

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 GARY PIERCE
CHAIRMAN
3 SANDRA D. KENNEDY
COMMISSIONER
4 PAUL NEWMAN
COMMISSIONER
5 BOB STUMP
COMMISSIONER
6 BRENDA BURNS
COMMISSIONER

7
8 IN THE MATTER OF THE JOINT NOTICE
AND APPLICATION OF QWEST
CORPORATION, QWEST
9 COMMUNICATIONS COMPANY, LLC,
QWEST LD CORP., EMBARQ
10 COMMUNICATIONS, INC. D/B/A CENTURY
LINK COMUNICATIONS, EMBARQ
11 PAYPHONE SERVICES, INC. D/B/A
CENTURYLINK, AND CENTURYTEL
12 SOLUTIONS, LLC, FOR APPROVAL OF
THE PROPOSED MERGER OF THEIR
13 PARENT CORPORATIOONS QWEST
COMMUNICATIONS INTERNATIONAL INC.,
14 AND CENTURYTEL, INC.

Docket Nos.: T-01051B-10-0194
T-03902A-10-0194
T-02811B-10-0194
T-20443A-10-0194
T-04190A-10-0194
T-03555A-10-0194

15 **RUCO'S CLOSING BRIEF**

16 **INTRODUCTION**

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18 The Residential Utility Consumer Office ("RUCO") submits this Brief in response to the
19 joint application for approval of the proposed merger of Qwest Communications International
20 Inc. ("Qwest") and CenturyLink, Inc. ("CenturyLink"¹ – collectively the "Joint Applicants", post
21 merger the "merged company"). RUCO recommends that the Arizona Corporation

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23 ¹ The May 13, 2010 Application was filed by Qwest and CenturyTel, Inc. A press release dated May 20, 2010
24 announced that, during CenturyTel, Inc.'s annual meeting, shareholders approved changing the company's legal
name from CenturyTel, Inc. to CenturyLink, Inc. The press release appears on CenturyLink's website
(http://ir.centurylink.com/phoenix.zhtml?c=112635&p=irol-newsArticle_Print&ID=1429678&highlight=)

1 Commission ("Commission") approve the terms and the conditions of the Settlement
2 Agreement ("Settlement" or "Agreement") recommending approval of the merger, entered into
3 by RUCO, the Commission's Staff ("Staff"), and the Joint Applicants. The Settlement is in the
4 public interest. The Settlement will result in a company that is financially superior to the
5 present day Qwest. The Settlement will provide numerous benefits for the ratepayers of
6 Arizona. The Settlement is a good deal for Arizona's ratepayers and the Commission should
7 approve the Settlement.

8 **The Settlement is in the public interest.**

9 The Settlement is in the public interest. The standard that this Commission has applied
10 when analyzing the public interest in the past has been broad and encompasses consideration
11 of all of the relevant facts. In Decision No. 67454 (In the Matter of the Reorganization of
12 Unisource Energy Corporation, Docket No. E-04230A-03-0933) the Commission explained the
13 applicable standard:

14 Although Rule 803(C) establishes a minimum standard for Commission
15 consideration of affiliate transactions, it is not the only applicable standard
16 of review. The Commission has a constitutional duty to make and enforce
17 reasonable rules, regulations and orders to protect the convenience,
18 comfort, safety and health of employees and patrons of public service
19 corporations. Ariz. Const. Art. 15 § 3. The Commission must act in the
20 "public interest." *James P. Paul Water Co. v. Arizona Corporation
Commission*, 137 Ariz. 426, 429, 671 P.2d 404, 407 (1983). The inquiry into
21 the "public interest" is broad and the Commission should examine all the
22 evidence available in determining what is in the public interest. See *Pueblo
Del Sol Water*, 160 Ariz. at 286.

23 The factors set forth in Rule 803(C), the so-called "No Harm" Rule,
24 express the areas that are of usual concern when evaluating transactions
regarding the holding company structure. Rule 803(C) employs the
permissive "may" to evaluate when rejection of a proposed transaction is
appropriate. The use of the term "may" suggests that the Commission has
broader discretion to consider factors other than those expressed in the
Rule - i.e., impairment of financial status, ability to attract capital at fair and
reasonable terms or the ability to provide safe, reasonable and adequate
service. Although the purpose of Rule 803(C) may be, as UniSource

1 argues, to protect ratepayers from having to pay higher rates, it is clear that
2 the Commission has a broader duty to consumers, employees and the
3 public than to merely protect against higher rates. The Commission's duty
4 extends to quality of service and safety. Indeed, the Commission has found
5 that the Affiliated Interest Rules should be applied to maximize protection to
6 ratepayers. Decision No. 65453 at 18. The duty to act in the public interest
7 requires this Commission to consider all factors implicated in this
8 transaction and not solely the impairment of the financial status or services
9 of the public service corporations. A careful analysis of potential risks is
10 particularly crucial when the proposed transaction can impact the public
11 health and safety.

12 The individual circumstances of each case influence the scope and
13 breadth of the "public interest" inquiry. In some cases, the guidelines of
14 R14-2-803(C) may comprise the entire analysis of whether a proposal is in
15 the public interest. In other cases, circumstances may dictate that the
16 analysis of the "public interest" go beyond the specific language of Rule
17 803(C). The case before us, a proposed sale of a publicly traded public
18 utility holding company to a group of private investors by means of a
19 leveraged buyout, is, as far as we can tell, a case of first impression in
20 Arizona. Its uniqueness and the potential ramifications of the transaction
21 require close and careful scrutiny. In addition, this particular case requires
22 an analysis from an historical perspective. (Emphasis added)

23 Decision No. 67454 at 28-29.

24 Decision No. 67454 is instructive in the subject case. While merger of utilities are not
particularly common in Arizona, mergers of two very large utilities in Arizona are even more
rare and will require close and careful scrutiny. The terms and conditions of the Settlement
were the result of careful consideration and close scrutiny of the facts and circumstances of
this case. RUCO would not have agreed to the Settlement had the terms and conditions not
favored its constituency and been in the public interest.

1) The post merger company will be financially superior to present day Qwest.

The public interest analysis requires the Commission consider whether the Settlement
would impair the financial viability of the public utility. A.A.C. R14-2-803(C) specifically
addresses the financial consideration:

At the conclusion of any hearing on the organization or reorganization
of a utility holding company, the Commission may reject the proposal

1 if it determines that it would impair the financial status of the public
2 utility, otherwise prevent it from attracting capital at fair and
3 reasonable terms, or impair the ability of the public utility to provide
4 safe, reasonable and adequate service.

5 The Settlement in this case would not impair the financial status of either joint applicant,
6 would not prevent either joint applicant from attracting capital at fair and reasonable terms or
7 impair the joint applicant's ability to provide safe, reasonable and adequate service. On the
8 contrary, the merged company will be a financial improvement over Qwest, in a better position
9 to attract capital and at least as good of a position if not in a better position to provide
10 reasonable and adequate service.

11 The numbers speak for themselves. Staff's witness, Pedro Chaves, testified that as of
12 March 31, 2010, Qwest's capital structure consisted of \$13,546 million debt and a negative
13 \$1,120 million in equity. S-7 at 5². According to Mr. Chaves, Qwest's negative equity position
14 restricts its access to the capital markets. Id. On the other hand, CenturyLink and Qwest
15 expect a post-merger consolidated capital structure for CenturyLink consisting of 52.5 percent
16 debt and 47.5 percent equity. Id. at 7. The merged result, from a financial standpoint, is far
17 more favorable to Qwest's current capital structure.

18 Nobody, not even the parties that oppose the Settlement, can reasonably dispute Mr.
19 Chaves' financial conclusions that "Arizona subsidiaries of QCII would benefit from having a
20 parent company that has a financially prudent capital structure as opposed to QCII's existing
21 capital structure with negative equity."³ Id. Mr. Chaves further concludes that "... the
22 proposed transaction will benefit QCII's Arizona subsidiaries by providing improved access

23 ² For ease of reference, trial exhibits will be identified similar to their identification in the Transcript of Proceedings.
24 The transcript volume number will identify references to the transcript.

³ QCII refers to Qwest in this Brief.

1 to the capital markets because the post-merger ultimate parent, CenturyTel, Inc., will have
2 a financially prudent capital structure as opposed to QCII's negative equity position."

3 Prior to the time the Joint Applicant's filed their application with this Commission (May
4 13, 2010), several credit rating agencies were critical of the merger. In a report⁴ dated April
5 22, 2010, Bank of America/Merrill Lynch analysts Kevin Christiano and Connie Chan stated
6 that Standard & Poor had placed CenturyLink on watch negative, and said that a one or two
7 notch downgrade is likely. RUCO-1 at 11. The analysts also stated that Fitch also placed the
8 company on watch negative while Moody's affirmed the company's Baa3 rating and changed
9 its outlook to negative. Id. Both Christiano and Chan speculated that CenturyLink will almost
10 certainly be downgraded to below investment grade by Standard & Poor and retain investment
11 grade ratings at Moody's. Id. While the analysts described Fitch as a wild card, they
12 expressed their opinion that when the proposed merger is completed there is a reasonable
13 chance that Fitch will rate the company BBB-, downgrading CenturyLink from its current Baaa3
14 rating. Id. at 12.

15 These reports were and still are a concern. It is not RUCO's intent to downplay their
16 importance or the concerns they raise. However, these initial reactions are just one piece of
17 the puzzle and should not be viewed in a vacuum. They are also speculative and there have
18 been numerous changed circumstances that weigh against potential downgrades since these
19 statements were made. For example, the merger has since been approved by public utility
20 commissions in numerous states where the joint applicants filed merger applications. Despite
21 these approvals, these downgrades have yet to come into fruition. Another changed

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24 ⁴ "The Worst Kept Secret: CenturyLink & Qwest to Merge," Bank of America/Merrill Lynch Merger Acquisition
Divestiture report on CenturyTel dated April 22, 2010 provided in Qwest's Response to ACC Staff Data Request
2-002

1 circumstance is that Qwest and CenturyLink have paid down their combined debt since the
2 application was filed. At year end 2009, the combined debt was \$19.4 billion. Transcript at
3 51. At the end of the 2010 third quarter, the combined debt was paid down another \$1.1 billion
4 to \$18.3 billion. Id.

5 Christiano and Chan also believe that the combined entity resulting from the proposed
6 merger has investment grade credit metrics stating that, on a pro-forma basis, a
7 Qwest/CenturyLink combined entity would have ended 2009 with strong credit metrics
8 including 2.2 times net leverage assuming run-rate synergies. RUCO-1 at 12. The analysts
9 pointed out that, according to CenturyLink, no new financing or refinancing would be required
10 as a result of the transaction and that, during a recent conference call, CenturyLink's
11 management repeatedly mentioned that it intends to take a "conservative" approach to its
12 capital structure. Id. at 12. Christiano and Chan also stated that bondholders should be
13 comforted by the fact that both CenturyLink's Glen Post and Stewart Ewing will be the
14 respective CEO and CFO of the merged company. According to the analysts, both
15 CenturyLink executives have a long track record of pursuing conservative financial policies. Id.

16 It is also noteworthy that despite the recent acquisitions that have taken place, for the
17 period of 2005 through the present, CenturyLink has managed to maintain a balanced capital
18 structure. Transcript at 513. These favorable observations mitigate some of the concerns
19 raised by the earlier comments.

20 RUCO does not dismiss the analysts' predictions. RUCO understands, however, that
21 regardless of the predications there are no guarantees. There is strong evidence in the record
22 discussed above, evidence which RUCO believes outweighs the now dated analyst
23 predictions, which indicates that the resulting merged utility will be significantly stronger
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1 financially, than the current Qwest – even if the result is a credit downgrade in the foreseeable
2 future.

3 **2) The broadband provisions of the Settlement are in the public interest.**

4 The Proposed Settlement Agreement also includes a commitment from the Joint
5 Applicants that the merged entity will invest no less than \$70 million in broadband
6 infrastructure in Arizona over a five year period beginning January 1, 2011. JA-2, Condition
7 #17. This investment in infrastructure shall take place over a five year period beginning on
8 January 1, 2011. Id. Each year, for the next three years, the merged company will meet with
9 Staff and RUCO to review among other things, compliance with the broadband commitment,
10 and the merged company's deployment of broadband for the previous year as well as the
11 plans for broadband deployment over the next year. Id., Condition 18

12 The Joint Applicants made a broadband commitment of this magnitude in only two other
13 states in Qwest's entire service territory – Colorado and Oregon. In Colorado, Qwest serves
14 more customers than in Arizona. Based on the number of end users, by comparison Arizona's
15 broadband commitment is one of the top commitments in the entire Qwest territory.

16 The commitment to invest a minimum of \$70 million in broadband in Arizona, or any
17 amount for that matter is a prerogative of management. Likewise, where the Company
18 chooses to invest the broadband is also a prerogative of management. Since broadband is an
19 unregulated service, a multi-million dollar commitment to deploy it would not be jurisdictionally
20 available to the Commission absent consent of the Joint Applicants, which would be unlikely
21 through formal litigation. *State of Missouri ex rel. Southwestern Bell Telephone Co. v. Public*
22 *Service Commission of Missouri*, 262 U.S. 276, 289, 43 S.Ct. 544, 547, 67 L.Ed. 981, 31
23 *A.L.R. 807* as cited in *Southern Pac. Co. v. Arizona Corp. Commission*, 98 Ariz. 339, 343, 404
24 *P.2d 692, 696, (Ariz. 1965)* (It must never be forgotten that, while the state may regulate with

1 a view to enforcing reasonable rates and charges, it is not the owner of the property of public
2 utility companies, and is not clothed with the general power of management incident to
3 ownership.')

4 RUCO-3 at 10

5 The public benefit to Arizona of such a large commitment cannot be understated. There
6 are unserved and underserved areas in Arizona where broadband deployment is necessary.
7 The Commission only needs to review the public comment offered at the beginning of this case
8 to get a flavor of this. On the first day of the evidentiary hearing one member of the public from
9 Bisbee discussed the need for improved internet service in and around Bisbee. Of course,
10 Bisbee is not the only area where broadband expansion would improve access to the internet.
11 Id. at 10-11

12 By giving the Joint Applicants discretion on where to deploy the \$70 million of
13 broadband infrastructure, the merged company, with its intimate knowledge of its infrastructure
14 and its service territory, can maximize its resources in ways that will result in the largest
15 number of customers receiving the greatest benefit. Id. The merged company is in the best
16 position to ascertain where broadband can best be deployed. It seems unlikely that RUCO or
17 Staff would be in a better position than the merged company to make specific allocations of
18 broadband, at least at the beginning. RUCO and Staff, however, will have the ability to review
19 the deployment of the broadband over the next three years and offer input, including specific
20 allocation recommendations, pursuant to the reporting requirements of the Settlement. Absent
21 the Settlement, the utility is under no obligation to report to RUCO, Staff or the Commission on
22 its unregulated services including broadband.

23 Additionally, Commission-directed deployment of broadband would have the effect of
24 politicizing these decisions. The Commission would be in the unenviable position of selecting
some communities and rejecting others. Finally, CenturyLink has a reputation of doing a good
job serving its rural constituents. RUCO believes CenturyLink's corporate culture of care for its

1 rural constituents will carry into its management decisions where it deploys broadband in
2 fulfillment of its \$70 million commitment.

3 From RUCO's standpoint, should it appear over the course of the next three years that
4 the merged company is deploying broadband in a manner that is not beneficial to ratepayers, it
5 will be RUCO's position that the merged company is not acting in the spirit of the Agreement
6 and RUCO will consider its legal options. Moreover, it would truly not be in the merged
7 company's best interests to not honor the spirit of the Agreement or work with the state
8 agency's that regulate it as it makes its initial footprint in Arizona. So far, from what RUCO has
9 seen, given the concessions in the Agreement, the Joint Applicants are doing just the opposite
10 - they appear to be doing everything in their power to start out leaving a favorable impression.

11 The issue of post merger broadband deployment is very important to RUCO. RUCO
12 strenuously negotiated this issue and is pleased with the result. The Joint Applicant's
13 broadband commitment goes a long way to improve Arizona's broadband infrastructure.

14 **3) The post merger Company should also provide safe, reasonable and**
15 **adequate service**

16 The Settlement should also provide a level of service that is at least equal to that
17 provided currently. RUCO's focus in this case has been primarily the financial analysis.
18 RUCO, however, is a signatory to the Settlement which has focused many of its conditions on
19 the quality of service. RUCO partook in the discussions regarding the retail service conditions
20 throughout the negotiations, added its input and is keenly aware of the merged companies'
21 post merger obligations. While RUCO cannot guarantee that the level and quality of retail and
22 wholesale service will remain on par with Qwest's current service, CenturyLink has agreed and
23 gone well beyond what the Commission could order it to do to effectuate adequate service. In
24

1 his Settlement testimony, Staff's Assistant Director, Elijah O. Abinah goes through each of the
2 retail conditions regarding quality of service.

3 Regarding the retail service of quality conditions, Mr. Abinah concludes:

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5 The Joint Applicants also agree that they will not seek to make
6 changes to the existing Service Quality Tariff for 2 years unless
7 recommended by the Commission or the Commission Staff. After the
8 two year period, the Service Quality tariff will continue in effect, and the
9 Joint Applicants can apply to make changes to the tariff which may or
10 may not be accepted by the Commission.

11 Other retail commitments include the provision of information on the
12 Merged Company's Internet Protocol Television ("IPTV") deployment
13 plans and broadband deployment plans. There are also commitments
14 relating to the integration of Qwest's retail support systems with
15 portions of the CenturyLink and/or Embarq systems. The Merged
16 Company also agrees to maintain or improve its pre-merger complaint
17 status in the Qwest Arizona service areas. In addition, the Merged
18 Company agreed to ensure that retail support centers are sufficiently
19 staffed with adequately trained personnel who will provide a level of
20 service not less than and functionally equivalent to that provided in the
21 Qwest Arizona service area. (Emphasis added).

22 S-1 at 14-15.

23 RUCO believes that the Settlement satisfies this aspect of the standard and that the
24 post merger company, as Mr. Abinah concludes, "... will provide a level of service not less than
and functionally equivalent to that provided in the Qwest Arizona service area."

1 **4) Other provisions of the Settlement that are in the public interest.**

2 There are numerous other provisions of the Settlement which, if approved, make the
3 merger in the public interest. Among those provisions are the following:

- 4 (a) The maintenance of existing retail service quality measures for a period of two
5 (2) years.

- 1 (b) The implementation of a new local market model whereby operating decisions
2 are pushed closer to the customer, increasing responsiveness to customers'
3 needs, marketing flexibility, and targeted investment.
- 4 (c) No successor entity will recover through wholesale service rates or other fees
5 paid by CLECs or through Arizona end-user retail rates the acquisition costs of
6 the merger.
- 7 (d) The extension of interconnection agreements, wholesale agreements,
8 commercial agreements and tariffs for the benefit of CLECs and their respective
9 customers.
- 10 (e) The Joint Applicants will evaluate existing litigation involving the Commission and
11 make a good faith effort to resolve the issues without further litigation.
- 12 (f) The Joint Applicants have agreed to significant reporting to the Commission
13 which will enable the Commission to better evaluate improvements in service
14 quality, customer complaints, infrastructure, broadband coverage, and the
15 financial status of the Joint Applicants.
- 16 (g) A number of retail conditions that insure competitive local exchange carriers
17 ("CLECs") continued ability to compete fairly.
- 18
- 19

20 RUCO-3 at 12-13. Individually and together, all of these benefits to Arizona's ratepayers are
21 in the public interest.

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24

1 **CONCLUSION**

2 The Settlement in this case was the result of extensive negotiations among the parties.
3 Like all Settlements, the end result is the product of much give and take. From RUCO's
4 perspective, RUCO felt there was more give than take on the part of the Joint Applicants which
5 RUCO believes is reflected by the terms of the Settlement. In the end, however, it appears
6 clear to RUCO that the ratepayers will be better off with a post merger company that is
7 significantly stronger financially than the status quo. RUCO supports the Settlement, believes
8 it is in the public interest, and recommends the Commission approve the Settlement in its
9 entirety.

10 RESPECTFULLY SUBMITTED this 18th day of January, 2011.

11
12
13 _____/S/
14 Daniel W. Pozefsky
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