, which operate as telecommunications utilities in the state of Oregon. Qwest did not join as an applicant in the matter because ORS 759.375 and ORS 759.390 do not apply to Qwest due to the Commission's approval of its price plan in Order No. 08-408, UM 1354, which include the waivers of these statutes.[4] The operating subsidies include the four separate Incumbent Local Exchange Carriers (ILECs) in Oregon (no change from current allocated areas) – CenturyTel of Oregon Inc., CenturyTel of Eastern Oregon, Inc., United Telephone Company of the Northwest (dba Embarq), and Qwest Corporation (Qwest) (collectively, Operating Companies).

[4] Docket UM 1484, Application for an Order to Approve the Indirect Transfer of Control of Qwest Corporation (Application), page 1, dated May 24, 2010.

A Prehearing Conference was held on June 8, 2010; and on June 22, 2010, the Administrative Law Judge (ALJ) issued his Prehearing Conference Report and Ruling. On June 22, 2010, CenturyLink and Qwest submitted supplemental testimony concerning competitive issues to support their application. On August 2, 2010, the ALJ granted an unopposed motion to amend the procedural schedule. Settlement conferences were conducted on August 3, 2010, August 17, 2010, and August 30, 2010. Additional settlement conferences are scheduled for September 8, 2010, September 27, 2010, and October 12, 2010.

Q. PLEASE SUMMARIZE CENTURYLINK AND QWEST'S OPERATIONS.

A. According to the Application, CenturyLink is a publicly-traded Louisiana corporation with headquarters in Monroe, Louisiana. CenturyLink serves approximately 7 million access lines nationwide, 2.2 million broadband subscribers, and over 553,000 video subscribers in 33 states.[5] CenturyLink Oregon ILECs are telecommunication utilities as defined in ORS 759.005 and are subject to traditional rate regulation. Combined, the Century Link ILECs serve approximately 109,000 access lines in the state.[6]

Qwest is a subsidiary of QCII, which is a publicly traded corporation with its headquarters in Denver, Colorado. Qwest provides ILEC services in 14 states, serving approximately 10.3 million local access lines. Qwest serves approximately 802,000 access lines, as well as intrastate interexchange services, in Oregon.

[5] Application, dated May 24, 2010, at 7.
[6] *Id.* at 8.

Both the CenturyLink Oregon ILECs and Qwest provide regulated retail and wholesale services under the jurisdiction of this Commission, as well as interconnection services to Competitive Local Exchange Carriers (CLECs) through numerous interconnection agreements approved by the Commission.[7]

The combined operation will serve over 5 million broadband customers and 17 million access lines (over 900,000 in Oregon) across 37 states.[8]

Q. PLEASE PROVIDE A BRIEF BACKGROUND OF THE TRANSACTION.

A. According to the Application, on April 21, 2010, Qwest, CenturyLink, and SB 44 Acquisition Company (Acquisition Company) entered into an Agreement and Plan of Merger (Merger Agreement). Under the terms of the Merger agreement, QCII and Acquisition Company will merge, after which QCII will be the surviving entity and the Acquisition Company will cease. QCII will become a wholly-owned, first-tier subsidiary of CenturyLink. According to CenturyLink, there will be no change in corporate structure of the respective CenturyLink and QCII operating entities as a result of the Transaction. Qwest will remain a subsidiary of QCII.[9,10]

The transaction is a tax-free, stock-for-stock business deal with no new debt or refinancing required. Shareholders of QCII will receive 0.1664 shares of CenturyLink for each share of QCII common stock owned at closing. Upon closing, shareholders of pre-merger CenturyLink will own approximately

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[7] *Id.* at 8, 9 and 10.
[8] CenturyLink and Qwest Merger Transaction Overview, Oregon Public Utility Commission, dated May 3, 2010, at 6. Included in Staff Exhibit 102, pages 1 - 9.
[9] Application, dated May 24, 2010, at 4.
[10] Please see Staff Exhibit 102, page 10 for a diagram of the merger.

50.5 percent of post-merger CenturyLink and shareholders of the pre-merger QCII will own approximately 49.5 percent of post-merger CenturyLink.

CenturyLink will issue new stock to acquire QCII. It is not paying cash or financing the transaction through debt.[11] With that said, it is important to note that CenturyLink will be assuming $11.8 billion in Qwest debt, resulting in a total CenturyLink corporate debt of $19.4 billion. The increased debt will increase CenturyLink's pre-merger leverage (Net debt/trailing EBITDA) of 2.0x to a post-merger level of 2.4x. (*See* Staff/200, Ordonez/4)

Q. HAS CENTURYLINK FILED A SIMILAR APPLICATION IN OTHER STATES?

A. Yes. As a result of being under certain regulatory requirements by federal and state agencies, CenturyLink was required to file for approval in several jurisdictions. The table below summarizes the status of jurisdictional approvals as of June 21, 2010, (based on CenturyLink's response to Staff Data Request No. 24).[12]

Table 2 – List of Regulatory Approvals

Regulatory Agency	Approval Necessary (Yes/No)	Current Status if Approval is Pending	Scheduled Hearing Date (if applicable)	Projected Close Date
Federal Filings				
DOJ/FTC	Yes	Initial HSR filing on 5/12/2010; refiled on 6/15/10 to provide additional information	N/A	Pending

[11]Application, dated May 24, 2010, at 5.
[12] Included in Staff Exhibit 102, pages 11-12.

Regulatory Agency	Approval Necessary (Yes/No)	Current Status if Approval is Pending	Scheduled Hearing Date (if applicable)	Projected Close Date
FCC	Yes	214 Application filed on 5/7/2010	Comments due 7/12/10; reply comments due 7/27/10	Pending
State filings – ILEC States				
Arizona	Yes	Application filed 5/28/10	Schedule Pending	Pending
California	Yes	Advice letter filed 5/14/10	N/A	Pending
Colorado	Yes	Application filed 5/27/10	Schedule Pending	Pending
Georgia	Yes	Application filed 5/2510	Schedule Pending	Pending
Iowa	Yes	Application filed 5/24/10	Schedule Pending	Pending
Louisiana	Yes	Application filed 5/19/10	Schedule Pending	Pending
Minnesota	Yes	Application filed 5/13/10	Schedule Pending	Pending
Mississippi	Yes	Application filed 5/25/10	Schedule Pending	Pending
Montana	Yes	Application filed 5/28/10	Schedule Pending	Pending
Nebraska	Yes	Application filed 6/4/10	Schedule Pending	Pending
New Jersey	Yes	Application filed 5/19/10	Schedule Pending	Pending
Ohio	Yes	Application filed 5/28/10	Schedule Pending	Pending
Oregon	Yes	Application filed 5/21/10	October 20-21	Pending
Pennsylvania	Yes	Application filed 5/14/10	Schedule Pending	Pending
Utah	Yes	Application filed 5/28/10	October 26-27	Pending
Virginia	Yes	Application filed 5/25/10	Schedule Pending	Pending
Washington	Yes	Application filed 5/13/10	January 5-7, 2011	Pending

State Filings – Non-ILEC States				
Regulatory Agency	**Approval Necessary (Yes/No)**	**Current Status if Approval is Pending**	**Scheduled Hearing Date (if applicable)**	**Projected Close Date**
Alaska	Yes	Application filed 6/3/120	Schedule Pending	Pending
District of Columbia	Yes	Application filed 6/4/10	Schedule Pending	Pending
Hawaii	Yes	Application filed 6/3/10	N/A	Approved 6/15
Maryland	Yes	Application filed 6/8/10	Schedule Pending	Pending
New York	Yes	Application filed 6/4/10	Schedule Pending	Pending

Q. PLEASE SUMMARIZE THE CUSTOMER BENEFITS OF THIS MERGER AS PRESENTED BY CENTURYLINK.

A. CenturyLink, in its *CenturyLink and Qwest Merger Transaction Overview, Oregon Public Utility Commission*, dated May 3, 2010, lists the following as general customer benefits:

1. <u>Increased Capabilities</u>: Creates a stronger data/voice and long-haul competitor to the long haul efforts of the two largest integrated communication companies.
2. <u>Expanded and Enhanced Consumer Offerings</u>: Increases the likelihood of faster, broader broadband service deployment enabling terrestrial based video competition via IPTV.
3. <u>Customer Focus</u>: Creates a local go-to-market focus bringing decisions closer to the needs of local customers and communities.
4. <u>Financial Strength and Flexibility</u>: The combined company's sound capital structure will support its ability to take advantage of

> opportunities that may arise, while continuing to invest in its business.[13]

Additionally, in its application and in direct testimony, the Company discusses its track record of successfully integrating companies including its recent merger with Embarq that was approved by the Commission in Order No. 09-169 (UM 1416);[14] and the increased economies of scale and scope that will result from the merger.[15]

Q. DID CENTURYLINK, IN ITS TESTIMONY, OFFER ANY CONDITIONS OR COMMITMENTS CONCERNING THESE CUSTOMER BENEFITS?

A. No.

Q. HAS CENTURYLINK TOUTED ANY OTHER BENEFITS TO THE TRANSACTION?

A. Yes. In its CenturyLink and Qwest Merger Conference Call, dated April 22, 2010, CenturyLink lists the following as shareholder positives of the transaction:

1. Maintain annual dividend of $2.90 per share; and
2. Significant synergy savings of $625 million run-rate, which includes $50 million of run-rate capital expenditure (capex) synergies.[16]

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[13] CenturyLink and Qwest Merger Transaction Overview, Oregon Public Utility Commission, dated May 3, 2010, at 7. Included in Exhibit Staff 102, pages 1-9.
[14] Application at 7-8 and 21-22; CTL/200, Schafer/7-12; and CTL/201, Schafer.
[15] *Id.* at13. See also Qwest/1, Peppler/10-13.
[16] CenturyLink and Qwest Merger Conference Call, dated April 22, 2010. Included in Staff Exhibit 102, page 13.

Q. DO THESE SHAREHOLDER POSITIVES TRANSLATE TO POSTIVES FOR CUSTOMERS?

A. No. In fact, these positives for shareholders could come as a detriment for customers. Concerning the level of dividends, CenturyLink could potentially place a higher priority on paying dividends to shareholders than maintaining service quality and investing in business operations. If earnings per share are lower than the dividend per share, the Company would need to reach into free-cash flow to pay those dividends. Being that depreciation expense is a significant contributor to free cash flow, paying of dividends could consume funds that could have been allocated for plant investment.

Also, in order to achieve the operating synergy goals, CenturyLink projects one-time operating costs of $650 to $800 million. In order to achieve the capital synergy goal, CenturyLink projects one-time capital costs of $150 to $200 million.[17] These one-time costs, could potentially consume funds that may have otherwise been allocated to benefit customers such as broadband expansion, improved service quality, and additional product offerings.

In addition, the combined company, despite the increased economies of scale and scope, will continue to confront access line losses that could negatively affect revenues, resulting in decreased funds to invest in the Oregon network. In fact in Qwest/1, Peppler/15, Qwest states that its residential and business access lines in Oregon declined more than 50 percent when in this same time

[17] CenturyLink and Qwest Merger Conference Call, dated April 22, 2010. Included in Staff Exhibit 102, page 13.

period, Oregon's actual population grew by 24 percent.[18] It is interesting to note that CenturyLink in CTL/300, Bailey/16 actually admits the companies have not attempted to identify the specific benefits of new services that might be made available as a result of the transaction by stating:

> No. The process of integration is too early at this point to estimate the full extent of the opportunities to provide new products and services to customers and to increase broadband penetration rates in the combined service territory.[19]

Finally, the increased value to shareholders of rapid expansion, high dividends, and higher share prices for Qwest shareholders could result in a CenturyLink's management being more focused on shareholders than Oregon customers. In fact in its SEC S-4 filing, the Company acknowledges this risk of rapid expansion by stating:

> CenturyLink's future results will suffer if CenturyLink does not effectively manage its expanded operations following the merger.[20]

Q. WHAT ARE THE RISKS OF THE TRANSACTION TO CENTURYLINK CUSTOMERS?

A. As previously mentioned, Staff believes the risks of the transaction are considerable and include:

1. Maintaining a dividend of $2.90 per share;
2. CenturyLink taking on increased and substantial debt;

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[18] Docket UM 1484 Qwest/1, Peppler/15.
[19] Docket UM 1481 CTL/300, Bailey/16.
[20] CenturyLink SEC Form S-4, dated July 16, 2010, at 20. Included in Staff Exhibit 102, page 20.

3. Increased debt leverage, Net Debt/EBITDA (from approximately 2.0x to 2.4x (2.2x if synergies are achieved));
4. Potential for CenturyLink debt to fall below investment grade;
5. CenturyLink taking on steeper access line losses (Qwest currently has an 11 percent line loss as compared to CenturyLink's 6.6 percent);
6. Post-merger CenturyLink being less profitable than pre-merger CenturyLink. The decreased profitability may preempt or halt broadband expansion in legacy CenturyLink territories;
7. The inability to effectively ring fence the operating companies from the parent company;
8. CenturyLink is still in the process of integrating Embarq (a company that was approximately three times the size of CenturyTel when the merger occurred) and the focus of rapid expansion in a short period may result in a lack of focus in Oregon;
9. CenturyLink does not have experience as a BOC which may have an adverse effect on competition; and
10. Associated risks as presented by CenturyLink in its SEC Filing S-4 dated June 4, 2010.

Q. PLEASE BRIEFLY LIST THE OPERATIONAL RISK FACTORS PRESENTED BY THE COMPANY IN ITS SEC FORM S-4.

A. The listed operational risk factors include:

- CenturyLink expects to incur substantial expenses related to the merger;

- Following the merger, the combined company may be unable to integrate successfully the businesses of CenturyLink and Qwest and realize the anticipated benefits of the merger;
- The merger will change the profile of CenturyLink's local exchange markets to include more large urban areas, with which CenturyLink has limited operating experience;
- Following the merger, the combined company may be unable to retain key employees;
- If CenturyLink and Qwest continue to experience access line losses similar to the past several years, following the merger, the combined company's revenues, earnings and cash flows may be adversely impacted;
- CenturyLink and Qwest face competition, which is expected to intensify and place further pressure on the market share of the combined company;
- CenturyLink could be harmed by rapid changes in technology;
- The industry in which CenturyLink operates is changing; CenturyLink cannot assure you that its diversification efforts will be successful;
- CenturyLink may not be able to grow through acquisitions;
- CenturyLink's future results will suffer if CenturyLink does not effectively manage its expanded operations following the merger;
- Following the merger, CenturyLink may need to conduct branding or rebranding initiatives that are likely to involve substantial costs and may not be favorably received by customers;
- Following the merger, CenturyLink's relationship with other communications companies will continue to be material to its operations and will expose it to a number of risks and
- Network disruptions or system failures could adversely affect CenturyLink's operating results and financial conditions.[21]

[21] CenturyLink SEC Form S-4, dated July 16, 2010, at 16–21. Included in Staff Exhibit 102, pages 16–21.

In addition to operating risks, the Company lists numerous risks under Risks Relating to the Merger, Regulatory and Legal Risks and Other Risks.[22] It is important to note that the SEC requires, as a matter of full disclosure, the inclusion of any and all potential risks to shareholders even if they are unlikely to occur. However, these risks are real risks that can negatively impact customers.

Q. DO YOU BELIEVE THE FOUR STATED CUSTOMER BENEFITS OUTWEIGH THE MANY RISKS OF THE TRANSACTION?

A. No.

Q. HOW CAN THE COMMISSION REDUCE THE MANY RISKS ASSOCIATED WITH THE TRANSACTION?

A. Staff has recommended numerous conditions that are designed to protect customers and the public generally. Please note that Staff separated the conditions into general categories. These categories are:

- Records/Rates/Tariffs/Access to Books
- Broadband
- Financial
- Service Quality and Safety – Retail
- Operations Support Systems
- Long Distance
- Wholesale Services
- OTAP/Lifeline
- Affiliated interests/Non-regulated Operations
- Most Favored State Commitment

Many of the recommended conditions are similar to the conditions ordered in Commission Order 10-067 (UM 1431) involving the indirect transfer of control

[22] *Id.* at 21–22. Included in Staff Exhibit 102, pages 21–22.

of Verizon Northwest Inc. to Frontier Communications Corporation and Commission Order No. 09-169 (UM 1416) involving the merger between CenturyTel and Embarq. As a difference from the conditions accepted by CenturyLink in UM 1416, Staff prepared numerous additional conditions that address broadband, long distance, service quality, Oregon Telephone Assistance Programs, and competitive issues. The recommended conditions also require increased reporting that will allow Staff, parties, and interested persons to monitor the transition of Qwest's operations to CenturyLink. These types of additional conditions were approved by the Commission in UM 1431. As previously mentioned, Staff does not believe its conditions will completely mitigate the risks to meet the statutory requirements due to the financial risk posed by the change in ownership, the inability to ring fence the operating companies from the parent, CenturyLink, and risks relating to competition.

Q. PLEASE DISCUSS THE RISK OF MAINTAINING A $2.90 PER SHARE DIVIDEND.

A. CenturyLink's post-transfer dividend policy of maintaining a $2.90 per share dividend may be problematic. In its response to Staff Data Request No. 7, CenturyLink had 301,031,397 outstanding shares in 2010. If CenturyLink shareholders will own 50.5 percent of the combined company, total outstanding shares will equal approximately 596,101,776. Dividend payments of $2.90 per share will equal approximately $1.73 billion.

As a result, CenturyLink could potentially place a higher priority on paying dividends to shareholders than maintaining service quality and investing in business operations. CenturyLink's Pro forma income statement in its SEC Form S-4 shows earnings per share (EPS) of $2.40.[23] This is $0.50 less than the $2.90 dividend per share. A dividend that is higher than the EPS will require an allocation of CenturyLink's cash flow from operations that could result in hindering upgrading its current network infrastructure and may delay or cease broadband expansion in CenturyLink's legacy service area as overall demand for landlines falls.

As a result, Staff's recommended condition No. 15 places a restriction on the amount of net income the operating companies can dividend up to any company (including affiliates and subsidiaries of post-merger CenturyLink) if the Company's Net debt/training 12-month EBITDA is greater than 2.6x. It is important to note that Staff's metric of 2.6x allows some cushion over the 2.4x (2.2x if synergies are achieved) projected by the Company. CenturyLink actually accepted a similar condition concerning operating company dividends in UM 1416, Commission Order No. 09-169. It is important to note that the dividend condition in UM 1416 used a different metric (average market value of CenturyTel's common equity is less than 50 percent of the book value of CenturyTel's net debt) than the net leverage metric used in Staff condition 15.

Q. HAS THE COMMISSION APPROVED RESTRICTION OF DIVIDENDS OR DISTRIBUTIONS IN ANY PREVIOUS TELECOMMUNICATIONS MERGER FILING?

[23] CenturyLink SEC Form S-4, dated July 16, 2010, at 113. Included in Staff Exhibit 102, page 23.

A. Yes. As previously mentioned, the Commission has placed restrictions on dividends or distributions in UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Condition 4.j. I believe that this recommended condition reduces the risks of the transaction and helps ensure that the "in the public interest, no harm" standard is achieved.

Q. PLEASE DISCUSS THE RISKS THAT PERTAIN TO INCREASED DEBT, INCREASED NET LEVERAGE, THE POTENTIAL FOR CENTURYLINK DEBT TO FALL BELOW INVESTMENT GRADE, AND THE POTENTIAL TO BECOME LESS PROFITABLE.

A. Staff Ordonez in Staff/200, Ordonez/6-8 discusses the financial risks associated with the transaction. As Staff Ordonez demonstrates in Staff/200, Ordonez/4, CenturyLink's debt will increase from $7.6 billion to $19.4 billion. As a result, the debt service of this increased level of debt will increase from the current $556 million to $1,543 million.[24] Although the Company will have increased revenue to service this debt, if Qwest line losses continue on its current pace (approximately 11 percent per year), the debt service will require a higher allocation of CenturyLink's cash flow from operations. The increased debt service could potentially result in hindering CenturyLink from upgrading its current network infrastructure and may delay or cease broadband expansion in CenturyLink's legacy service area as overall demand for landlines falls. In fact, a May 5, 2010, article from MarketWatch points out that total phone lines, including business and wholesale, dropped 10.5 percent to 9.39 million from a

[24] CenturyLink SEC Form S-4, dated July 16, 2010, at 113. Included in Staff Exhibit 102, page 23.

year earlier; and that second quarter 2010 revenue dropped 5 percent from the same quarter of 2009.[25]

Concerning the risk of increased leverage, Staff Ordonez in Staff/200, Ordonez/6, succinctly states:

> Financial leverage is the extent to which a company relies on debt rather than equity for capitalization. Measurements of financial leverage assist in determining the likelihood a firm will default on its contractual debt. The more debt there is on a company's balance sheet relative to equity, the greater the probability that it will be unable to fulfill its contractual obligations. [26]

Additionally, because Qwest's debt is currently non-investment grade, CenturyLink's acquisition of Qwest could result in a possible downgrade of CenturyLink's credit rating from BBB- to BB+ or BB (*See* Staff/200, Ordonez/13). Staff Ordonez also points out in Staff/200, Ordonez/12 that Qwest has a higher prospective interest rate than CenturyLink's in issuing debt securities. Higher interest rates result in higher debt service payments. As previously mentioned, the increased debt service will require a higher allocation of CenturyLink's cash flow from operations, which could hinder CenturyLink from upgrading its current network infrastructure and may delay or cease broadband expansion in CenturyLink's legacy service area as overall demand for landlines falls.

Staff Ordonez also discusses profitability and the effect of lower profitability in Staff/200, Ordonez/7. In Table 2 of Staff/200, Ordonez/7, Mr. Ordonez shows the CenturyLink's pre-merger profitability (EBITDA Margin) will decrease from

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[25] http://www.marketwatch.com/story/qwest-communications-profit-drops-26-2010-08-04.
[26] Ross, Westerfield and Jaffe, Corporate Finance 36 (McGraw-Hill Irwin, 2005).

its current 50 percent to a 41 percent post-merger profitability. The lower levels of profit could become a detriment to CenturyLink's current customers because a less profitable and more leveraged company may experience more difficulties and costs in procuring capital in the capital markets. These may affect the level of investment including investments in broadband by CenturyLink towards its current pre-merger customers.

Q. HOW DOES CENTURYLINK'S CAPITAL STRUCTURE DIFFER BETWEEN PRE- AND POST-MERGER?

A. In CenturyLink's response to Staff Data Request No. 3,[27] the Company provides the pre- and post-merger capital structure and cost of capital:

Table 3 - Pre-Merger Capital Structure

Component	% of Capital	Cost	Weighted Cost
Long Term Debt	42.60%	7.65%	3.26%
Preferred Stock	N/A	N/A	00.00%
Common Equity	57.40%	10.40%	5.97%
Total	**100%**		**9.23%**

Table 4 - Post-Merger Capital Structure

Component	% of Capital	Cost	Weighted Cost
Long Term Debt	52.10%	8.15%	4.25%
Preferred Stock	N/A	N/A	00.00%
Common Equity	47.90%	13.40%	6.42%
Total	**100%**		**10.67%**

As can be seen from the above tables, the post-merger company has a higher debt level, higher cost of debt, and a higher cost of capital. To address the

[27] Included in Staff Exhibit 102, page 24.

potential harm of the capital structure on customers, Staff's recommended condition 8 states:

> The Operating Companies will not advocate in any general rate case proceeding for a higher overall cost of capital as compared to what its cost of capital would have been absent the transaction, but the Operating Companies may seek a cost of capital under the then-existing capital market conditions.

Q. DOES STAFF PROPOSE ANY METHODS TO RING FENCE THE OPERATING COMPANIES FROM THE CENTURYLINK?

A. No. Ring fencing the Oregon operating companies from CenturyLink would be a challenge due to CenturyLink's proposed organizational structure. Based on the proposed organizational structure, CenturyLink's Oregon operating companies would not be well-defined subsidiaries that have their own credit ratings and access to capital. Further, the nature of the business activities across the CenturyLink subsidiaries may not be sufficiently diversified to enable a non-consolidation opinion to be obtained even if the operating companies were well-defined subsidiaries.

Staff's perspective on ring fencing continues to be that ring fencing energy utilities is always appropriate and achieves the desired effect of isolating the utility from negative financial impacts created by its parent company or other affiliates. In a bankruptcy of an energy utility, customers face significant risks due to the uncertainty of preeminence of federal versus state law. For example, a plan for reorganization put forth by creditors could entail selling generation assets including low cost resources, or selling storage facilities for natural gas companies. If adopted, customers would lose the benefits of those resources and the state may not be successful in opposing such a structuring given the uncertainty over whether federal bankruptcy preempts state regulatory authority. The output from electrical generating resources can be sold in the wholesale market distinct from the retail customers of the utility.

With respect to telecommunications utilities, presumably the greatest value for creditors of local plant is one of continued operations. It is doubtful that local loop and switches would be transported and sold elsewhere and as such is quite different from electricity economics. Because of the different nature of operations between energy utilities and telecommunications, ring fencing could be counterproductive for telecommunications utilities and possibly result in higher interest rates and increased financial risks of the operating companies.

In UM 1431 (Commission Order No. 10-067), the parties agreed to replace the Staff recommended ring fencing condition with a broadband commitment that invests up to $25 million in Oregon and increases broadband availability in 18 wire centers in Oregon. The commitment includes a fast (two-year) completion, which ensures broadband investments will be quickly focused towards Oregon. As a result, the Commission should require a similar broadband commitment from CenturyLink. There are significant risks, most notably financial, competition, and corporate focus, to the transaction. A broadband commitment would offset risks of the transaction with a benefit for customers.

SYNERGY SAVINGS

Q. DOES CENTURYLINK ADDRESS SYNERGY SAVINGS OF THE TRANSACTION?

A. Yes. CenturyLink believes it may achieve $575 million in annual operating cost synergies and $50 million in annual capital expenditure (capex) synergies. These purported synergies will result from savings in corporate overhead, network and operational efficiencies, Information Technology (IT) support, increased purchasing power, and advertising and marketing.[28]

Q. ARE THESE SYNERGY SAVINGS SIMILAR TO THE SYNERGY SAVINGS REPORTED IN THE EMBARQ/CENTURYTEL MERGER, DOCKET NO. UM 1416?

A. Yes. Staff calculates that the synergy savings are approximately 8.7 percent of consolidated EBITDA.[29] In UM 1416, the Embarq/ CenturyTel synergy savings were approximately 9.5 percent of consolidated EBITDA.[30] As a result, the synergy savings, if achieved, are comparable to those projected in the Embarq/CenturyTel merger. In a highly confidential response to a Staff Data Request, CenturyLink demonstrated significant strides in achieving the synergy savings stated in UM 1416. However, it should be noted that some of CenturyLink's post-transfer financial projections take into consideration the synergy savings. As such, if CenturyLink does not fully achieve the synergy

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[28] CenturyLink and Qwest Merger Conference Call, dated April 22, 2010. Included in Staff Exhibit 102, page 13.

[29] CenturyLink witness Bailey, actually estimates in CTL/300, Bailey/15 that the $625 million in combined synergy savings is less than 8 percent of Qwest's operating cash. Mr. Bailey also states that the synergy savings are below 9 percent of the target company cash operating expenses.

[30] Based on data included in Staff's UM 1416 public meeting memo.

savings, net income and cash flow will be lower than current projections. As previously mentioned, CenturyLink in its SEC Form S-4 points out that

> The inability to successfully combine the businesses of CenturyLink and Qwest in a manner that permits the combined company to achieve the cost savings anticipated to result from the merger, which would result in the anticipated benefits of the merger not being fully realized in the time frame currently anticipated or at all.[31]

Q. ARE OREGON OPERATIONS INCLUDED IN THE SYNERGY SAVINGS?

A. No, at least not initially. However, the Company has not offered any commitments concerning retention and pay of Oregon personnel in the same manner as Frontier in UM 1431.

Q. DOES THE AMOUNT OF SYNERGY SAVINGS POSE A POTENTIAL RISK TO CUSTOMERS?

A. Yes. Although the purported synergies will result from savings in corporate overhead, network and operational efficiencies, Information Technology (IT) support, increased purchasing power, and advertising and marketing, CenturyLink will also be required to pay stated dividends, service the higher debt load, confront increasing landline losses, and invest in certain investments that may be required as part of any state or federal merger approval. If all these factors come into play, investments needed to improve or maintain the current level of service for Oregon retail customers may become a low priority of the Company.

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[31] CenturyLink SEC Form S-4, dated June 4, 2010, at 17. Included in Staff Exhibit 102, page 17.

GOODWILL

Q. ARE THERE GOODWILL ISSUES CONCERNING THIS TRANSACTION?

a. Yes. Partially as a result of previous transactions, CenturyLink currently shows $10.252 billion of goodwill on its pro forma balance sheet. In an acquisition, goodwill is recognized as the excess of the cost of an acquired entity over the net of the amounts assigned to identifiable assets acquired (including identifiable intangibles) and liabilities assumed.[32] Based on the pro forma financial statements contained in the Form S-4 (Joint Proxy Statement) filed with the SEC, the estimated post-merger goodwill that will be carried on CenturyLink's balance sheet is approximately $20,681 billion,[33] which is over double the current amount. In CTL/300, Bailey/33, Mr. Bailey states in footnote 23 that the transaction premium is estimated to be approximately 15 percent using the share prices of Qwest and CenturyLink at the New York Stock Exchange close of the day before the announcement.[34]

The potential problem with a large amount of goodwill on a company's books is that goodwill cannot be amortized over a given period of time. According to Generally Accepted Accounting Principles (GAAP), goodwill must be tested for impairment on an annual basis. Impairment occurs when the fair value of a long-term asset group is less than the book value. If goodwill is impaired, its carrying amount is reduced and an impairment loss is recognized on a

[32] *GAAP 2005, Interpretation and Application of Generally Accepted Accounting Principles*, Wiley, page 367. Included in Staff Exhibit 102, page 25.
[33] Figures taken from CenturyLink's SEC Form S-4, dated July 16, 2010, page 112. Included in Staff Exhibit 102 page 26.
[34] Docket UM 1484, CTL/300, Bailey/23.

company's income statement. As a result, impairment losses could potentially create earnings volatility with no cash flow effects and signal a loss in economic value of the company.

Both CenturyLink and Qwest's 2009 annual evaluation of goodwill resulted in conclusions that goodwill was not impaired. If goodwill was substantially impaired, the impairment loss would be a non-cash charge to earnings and would not, by itself, necessitate the issuance of debt or other financing for the impairment loss. Staff placed a recommended condition that goodwill would be carried on the books of the parent company and that the Company would not seek to recover in Oregon retail or wholesale rates any acquisition premium paid by CenturyLink to Qwest.

Q. IN ADDITION TO THE DIVIDEND CONDITION, DOES STAFF RECOMMEND ADDITIONAL FINANCIAL CONDITIONS?

A. Yes. Staff recommends six additional conditions which require enhanced reporting concerning Net debt/trailing 12-month EBITDA, increased reporting concerning financial data, a restriction of requesting approval from the Commission to encumber the assets of the Operating Companies, restriction of including any acquisition premium in rates, and agreement by CenturyLink that the Qwest operating company would be subject to ORS 759.395 and ORS 759.380, notwithstanding the price plan. Staff believes that a commitment from CenturyLink that the Qwest operating company would be subject to ORS 759.395 and ORS 759.380 is important in order to ensure the Commission approval authority over a subsequent sale of Qwest properties.

Q. HAS THE COMMISSION APPROVED FINANCIAL CONDITIONS IN PREVIOUS TELECOMMUNICATIONS MERGER FILINGS?

A. Yes. The Commission has placed financial conditions on previous mergers/financing applications. These financial conditions include:

- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Conditions 4.j., 4.k., 4.l., and 4.m; and
- UM 1431 (Verizon Northwest/Frontier), Commission Order No. 10-067, Conditions 15 to 17.

The Commission should adopt Staff's recommended conditions concerning, records, access to books, rates, and tariffs. These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is met.

RECORDS/RATES/TARIFFS/ACCESS TO BOOKS

Q. ARE THERE CONCERNS ABOUT CENTURYLINK'S ABILITY TO PROVIDE ACCESS TO BOOKS AND RECORDS?

A. No. CenturyLink has previously met all Oregon reporting and tariff requirements. However, because of the significant change in the scale of CenturyLink's Oregon operations, Staff recommends certain conditions (listed later in testimony) in order to ensure that:

- Staff has proper access to all books and records of the transaction;
- The four current Oregon operating companies are maintained immediately after completion of the transaction;
- Existing agreements are maintained;
- Existing tariffs are maintained;

- Qwest's UM 1354 price plan (Order Nos. 08-408, 08-544, and 10-215) is maintained for the Qwest ILEC;
- The transaction is transparent to customers;
- Customers will not be harmed by higher rates that result from the transaction; and
- The Commission is able to monitor the impacts on Oregon operations and customers.

Q. HAS THE COMMISSION PREVIOUSLY APPROVED RECORDS, ACCESS TO BOOKS, RATES, AND TARIFF CONDITIONS IN PREVIOUS TELECOMMUNICATIONS MERGER ORDERS?

A. Yes. The Commission has required records, access to books, rates and tariff conditions in previous telecommunications merger applications. These dockets include:

- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Conditions 1, 2, 3, 4.d., 4.e., 4.f, 4.g., 4.h., 4.i., and 4.o; and
- UM 1431 (Verizon Northwest/Frontier), Commission Order No. 10-067, Conditions 1 to 13.

The Commission should adopt Staff's recommended conditions concerning, records, access to books, rates, and tariffs. These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is met.

SERVICE QUALITY

Q. ARE THERE CONCERNS ABOUT CENTURYLINK'S ABILITY TO PROVIDE ADEQUATE LEVELS OF RETAIL SERVICE QUALITY?

A. Yes. Both Staff Witness Reynolds (Staff/300) and Staff Witness Emmons (Staff/400) discuss service quality issues and associated concerns resulting from the transfer. Recommended ordering conditions 22 through 28 (listed later in testimony) ensure that adequate service quality is maintained through enhanced service quality and safety reporting and actions. As previously mentioned, CenturyLink may come under pressure to reduce investments and operations in Oregon in order to maintain shareholder dividends, service a greater debt load, or allocate capital resources to other states that resulted from acceptance of certain merger conditions. Staff recommended condition 24 allows Staff to have the ability to monitor CenturyLink's investments in Oregon including a comparison to other states. This condition will allow Staff to be proactive in working with the Company to ensure Oregon retail service quality is not deteriorated.

Staff recommended ordering condition 28 requires CenturyLink to construct a physical communication link between the cities of Lincoln City and Newport, Oregon, which would allow network redundancy. Commission Safety Staff believes that this link is necessary as a result of system outages, community isolation, and lack of network redundancy. Additionally, Staff has received a letter in support of such condition from the Oregon Military Department, Oregon Emergency Management (OEM).[35] In UM 1484 CUB/100, Feighner/3, Mr. Feighner also supports construction of a physical connection between Lincoln City and Newport, Oregon, or some other form of network redundancy.

Q. IN PARKER COMMUNICATIONS/100, PARKER/3-4, MR. PARKER RECOMMENDS A MORE DETAILED COMMITMENT CONCERNING COASTAL NETWORK REDUNDANCY. DOES STAFF BELIEVE THE ADDITIONAL REQUIREMENTS ARE NECESSARY?

A. No. Discussions with Safety Staff who act as a liaison to OEM believe that the Staff recommended condition is adequate to ensure network redundancy. I have been informed that Safety Staff had previously suggested in dialogue with the Lincoln County Legislative Representative and with the former Commission Chair that the resolution of redundancy could have been solved by the collaborative actions of resident Lincoln County CLECs. This suggestion was rejected by these parties in favor of placing the cost, construction, maintenance and the operation of the deployment, which enables the diverse routing of region traffic on the incumbents in North and South Lincoln County.

Secondly, if this stipulation is enacted and becomes operational, ISP operators can contract with the incumbent for Special Access services which could access the proposed facility at the existing tariff rates.

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[35] Included in Staff Exhibit 102, page 27.

Q. HAS THE COMMISSION APPROVED SERVICE QUALITY STANDARDS IN PREVIOUS TELECOMMUNICATIONS MERGER ORDERS?

A. Yes. The Commission has required service quality standards in previous merger applications. These dockets include:

- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169, Condition 4.n; and
- UM 1431 (Verizon Northwest/Frontier), Commission order No. 10-067, Conditions 18 to 27.

The Commission should adopt Staff's recommended service quality and safety conditions. These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is met.

OPERATING SUPPORT SYSTEMS

Q. ARE THERE CONCERNS ABOUT CENTURYLINK'S AND QWEST'S OPERATION SUPPORT SYSTEMS (OSS)?

A. No, not initially. It is important to note that CenturyLink has yet to complete its customer conversion project, including Oregon customers, from its merger with Embarq. In CTL/202, Schafer, the Company's witness sets a third quarter 2011 completion time for the customer conversion. According to the timeline, the Company completed conversion of its Ohio and North Carolina customers in May 2010. It is important to note that if CenturyLink acquires Qwest's 10 million access lines, it will have grown by approximately nine times its size within less than two years. The concern is that CenturyLink is still in the midst of fully integrating the former Embarq customers into CenturyLink and sufficient time has not passed to determine how smoothly that merger activity will actually have progressed before the Commission must make a determination on the more significant merger with Qwest.

CenturyLink may eventually transition Qwest from the Qwest systems to CenturyLink's OSS. Because the transferred Qwest properties are larger than CenturyLink's current properties, Staff has no means of being assured that CenturyLink's OSS can handle the increased traffic, both retail and wholesale. As a result, Staff condition 29 requires certain reporting by the Company on its OSS conversion activities. Both Staff Witnesses Reynolds and Marinos further discuss OSS aspects and risks of this transaction in Staff/300 and Staff/500.

Q. IS CENTURYLINK PERFORMING A REPLICATION OF QWEST'S OSS IN A SIMILAR FASHION AS OCCURRED IN UM 1431?

A. No. CenturyLink is acquiring Qwest as a whole, which is unlike UM 1431 where Frontier only acquired certain Verizon properties and not Verizon as a whole. As a result, CenturyLink will not have to replicate the Qwest OSS as was required by Frontier in UM 1431. Although at some point in the future, CenturyLink may integrate the Qwest OSS to the CenturyLink OSS. In a response to Staff Data Request No. 32, CenturyLink stated:

> At this time, system integration plans for the proposed transaction with Qwest have not been fully developed. In fact, complete integration plans cannot be developed until the merger is concluded. However, because the transaction results in the entirety of Qwest, including operations and systems, merging into and operating as a subsidiary of CenturyLink, it will allow a disciplined approach to systems

> and practices integration decisions to proceed in a disciplined manner.[36]

When asked for additional clarification on its plans concerning wholesale OSS operations, the Company responded to Staff Data Request No. 60 by stating:

> Integration planning is in the early stages and decisions on wholesale OSS systems have not been made at this time. Upon merger closing, there will be no immediate changes to Qwest's or CenturyLink's OSS. Any changes will occur only after a thorough and methodical review of both companies' systems and processes to determine the best system to be used on a go-forward basis. Decisions will be made from both a combined company and a wholesale customer perspective and consistent with the continued provision of quality service to our wholesale customers.[37]

Although Staff does not have any reason not to believe that the Company will take a disciplined and methodical approach, Staff is requiring certain reporting concerning the integration of Qwest's OSS.

Q. PLEASE EXPLAIN STAFF'S SPECIFIC CONDITION TO ADDRESS THE COMPANY'S CURRENT AND FUTURE OSS?

A. Yes. Staff recommended condition 29 (listed later in testimony) requires CenturyLink to maintain Qwest's legacy OSS intact for a minimum of three years after closing of the transaction; and requires increased reporting concerning the UM 1416 CenturyTel/Embarq conversion. Staff believes that the Company's increased focus on integrating Qwest properties may take focus off its current customers. As such, Staff is recommending reporting concerning the CenturyLink legacy properties to ensure current customers are not harmed by this transaction. As a result of the inherent risks (personnel,

[36] Included in Exhibit Staff 102, page 28.
[37] Included in Exhibit Staff 102, page 29.

technical, data integration, support) surrounding the different OSSs that will be used by CenturyLink, the Commission should adopt Staff's recommended conditions as necessary to meet the statutory standard, "in the public interest, no harm" for approving the transaction.

CAPITAL EXPENDITURES

Q. DOES STAFF INCLUDE ANY SPECIFIED AMOUNT OF CAPITAL EXPENDITURES IN THE RECOMMENDED CONDITIONS?

A. With the exception of broadband expansion and a physical communication link between the cities of Lincoln City and Newport, Oregon, Staff is not requiring any specific amount of capital expenditures in the recommended conditions. Based on the no harm standard, Staff believes that the test of sufficient capital expenditures will be reflected in CenturyLink's ability to meet its service quality requirements pursuant to Commission statutes and rule (ORS 759.450 – 455 and OAR 860-023-0055). The service quality standards are effectively the performance measurements in place to ensure adequate customer service. Staff Witnesses Reynolds and Emmons further discuss the service quality aspects of this transaction in Staff/300 and Staff/400. With that said, Staff has concerns about the age of CenturyLink and Qwest switches.

Staff's recommended condition 24 was included to partially address these concerns. Additionally, as previously mentioned, condition 24 allows Staff to have the ability to monitor CenturyLink's investments in Oregon including a comparison to other states. This condition will allow Staff to be proactive in working with the Company to ensure Oregon retail service quality is not deteriorated.

BROADBAND

Q. DID STAFF PROPOSE A BROADBAND CONDITION SIMILAR TO THE ONE ACCEPTED BY THE COMMISSION IN UM 1431?

A. Yes. Staff modeled a Broadband Condition, recommended condition 13, that closely resembles the broadband condition in UM 1431. Similar to concerns in UM 1431, Staff has concerns that during the post-transaction period, CenturyLink may not have the financial capability and the adequate attention to invest in the Oregon communications network; and the sufficiency of funds to dedicate to Oregon-specific investments. To realize public benefits and to protect against potential harms, CenturyLink should be required to spend a specific level of capital expenditures for broadband over a defined period of time, in order to meet specific accessibility milestones. Staff's recommended condition requires CenturyLink to spend $20 million for broadband improvements by July 1, 2012. Additionally, the condition requires CenturyLink to place $40 million in an escrow account in order to achieve certain accessibility and broadband speed milestones.

A broadband commitment should provide the Commission a high degree of certainty that CenturyLink will commit sufficient capital and attention to maintain and enhance its Oregon network. Additionally, the quick timeline to make capital improvements will help reduce the risk of a future unforeseen financial circumstance that would preclude the commitment from being fulfilled.

The $40 million recommended by Staff to be placed in escrow will also ensure funds are set aside and dedicated to Oregon.

It is important to note that in Qwest testimony, Qwest/1, Peppler/9, the Qwest witness states:

> Qwest is seeking $44 million in Oregon to fund projects totaling $59 million for the deployment of broadband services to more than 71,000 new living units.[38]

This statement indicates that there is additional opportunity to expand broadband in Oregon. This expansion should not only occur in Qwest service territory, but for legacy CenturyLink territories. Expansion in legacy CenturyLink territory is necessary to offset the risk of the transaction on CenturyLink's rural customers.

As previously mentioned, CenturyLink has not completed the customer conversion in Oregon as it has in Ohio and North Carolina. Although Staff is confident that the Federal Communication Commission (FCC) will impose broadband conditions on CenturyLink, Staff believes that Oregon should not be last in line to receive any FCC mandated broadband expansion. Staff's condition 13 would prevent a lack of focus in Oregon. As previously mentioned, Oregon customers are exposed to significant risks from the transaction and a dedicated effort to improve broadband associability in Oregon would help offset the considerable risks. This is important because CenturyLink witness Bailey in CTL/300, Bailey/16 states that the process of integration is too early to estimate the full extent of opportunities for increased

[38] Docket UM 1481, Qwest/1, Peppler/9-10

broadband penetration rates in the combined service territory.[39] It is important to note that a total investment of $60 million equals approximately $71 per line based on a total combined access line count of 851,042. On a per line basis this is approximately 24 percent less than what Frontier committed in UM 1431 ($25 million divided by 269,415 access lines - $93 per access lines). The $71 per line is also minimal compared to the $5,208 per line that CenturyLink invested in Oregon wire line improvements.[40] As previously mentioned, dividend payments of $2.90 per share will equal approximately $1.73 billion paid annually to shareholders. In comparison, the Company should be willing to show a commitment to Oregon of $60 million over a three year period.

Staff condition 14 requires broadband reporting. This condition mirrors the broadband reporting condition imposed by the Commission in UM 1431. Staff believes there should not be a degradation in conditions that have been previously imposed by the Commission. Staff believes these requirements are consistent with the "in the public interest, no harm" standard.

Q. HAVE YOU REVIEWED MR. PARKER'S TESTIMONY CONCERNING RELIABILITY AND SPEED OF THE INTERNET?

A. Yes.

Q. DO YOU BELIEVE THIS CONDITION IS NECESSARY?

A. Staff has not had sufficient time to examine the technical aspects of

[39] Docket UM 1484 CTL/300, Bailey/16.
[40] Response to Staff Data Request No. 25. Included in Staff Exhibit 102, pages 30.

Mr. Parker's recommendation. However, Staff's condition 13 allows for a total of $60 million to spend on broadband infrastructure improvements. If sufficient funds are available after the milestones listed in condition 13 are completed, Staff would support the use of surplus funds to effectuate Mr. Parker's recommended condition.

COMPETITIVE ISSUES / LONG DISTANCE

Q. WOULD THIS TRANSACTION HAVE ANY NEGATIVE EFFECTS ON COMPETITION?

A. Yes. Staff Witness Marinos discusses potential problems concerning competition, wholesale customers, and interconnection aspects of this transaction in Staff/500. Staff Witness Marinos also addresses the risks associated with CenturyLink not being a BOC and the recommended conditions to minimize these risks. Additionally, Staff witness Marinos addresses concerns about Long Distance and recommends certain conditions to remedy these concerns.

OTAP / LIFELINE

Q. DOES STAFF HAVE CONCERNS ABOUT THE MERGER'S EFFECT ON OREGON TELEPHONE ASSISTANCE PROGRAMS (OTAP) AND LIFELINE?

A. Yes. Staff Witness Cray explains Staff's concerns about OTAP/Lifeline and recommends certain conditions to remedy these concerns in Staff/600.

AFFILIATED INTERESTS

Q. ARE THERE AFFILIATED INTEREST CONCERNS REGARDING THIS TRANSACTION?

A. Yes. There are basically two affiliated interest (AI) issues: (1) Qwest being exempted from affiliated interest filings resulting from UM 1354, Qwest's price plan; and (2) the current status of the management service AI agreement between CenturyLink and CenturyLink operating companies, including the three CenturyLink ILECs. According to CenturyLink's response to Staff Data Request No. 23:

> CenturyLink does not currently anticipate changes in the type of affiliated services provided to or from the Oregon operating companies as a result of the transaction. To the extent affiliated interest changes do occur, new or updated agreements will be filed with the Commission as appropriate.[41]

Concerning Qwest and AI contracts, Qwest is currently exempt from affiliated interest filings as a result of its price plan. To ensure CenturyLink is not over allocating management or other affiliate costs to Qwest, recommended condition 53 will require CenturyLink to file an updated Cost Allocation Manual for services that reflect as charges and credits to operating accounts in each operating company's Oregon Form-O within six months after close of the transaction.

[41] Included in Staff Exhibit 102, page 31.

Q. HAS THE COMMISSION APPROVED AI CONDITIONS IN PREVIOUS TELECOMMUNICATIONS MERGER FILINGS?

A. Yes. The Commission has placed AI conditions on previous mergers/financing applications. These AI conditions include:

- UM 1416 (CenturyTel/Embarq), Commission Order No. 09-169 Conditions 4.p. and 4.q; and

- UM 1431 (Verizon Northwest/Frontier), Commission Order No. 10-067, Conditions 51 to 53.

The Commission should adopt Staff's recommended AI conditions. These recommended conditions reduce the risks of the transaction and help ensure that the "in the public interest, no harm" standard is achieved.

<u>ISSUE 3 - RECOMMENDED CONDITIONS PROPOSED BY STAFF</u>

Q. PLEASE SUMMARIZE STAFF'S RECOMMENDED CONDITIONS.

A. A complete listing of the conditions starts on page 45 of this testimony. As previously mentioned Staff separated the conditions into general categories. These categories are:

- Records/Rates/Tariffs/Access to Books
- Broadband
- Financial
- Service Quality and Safety – Retail
- Operations Support Systems
- Wholesale Services
- Long Distance
- OTAP/Lifeline
- Affiliated interests/Non-regulated Operations
- Most Favored State Commitment

Records/Rates/Tariffs/Access to Books

These conditions are recommended in order to ensure:

- Staff has proper access to all books and records of the transaction;
- The four current Oregon operating companies are maintained immediately after completion of the transaction;
- Existing agreements are maintained;
- Existing tariffs are maintained;
- Qwest's UM 1354 price plan (Order Nos. 08-408, 08-544, and 10-215) is maintained for the Qwest ILEC;
- The transaction is transparent to customers;
- Customers will not be harmed by higher rates that result from the transaction; and
- The Commission is able to monitor the impacts on Oregon operations and customers.

Broadband

These conditions are recommended in order to ensure:

- Adequate investment in broadband improvements in Oregon including a specified amount to be placed in an escrow account to ensure funds are available for improvements; and
- Enhanced broadband reporting.

Financial

These conditions are recommended in order to ensure:

- A restriction on dividends by the operating companies to any affiliate if CenturyLink's Net Debt/trailing 12-month EBITDA is more than 2.6x;
- Enhanced reporting by CenturyLink;

- CenturyLink will not encumber the assets of the Oregon Operating Companies;

- Prevention of any acquisition premium going into rates; and

- CenturyLink agrees post-merger that any sale, transfer, or merger concerning Qwest properties will be subject to ORS 759.395 and ORS 759.380, notwithstanding the price plan.

<u>Service Quality and Safety – Retail</u>

These conditions are recommended in order to ensure:

- Enhanced service quality and safety reporting;

- A commitment by CenturyLink to maintain minimum service quality standards as being reported in Qwest's monthly service quality reports; and

- A commitment by CenturyLink to construct a physical communication link between the Cities of Lincoln City and Newport, Oregon within 24 months following the close of the transaction.

<u>Operations Support Systems</u>

These conditions are recommended in order to ensure:

- Enhanced reporting on integration efforts;

- Maintaining the current Qwest legacy OSS intact for a minimum of three years; and

- Achieving Commission approval prior to modifying Qwest/CenturyLink OSS

<u>Wholesale Services</u>

These conditions are designed to ensure that competitors and their customers are not harmed by the transaction; and that competition continues to be fostered in Oregon. Additionally, these conditions address the concerns of CenturyLink not having experience as a BOC.

Long Distance

These conditions are recommended in order to ensure current customers are afforded current choices concerning long distance service and the opportunity to change providers without paying any change charges for 90 days after close of the transaction.

OTAP/Lifeline

These conditions require enhanced reporting concerning OTAP/Lifeline programs.

Affiliated Interests/Non-regulated Operations

These conditions require enhanced affiliated interest reporting and timely filing of affiliated interests contracts that result from the transaction.

Most Favored State Commitment

This condition requires a favored state commitment that is consistent with the condition included in Commission Orders Nos. 09-169 and 10-067 for telecommunications utilities. Additionally, favored state conditions were also included in the UM 1209 (PacifiCorp/MEHC) and UM 1283 (Cascade Natural Gas/MDU Resources) stipulations.

STAFF'S RECOMMENDED CONDITIONS

Records/Rates/Tariffs/Access to Books

1. CenturyLink Inc. (CenturyLink) shall provide the Public Utility Commission of Oregon (Commission) access to all books of account, as well as, all documents, data, and records that pertain to the transaction.

2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or earnings review under an alternative form of regulation.

3. The Applicants shall immediately notify the Commission of any substantive material changes to the transaction terms and conditions from those set forth in their Application that: (1) occur while a Commission order approving the transaction is pending, or (2) occur before the transaction is closed, but after the Commission issues its order approving the transaction. The Applicants must also submit a supplemental application for an amended Commission order in this docket if the substantive transaction conditions and terms affecting Commission regulated services change as set forth in this condition.

4. Except as authorized by this Commission, CenturyLink (referring to the parent company at the conclusion of this transaction) will maintain an organizational structure that includes the four separate ILECs in Oregon (no change from current allocated areas) – CenturyTel of Oregon Inc., CenturyTel of Eastern Oregon, Inc. United Telephone Company of the Northwest (dba Embarq), and Qwest Corporation (Qwest) (collectively, Operating Companies). CenturyLink (also referred to as "Company") agrees that an application must be filed with the Commission should it propose to merge or consolidate the operations of the Operating Companies, to the extent required by Oregon law.

5. Prior to the closing of the transaction, customer notification of the merger and change of parent company will be given to all local exchange and long distance customers and comply with any Oregon and FCC rules and regulations. This notice will include notification to all existing and acquired OTAP/Lifeline customers that the acquisition will not affect their OTAP/Lifeline credits and that there is no action required on their part. Prior to the notification, CenturyLink will submit a draft of the OTAP/Lifeline portion to the OTAP Manager for review.

6. No Commission-regulated intrastate service currently offered by Qwest in Exchange and Network Services Tariff No. 33 and Private Line Transport Services Tariff No. 31 will be discontinued for a period of at least three years following the Closing Date, except as approved by the Commission.

7. Post-closing, the Qwest Operating Company shall follow the terms and conditions of Qwest's UM 1354 price plan (Order Nos. 08-408, 08-544, and 10-215). An exception to this condition is noted in Condition 12 below. Any proposed changes to the approved price plan must receive Commission approval. Within 60 days following any branding or administrative changes to Qwest's Oregon rates, rules, and regulations, CenturyLink will file updated Qwest Oregon rates, rules, and regulations that show the branding change.

8. The Operating Companies will not advocate in any general rate case proceeding for a higher overall cost of capital as compared to what its cost of capital would have been absent the transaction, but the Operating companies may seek a cost of capital under the then-existing capital market conditions.

9. Operating Companies will not seek recovery of one-time transition, branding or transaction costs in Oregon intrastate regulated rate proceedings. Operating Companies will not seek to recover through wholesale service rates one-time transaction, branding or transition costs.

10. Operating Companies will hold retail and wholesale customers harmless for increases in overall management costs that result from the transaction.

11. As a requirement for post merger financial reporting, each operating company will submit the Commission standard *Annual Report* Form O and Commission standard *Oregon Separated Results of Operations Report* Form I, unless otherwise approved by the Commission.

12. Beginning with the first of the month following 12 months after close of the transaction, and for two subsequent 12-month periods, CenturyLink shall file with the Commission a report describing:

    a. Substantive activities undertaken relating to integrating Qwest operations with CenturyLink, as well as achieving synergies made available as a result of this transaction. CenturyLink synergies will be reported on a CenturyLink total company basis;

    b. Costs and projected savings of each such respective activity on a CenturyLink total company and Oregon-allocated basis;

    c. Organizational and staff force changes in Oregon operations; and,

    d. Impacts on Oregon operations and customers.

    e. The reporting requirement required by Condition 12 shall end with the submission of the third report unless otherwise directed by the Commission.

Broadband

13. Before July 1, 2012, CenturyLink will prudently expend up to $20 million on broadband deployment in CenturyLink territory in Oregon. Before July 1, 2014, CenturyLink will prudently expend an additional $40 million ($60 million in aggregate) in the CenturyLink territory in Oregon. Funds used for investment can include Company funds, federal stimulus funds received through the American Recovery and Reinvestment Act (ARRA), Broadband Investment Plan (BIP), other stimulus or a combination of funds. CenturyLink will have broadband service available in not less than 95% of the legacy CenturyLink Oregon wire centers within two years of closing of the proposed transaction. By July 1, 2014, in aggregate, no less than 95% of households in legacy CenturyLink wire centers will have broadband available at no less than 1.5 mbps download speed. By July 1, 2014, in aggregate, no less than 95% of households in legacy Qwest wire centers will have broadband available at no less than 4.0 mbps download speed. CenturyLink may petition the Commission for a slower speed if 1.5 mbps or 4.0 mbps download speed cannot effectively be deployed.

    By July 1, 2013, CenturyLink shall report to the Commission on its progress towards meeting the broadband deployment thresholds contained in this condition. Should it appear that CenturyLink will not expend the entire $60 million meeting these thresholds, then CenturyLink shall consult with the Commission to identify additional priority areas within Oregon for which the remaining $60 million shall be expended.

    Within 180 days after closing, CenturyLink will submit to the Commission Staff a detailed broadband deployment plan identifying the wire centers and geographic areas CenturyLink is targeting for additional broadband deployment, any anticipated engineering or technical issues associated with the deployment, and the expected timeline for completing the deployment. CenturyLink agrees to consult with Staff regarding the timing of the deployment in specific wire centers and geographic areas the Commission identifies as priority areas.

    During the three-year period after closing, CenturyLink will file quarterly reports with the Commission, for Commission and CUB review, detailing the broadband deployment that CenturyLink has completed to date, identifying the additional number of households capable of receiving broadband during that preceding period, identifying any impediments that may prevent fulfillment of this condition and describing additional deployment CenturyLink plans to implement in the following year.

Within 60 days of closing, CenturyLink shall deposit in an Oregon bank account, Oregon escrow account or other Oregon account as approved by the Commission ("Account") $40 million to fulfill the remaining broadband commitment and this Account shall remain in place, retaining all deposited funds and interest thereon, until CenturyLink has met and completed, to the satisfaction of the Commission in its sole and reasonable discretion, the above broadband commitment contained in this condition (the Broadband Commitment).

In addition, any portion of the $20 million that has not been expended on broadband deployment as of July 1, 2012, in accordance with the first sentence of this condition shall also be deposited into the Account. The Account shall not be subject to any liens, security interests or claims of any other kind from any entity except CenturyLink and the Commission. In the event that CenturyLink does not ever meet the Broadband Commitment, the funds and all interest and earnings shall remain in the Account. Any administrative costs associated with the maintenance of the Account shall be borne solely by CenturyLink and not included in regulated accounts. In the event an institution acceptable to the Commission cannot be found to hold the Account under the conditions set forth in this condition, then the parties shall use best efforts to agree to an acceptable alternate method of setting aside funds that will be an equivalent financial incentive to CenturyLink to meet this condition. CenturyLink commits that this condition will not result in the diminishment of Oregon maintenance and investment expenditures in Oregon outside plant.

If CenturyLink determines that it is technically infeasible to fulfill one or more of the broadband deployment objectives identified above, CenturyLink will immediately (within 30 days of determining technical infeasibility) submit to the Commission a detailed report identifying the technical or operational impediments and limitations that prevent fulfillment of the condition and propose an alternative broadband deployment plan that provides at least a similar level of public benefit. The Commission may accept the alternative plan, or if it determines the alternative plan does not provide a similar level of public benefit, the Commission may order a different broadband deployment plan to provide a similar level of public benefit as an alternative to satisfy this condition.

Once the Commission makes this determination the Account funds will be released for the purpose of enhancing broadband quality and capacity and availability. CenturyLink and Qwest will report in its annual Form O Report for the current and preceding three years of expenditures in Plant Accounts 2111 – 2690 and Operating Expense Accounts 6110 – 6720.

14. Given that the Commission is approving the transaction based in part on the increased availability of broadband, CenturyLink is directed to provide the following reporting requirements:

    a. Not less than 90 days following the first anniversary of the close of the transaction, and for the four subsequent annual periods, CenturyLink shall provide the following reports on the preceding twelve-month period, regarding the provision of DSL service in Oregon:

    b. By month, the numbers of initial and verified trouble report complaint (TRC) data.

    c. The types and duration of TRCs.

    d. A brief caption as to the cause of each TRC. (TRCs may be grouped into categories for administrative reporting simplicity.)

    The filing must thoroughly document what information CenturyLink collects in the form of customer complaints about DSL service on the number, types, and causes of trouble that impinge on CenturyLink's provisions of DSL service in Oregon.

    CenturyLink must also file a report with the Commission not less than 90 days following the first anniversary of the close of the transaction, and for the four subsequent annual periods, the following:

    a. By customer class, wire center, by month, the number of DSL subscriptions.

    b. By customer class, wire center, by month, the number of requested DSL subscriptions.

Financial

15. If post-merger CenturyLink Inc.'s quarterly Net Debt/trailing 12-month EBITDA is more than 2.6x, the Operating Companies of post-merger CenturyLink Inc.'s will limit payments of dividends on common equity distributed to any company (including affiliates and subsidiaries of post-merger CenturyLink Inc.) holding shares of the Operating Companies to an amount not more than 50 percent of net income in the preceding fiscal year. The Operating Companies will limit payment of dividends on common equity in any quarter, if dividends are distributed quarterly, to not more than one-fourth of the annual limitation amount of 50 percent of net income in the preceding fiscal year.

a. The Net Debt/trailing 12-month EBITDA ratio will be calculated by Bloomberg L.P., as of the date post-merger CenturyLink files its quarterly 10-Q report with the Securities and Exchange Commission.

16. Within 30 days after the close of the transaction, CenturyLink will notify Commission staff of:

a. Post-merger CenturyLink's consolidated 2010 Net Debt/trailing 12-month EBITDA.

b. Post-merger rating agency reports of CenturyLink.

c. Pre-merger stand-alone CenturyLink's price per share as of the date of closing of the merger.

d. Pre-merger stand-alone Qwest's price per share as of the date of closing of the merger.

17. CenturyLink will not encumber the assets of the Oregon Operating Companies that are necessary or useful in the performance of their duties to the public without seeking Commission approval pursuant to ORS 759.375.

18. CenturyLink agrees that it will not seek to recover in Oregon intrastate regulated retail or wholesale rates any acquisition premium paid by CenturyLink for Qwest. Any acquisition premium will be recorded in the books at the parent level.

19. CenturyLink agrees that post-merger that any sale, transfer, or merger concerning Qwest properties will be subject to ORS 759.395 and ORS 759.380, notwithstanding the price plan.

20. After the closing of the transaction and for a period of not less than three years, CenturyLink must file with the Commission quarterly reports with:

a. CenturyLink's consolidated balance sheet.

b. Intercompany receivables and payables showing the beginning balance, the change for the quarterly and the ending balance of those accounts will be submitted to the Commission. This report shall be filed annually on April 1 of each year.

c. Dividend payments declared by CenturyLink to its shareholders (in total and per share) for that same time period.

21. These quarterly reports in condition 20 should be filed no more than 90 days following the close of each quarter. CenturyLink could waive this condition if its post transaction issuer credit rating is affirmed as investment grade by two of the following credit rating agencies: Fitch Ratings, Standard and Poor's or Moody's Investor Services.

Service Quality - Retail

22. Immediately after the close of this transaction, the Operating Companies will report retail service quality results in accordance with OAR 860-023-0055. CenturyTel is currently exempt from service quality reporting, having met the conditions of OAR 860-023-0055(16)(d), but is required to submit to the Commission the monthly CenturyTel retail service quality reports for two years after the close of this transaction.

23. CenturyLink will maintain current Commission minimum retail service quality standards (OAR 860-023-0055) as are currently being reported in the Qwest's monthly service quality reports to the Commission. If CenturyLink fails to maintain the current service quality levels for the Qwest Operating Company, it will be subject to potential penalties as set forth in ORS 759.450.

24. No later than one year from the close of the transaction, CenturyLink will provide to the Commission the following:

    a. A multi-year strategic plan that identifies the expected remaining life of each of the base unit and remote switches currently deployed in legacy Qwest's and legacy CenturyLink franchise area in Oregon and a proposed replacement plan for the switches, if any, so that CenturyLink will be able to meet the then current service standards pursuant to Oregon statutes and rules.

    b. For three years, an annual report detailing Oregon capital expenditures concerning planned actions on subsection (a) above. Included in the report will be a comparison of the amount of planned Oregon capital expenditures as a percentage of total system expenditures; and a comparison of the amount of capital expenditure per Oregon access line with the amount of capital expenditure per CenturyLink system-wide access lines.

25. CenturyLink will provide to Commission Staff in electronic form, and subject to confidentiality, the detailed, Form-477 data that the four Operating Companies are currently providing to the FCC for their service areas. This will be done annually for three years beginning with the year after the closing

of the transaction, subject to the continuation of the requirement for filing with the FCC.

Safety

26. CenturyLink is committed to complying with all applicable federal and Oregon safety standards and requirements, and will commit to comply with the safety and reliability laws in Oregon per ORS 757.035, OAR 860 Division-024, and OAR 860 Division-028.

27. Within seven (7) days after close of the transaction, CenturyLink agrees to provide the Commission a listing of CenturyLink primary and secondary points of contact within its new organization for safety and pole attachment matters.

28. CenturyLink will construct a physical communication link between the Cities of Lincoln City and Newport, Oregon within 24 months following the close of the transaction. The deployment expectation is that this link construct have, at a minimum, the bandwidth capacity of OC-192 in both directions to each community.

Operations Support Systems (OSS)

29. The Applicants commit to the following OSS actions:

<u>General</u>

Operations support systems included in this requirement will include:

a. Systems used to monitor cable and pair information and operation,
b. Systems used to track or monitor in-service circuit equipment information,
c. Systems used to track or monitor switch components,
d. Billing systems, and
e. Systems used for customer pre-ordering, ordering, provisioning, maintenance, and repair operations.

This requirement applies to both wholesale and retail systems.

CenturyLink will keep Qwest's legacy operations support systems intact for a minimum of three years after the closing of the transaction.

Prior to modifying or integrating existing Qwest/CenturyLink operations support systems, CenturyLink will request approval from the Commission six months in advance of the proposed action. Notification will consist of a description of the systems involved, the action to be taken, the proposed work schedule, a description of the Company's and customers' activities that will be affected, and a list of status reports to be provided to the Commission.

CenturyTel – Embarq Conversions

CenturyLink will provide to Commission Staff quarterly reports for the state of Oregon for the same performance measures as those currently submitted to the FCC in FCC 09-54. This reporting requirement will begin with data for the first quarter following Commission approval of the merger and will continue at least through the end of 2012. During 2012, Commission staff will analyze the performance data and recommend whether there is a need for continued reporting.

CenturyLink will enable Commission staff to access the service quality data currently available to CLECs on the company's website.

Wholesale Services

30. CenturyLink will honor, assume or take assignment of all obligations under Qwest's existing interconnection agreements. CenturyLink will not terminate, change the conditions of (with the exception of those governing expiration), or increase the rates in, any effective interconnection agreement during the unexpired term of the agreement, or for a period of four years from the Closing Date, whichever occurs later, unless requested by the non-ILEC interconnecting party, approved by the Commission, or required by a change of law. Furthermore, CenturyLink will allow requesting carriers to extend existing interconnection agreements, whether or not the initial or current term has expired, at least four years from the Closing Date, or the date of expiration, whichever is later.

31. CenturyLink will honor or assume all obligations in effect as of the Merger Filing Date under Qwest's current intrastate tariffs, including those for access services, and price lists for wholesale services. CenturyLink will not increase rates for such services for a period of at least four years from the Closing Date.

32. CenturyLink will continue to provide intrastate transit service in all ILEC territories subject to the same rates, terms, and conditions that were provided as of the Merger Filing Date unless approved or directed otherwise by the Commission.

33. No Qwest wholesale intrastate service offered to competitive carriers as of the Merger Filing Date will be discontinued for four years after closing of the transaction except as approved by the Commission.

34. CenturyLink and all of its ILEC affiliates will comply with the statutory obligations applicable to all incumbent local exchange carriers (ILECs) under 47 U.S.C. Section 251 and 252. In the legacy Qwest territory, CenturyLink will not seek to avoid any of its obligations on the grounds that it is exempt from any of the obligations pursuant to Section 251(f)(1) or Section 251(f)(2) of the Act.

35. After the close of the transaction the legacy Qwest ILEC territory shall continue to be classified as a Bell Operating Company ("BOC"), pursuant to Section 3(4)(A)-(B) of the Communications Act and shall be subject to all requirements applicable to BOCs, including but not limited to the "competitive checklist" set forth in Section 271(c)(2)(B) of the Act.

36. In the legacy Qwest ILEC territory, CenturyLink shall comply with all wholesale performance requirements for all wholesale services, including those set forth in regulations, tariffs, and interconnection agreements applicable to legacy Qwest as of the Merger Filing Date, unless otherwise directed by the Commission or agreed to by customers.

37. Following the Closing Date, CenturyLink shall continue to comply with the provisions of the Qwest Performance Assurance Plan (QPAP) that are in effect as of the Merger Filing Date for at least four years following the Closing Date, or such period as negotiated by any other party in this docket, whichever is longer. CenturyLink shall provide the monthly reports of wholesale performance metrics that Qwest currently provides to Staff and to each CLEC. Any changes to the PIDs or PAP must be approved by the Commission or agreed to by affected wholesale customers. Staff will monitor QPAP reported data and alert the Commission if service performance appears to be deteriorating from pre-merger levels.

38. After the close of the transaction, CenturyLink shall provide and maintain updated escalation information, contact lists and account manager information that is in place at least 30 days prior to the transaction close date. For changes to support center locations, wholesale customer-impacting organizational structures, or contact information, CenturyLink will provide at least 30 days advance written notice to all CLECs and Commission Staff.

39. CenturyLink will continue to make available to each wholesale carrier in the Legacy Qwest ILEC territory the types of information that Qwest made available as of the Merger Filing Date concerning wholesale Operational Support Systems functions and wholesale business practices and

procedures, including information provided via the wholesale web site, notices, industry letters, the change management process, and databases/tools.

40. CenturyLink will maintain the current Qwest Change Management Process (CMP), utilizing the terms and conditions set forth in the CMP Document. Pending CLEC Change Requests shall be completed in a commercially reasonable time frame.

41. CenturyLink shall ensure that Wholesale and CLEC support centers are sufficiently staffed by adequately trained personnel dedicated exclusively to wholesale operations so as to provide a level of service that is comparable to that which was provided in the Legacy Qwest ILEC area prior to the transaction and to ensure the protection of CLEC information from being used for CenturyLink's retail operations.

42. The Merged Company shall allow a requesting competitive provider to use its pre-existing interconnection agreement, including agreements entered into with Qwest, as the basis for negotiating a new replacements interconnection agreement. If Qwest and a requesting competitive carrier are in negotiations for a replacement interconnection agreement before the Closing Date, the Merged Company will allow the requesting carrier to continue to use the negotiations draft upon which negotiations prior to the Closing Date have been conducted as the basis for negotiating a replacement interconnection agreement.

43. In the Legacy CenturyLink ILEC territory, the Merged Company will permit a requesting carrier to opt into any interconnection agreement to which Qwest is a party in Oregon, including agreements in evergreen status

Long Distance

44. For at least 180 days following the close of the proposed transaction, CenturyLink will offer substantially the same intrastate toll calling services, at the same rates, in the pre-merger Qwest area as provided by Qwest immediately prior to the closing. This includes the bundled service offerings of local and long distance at the same rates as set forth in the price lists of Qwest. In addition, CenturyLink will honor all commitments made by Qwest to customers regarding the terms for which promotional discounts on intrastate long distance services apply.

45. If CenturyLink changes the carriers it uses to provide intrastate long distance service to customers in either the pre-merger CenturyLink or the pre-merger Qwest areas, the company will notify each of the affected Oregon intrastate

long distance customers at least 30 days in advance of the change. Furthermore, for 90 days following any such change, CenturyLink will waive any change charges, e.g., PICs, for any affected long distance customer choosing to change carriers

OTAP/Lifeline

46. CenturyLink will designate a representative to serve on the Commission's Oregon Telecommunications Industry Advisory Committee which generally convenes on a quarterly basis should the incumbents representing Qwest and CenturyLink respectively, vacate their seats as a result of the merger.

47. Prior to any billing system consolidations or changes, CenturyLink will notify the OTAP Manager and Administrative Specialist with a description of how the OTAP credits are listed on customer bills. CenturyLink will also provide the OTAP Manager and Administrative Specialist a sample copy of a customer's bill that lists the OTAP/Lifeline credits. The OTAP Manager and Administrative Specialist will accept a redacted copy in which the customer's personal identifying information is protected.

48. CenturyLink will maintain staffing levels for its existing territories and its newly acquired territory for daily communications with Commission Staff regarding daily OTAP/Lifeline questions and concerns and OTAP/Lifeline reporting issues. Prior to any billing system consolidations or changes, CenturyLink will provide notice to the OTAP Manager of any of its staffing level changes, including its staff for filing with the Commission OTAP reimbursement reports, in any of its territories.

49. If legacy Embarq or CenturyTel staff identify an approved OTAP/Lifeline customer for the other's territory on a Commission-approval report due to Commission Staff error, legacy staff may either:

    a. Notify the OTAP Manager and Administrative Specialist of the discrepancy on the No Match report
    b. Contact legacy staff (and the OTAP Manager and Administrative Specialist) of the customer's respective territory to apply the OTAP/Lifeline credit to their account.

Note this does not apply to Qwest transactions due to its automated systems.

50. Before the close of transaction, CenturyLink will designate at least one liaison for higher level discussions with the OTAP Manager should the incumbents representing Qwest and CenturyLink respectively, vacate their positions as a result of the merger.

51. Post merger, CenturyLink will advise the OTAP Manager of any impending OTAP/Lifeline marketing and outreach efforts (e.g. radio public service announcements). In addition, CenturyLink will provide the OTAP Manager electronic copies of its OTAP/Lifeline advertising collateral.

52. Prior to the merger, CenturyLink including Embarq and Qwest will have no outstanding debt to the Commission with respect to the RSPF surcharge collection, remittance, and reporting requirements.

53. CenturyLink will provide notice to and obtain input from the OTAP Manager prior to making material changes to the existing Qwest mechanized OTAP reporting system.

Affiliated Interests/Non-regulated Operations

54. CenturyLink agrees that the Operating Companies will comply with all applicable Commission statutes and regulations regarding affiliated interest transactions, including timely filings of applications and reports, consistent with their respective forms of regulation, and terms of such regulation, as applicable to each respective Operating Company. To the extent affiliated interest changes do occur, the Company or its Operating Companies will make the appropriate affiliated interest filings pursuant to ORS 759.390 consistent with their respective forms of regulation.

55. Within 9 months after the close of this transaction, CenturyLink will file with the Commission affiliated interest agreements including an updated Cost Allocation Manual for services that reflect as charges and credits to operating accounts in Operating Companies' Form O.

56. The certificates of all CenturyLink and Qwest entities certified as Competitive Providers in Oregon will remain in effect and unchanged as of the date of close of the transaction. Thereafter, CenturyLink and Qwest will report any changes affecting those certificates in compliance with applicable Commission statutes and regulations.

Most Favored State Commitment

57. CenturyLink agrees that the Conditions may be expanded or modified as a result of regulatory decisions in other states and the FCC, including decisions based upon settlements, that impose conditions or commitments related to this merger proposal. CenturyLink agrees that the Commission may adopt any commitments or conditions from other states and the FCC that are

adopted after the final order in UM 1484 is issued that are related to addressing harms of this transaction if:

The commitment or condition does not result in the combined company being required to provide a "net benefit" and either:

i. The Commission or Staff had not previously identified the harm to Oregon ratepayers and such harm is applicable to Oregon; or

ii. The commitments or conditions in a final order of another state and the FCC are more effective at preventing a harm previously identified by the Commission or Staff.

Should new commitments or conditions meeting the requirements of subsections i. or ii. of this paragraph occur, CenturyLink will commit to the following process to facilitate a prompt decision from the Commission under this section:

a) Within fifteen (15) calendar days after a final order adopting a new condition or stipulation with new or amended commitments by a commission in another state jurisdiction and the FCC, CenturyLink will send a copy of the stipulation and commitment to Oregon Commission Staff and to all parties in UM 1484.

b) CenturyLink will notify the Commission that they have received the last such final order from other states and the FCC adopting new conditions, stipulations or commitments (the "Final Filing") within fifteen (15) calendar days of receipt and send it to Staff and all UM 1484 parties.

c) Within fifteen calendar days after the last such filing from the other states and the FCC ("Final Filing"), any party to this proceeding may file with the Commission its response, including its position as to whether any of the covenants, commitments and conditions from the other jurisdictions (without modification of the language thereof except such non-substantive changes as are necessary to make the commitment or condition applicable to Oregon), meets the two requirements set forth above, and should be adopted in Oregon. Any party filing such a response should serve it upon the UM 1484 parties.

Q. DO YOU BELIEVE THAT THESE CONDITIONS ARE SUFFICIENT TO FULLY MITIGATE THE RISKS TO THIS TRANSACTION?

A. No. As previously mentioned, although Staff believes its recommended conditions reduce the risks of the transaction, Staff does not believe its conditions will completely mitigate the risks to meet the statutory requirements due to the change in financial risk, wholesale competition risk, and the inability to effectively ring fence the Oregon operating companies from the parent, CenturyLink under the proposed organizational structure. With that said, many of these conditions were accepted by the Commission in the CenturyTel/Embarq merger approved in docket UM 1416 and the indirect transfer of Verizon Northwest properties to Frontier Communications Corporation approved in docket UM 1431.

Q. DOES THIS CONCLUDE YOUR REPLY TESTIMONY?

A. Yes.