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July 30, 2004

Ms. Beth O'Donnell
Executive Director
Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, KY 40602

RECEIVED
JUL 30 2004
PUBLIC SERVICE COMMISSION

RE: ALLTEL's Merger Plan

Case 2004-00302

Dear Ms. O'Donnell:

Enclosed for filing in the above-referenced matter is an original and eleven (11) copies of ALLTEL's Merger Plan. Please file-stamp the extra copy and return it to me in the self-addressed, pre-stamped envelope I have enclosed for your convenience.

Thank you for your cooperation in this matter. Please do not hesitate to contact me with any questions you may have.

Sincerely,

WYATT, TARRANT & COMBS, LLP

Noelle M. Holladay

Noelle M. Holladay

Enclosures

cc: Kimberly K. Bennett
James H. Newberry, Jr.

COMMONWEALTH OF KENTUCKY

RECEIVED
JUL 3 0 2004
PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

PLAN OF MERGER WITH RESPECT TO KENTUCKY ALLTEL, INC. AND ALLTEL KENTUCKY, INC.	)))	CASE NO. 2004-00302

Plan Regarding Merger

Kentucky ALLTEL, Inc. ("Kentucky ALLTEL") and ALLTEL Kentucky, Inc. ("ALLTEL Kentucky") (collectively, "the ALLTEL companies") file this Plan Regarding Merger as required by the Order of the Kentucky Public Service Commission ("Commission") dated February 13, 2002 in Case No. 2001-399:

INTRODUCTION

Any merger of Kentucky ALLTEL and ALLTEL Kentucky would require the companies to obtain permission from the FCC to maintain separate study areas for interstate settlement purposes under one merged operating company. The outcome and timing of such an FCC decision are impossible to predict. The Kentucky Commission's goals in ordering the filing of this plan could be accomplished more simply through means other than a legal merger of the ALLTEL companies. Those alternative means should be evaluated in the context of an informal conference, which may be arranged with Commission Staff and may provide all other affected persons notice and an opportunity to participate. *See*, 807 K.A.R. 5:001, Section 4.

BACKGROUND

In 2002, Kentucky ALLTEL was incorporated and sought Commission permission to acquire the Kentucky assets of Verizon South, Inc. so that Kentucky

ALLTEL could begin operating in the Commonwealth. ALLTEL Kentucky, an affiliate of Kentucky ALLTEL, was already operating in Kentucky at that time.

One of the issues addressed in Kentucky ALLTEL's acquisition case was whether Kentucky ALLTEL would merge with ALLTEL Kentucky. Kentucky ALLTEL witness, Steve Mowery, addressed this issue in his Direct Testimony filed on January 4, 2002. Mr. Mowery noted that a merger of the two ALLTEL companies at that time would provide unnecessary complications and confusion. In particular, Mr. Mowery explained:

> Kentucky ALLTEL and ALLTEL Kentucky operate independently and under very different tariffs and cost structures....
>
> *ALLTEL Kentucky is rate of return regulated in the interstate jurisdiction, while the Verizon Kentucky property is price cap and regulated under the CALLS access plan. The companies utilize different means of establishing their interstate access rates and, therefore, their interstate access rates are different.* While subject to FCC approval, it is expected that, following the acquisition of the Verizon Kentucky Business by Kentucky ALLTEL, Kentucky ALLTEL will be a CALLS company and will establish its interstate rates, subscriber line charges and universal service fund draws in accordance with the CALLS order of the FCC as Verizon does today. It is unlikely that a merger of a CALLS company and a non-CALLs company would occur without a change in the interstate regulation of one of the companies....These results would not be favorable for intrastate rates.
>
> Further, the CALLs plan was established by the FCC based on the participation of a finite number of companies, and the universal service fund that is a key part of that plan was sized based on the participation of the specific companies that participated in the design of the plan. The CALLs plan makes no provision for entry of companies....
>
> *It is quite common for holding companies to operate multiple ILECs in a given state....*Telephone and Data Systems, Inc. ("TDS") presently operates three separate ILEC subsidiaries in Kentucky and operates multiple ILECs in other states as well. CenturyTel, Inc. ("Century") and Citizens Communications Company ("Citizens") maintain multiple operating companies throughout the territories they serve....The foregoing are just a few examples of holding companies that operate more than one ILEC subsidiary in a state....*ALLTEL has substantial experience operating multiple subsidiaries in a state and has not found it to be confusing or in any way disadvantageous to customers....*

(Emphasis supplied.) Kentucky ALLTEL concluded that only after operating the newly acquired properties for a significant length of time would it be able to evaluate the viability of merging the two ALLTEL companies.

On February 13, 2002, the Commission issued an order ("Acquisition Order") approving Kentucky ALLTEL's acquisition and found as follows:

> **Merger of Kentucky Subsidiaries**
>
> In approving the petition by ALLTEL Corporation [*sic*] to acquire the Kentucky assets of Verizon, the Commission has determined that, for the present, ALLTEL will be permitted to operate two separate ILECs in this Commonwealth. The Commission agrees with ALLTEL that a merger of these two subsidiaries concurrent with the acquisition of the business from Verizon would cause unnecessary complications and confusion in the process. *The Commission also agrees that there are several operational differences between the two utilities that will have to be resolved before a merger can take place. However, the Commission does not believe that maintaining two separate ILECs will always be in the public interest.* Therefore, within 2 years of the closing date of the acquisition, the Commission will require ALLTEL to file a plan regarding the merger of ALLTEL, Inc. [*sic*] and ALLTEL Kentucky, Inc. *In developing the plan, ALLTEL, as a preliminary matter, should assume that the local service rate schedules now in place in ALLTEL Kentucky, Inc. could be retained as a separate rate schedule. ALLTEL should also assume that the ALLTEL Kentucky, Inc. study area will remain separate from the ALLTEL, Inc. study area for interstate settlement purposes. Finally, ALLTEL shall include in its plan the assumption that ALLTEL, Inc.'s intrastate access charge tariff will be adopted for ALLTEL Kentucky, Inc.'s operating area.* Such a plan should result in lower access charge fees for interexchange carriers that they can, in turn, pass on to Kentucky ratepayers in the form of lower toll charges....
>
> The Commission...HEREBY ORDERS that the application for the approval of ALLTEL's acquisition of Verizon's Kentucky assets is approved, subject to the following terms and conditions...Within 2 years of the closing date of this acquisition, ALLTEL shall file a plan regarding the merger of ALLTEL, Inc. and ALLTEL Kentucky, Inc. In developing the plan, ALLTEL shall rely on the assumptions specified herein.

(Emphasis supplied.) The ALLTEL companies are filing this Plan Regarding Merger in compliance with the Acquisition Order.

A merger of the two ALLTEL companies must comply with applicable federal as well as state law and should be structured to minimize any adverse consequences. One challenge implementing a merger of the two companies in accordance with federal and state law concerns the need to obtain approval from the Federal Communications Commission ("FCC") as a result of the different forms of interstate regulation applicable to the two ALLTEL companies.

DIFFERENCES BETWEEN ALLTEL KENTUCKY AND KENTUCKY ALLTEL

Reviewing the significant operational differences between ALLTEL Kentucky and Kentucky ALLTEL (as noted in the table below) is helpful in understanding the complex challenges associated with merging the two companies.

	ALLTEL Kentucky	**Kentucky ALLTEL**
1. Interstate Operations	• one rural USF study area • operates under federal rate of return ("ROR") regulation	• one rural and one non-rural USF study areas • operates under the Coalition for Affordable Local and Long Distance Service ("CALLS") price cap regulation plan (Upon Kentucky ALLTEL's acquisition of the properties, ALLTEL Corporation received a waiver from the FCC to allow its other ROR ILEC subsidiaries - including ALLTEL Kentucky - to remain ROR regulated given that Kentucky ALLTEL was price cap regulated. Kentucky ALLTEL adopted its predecessor's interstate rates, subscriber line charges ("SLCs"), and USF draws which were established in accordance with CALLS.)
2. Intrastate Operations	Regulated under the alternative regulation plan in K.R.S. §278.516, which provides electing utilities certain regulatory flexibilities (ALLTEL Kentucky elected to be so regulated on October 13, 1998, and the Commission recognized the election on December 30, 1998.)	Subject to traditional ROR regulation, which does not provide pricing flexibility absent the filing of a rate case
3. Service Quality	Required to comply with Commission's service standards applicable generally to all ILECs (ALLTEL Kentucky has	Subject to the service standards imposed on its predecessors (GTE and Verizon), which standards are significantly higher

	received only about 23 Commission complaints in the last four years.)	than those imposed on other carriers (Kentucky ALLTEL is currently incurring greater expense than comparable companies in an effort to meet the higher standards.)
4. Access lines	27,735 lines (per the Commission's March 31, 2004 Quarterly Surveillance Report)	519,715 lines (per the Commission's March 31, 2004 Quarterly Surveillance Report)
5. Territories	Bullitt County consisting of the Zoneton , Mt. Washington, and Shepherdsville exchanges	Exchanges of Albany, Arlington, Ashland, Augusta, Barbourville, Bardwell, Bee Spring, Berea, Bradfordsville, Brodhead, Brooksville, Brownsville, Bryantsville, Burkesville, Burnside, Calvert City, Campbellsville, Caneyville, Catlettsburg, Cecilia, Clarkson, Columbia, Columbus, Cumberland, Dover, East Bernstadt, Elizabethtown, Eubank, Evarts, Ewing, Faubush, Fernleaf, Flatlick, Flemingsburg, Garrison, Germantown, Glasgow, Grayson, Greensburg, Greenup, Hazard, Hillsboro, Hodgenville, Hustonville, Irvine, Jenkins, Johnsville, Lancaster, Leatherwood, Lebanon, Leitchfield, Lewisburg, Lexington, Liberty, Livingston, London, Loretto, Mammoth Cave, Manchester, Mays Lick, Meads, Midway, Milburn, Monticello, Morehead, Mount Olivet, Mount Vernon, Nancy, Nicholasville, Olive Hill, Oneida, Owingsville, Paint Lick, Park City, Russell, Salt Lick, Science Hill, Scottsville, Sharpsburg, Shopville, Smithland, Smiths Grove, Somerset, South Hardin, South Shore, Tollesboro, Tompkinsville, Uniontown 1, Vanceburg, Versailles, Vicco Washinton, White Lily, Wilmore

As demonstrated above, ALLTEL Kentucky and Kentucky ALLTEL are very different with respect to, among other things, the territories they serve, the standards by which they measure the quality of their service, and the way they are regulated in the state and federal jurisdictions.

ACQUISITION ORDER AND MERGER ASSUMPTIONS

The Commission, in its Acquisition Order, made several preliminary assumptions with respect to a merger of the two ALLTEL companies. Those assumptions included the following: (1) ALLTEL Kentucky's local service rate schedules could be retained as a separate rate schedule; (2) ALLTEL Kentucky's federal study area would remain separate from Kentucky ALLTEL's federal study areas for interstate settlement purposes; and (3) ALLTEL Kentucky would adopt Kentucky ALLTEL's intrastate access charge tariff, which the Commission believed should result in lower charges for Kentucky ratepayers.

The first assumption, maintaining separate local rate schedules, would be easily accomplished. The merged entity could simply file a consolidated tariff that would include individual schedules.

The practicability of the second assumption (*i.e.*, maintaining separate federal study areas for interstate settlement purposes) would require special consideration by the FCC given the significant differences in the interstate regulatory plans applicable to the two companies. ALLTEL Kentucky is ROR regulated in the interstate jurisdiction, and Kentucky ALLTEL is regulated under the CALLS price cap plan. Considering that (i) the industry and the FCC are presently unsettled with respect to ongoing intercarrier compensation and universal service proceedings and (ii) CALLS is scheduled to expire on June 30, 2005 and it is unclear on what terms the FCC may modify, replace, or extend the plan, Kentucky ALLTEL and ALLTEL Kentucky cannot predict with certainty how the FCC would respond to a request for approval and in what time frame a decision would be issued.

The third assumption concerning ALLTEL Kentucky's intrastate access rates is problematic because the assumed result would probably not occur. In the Acquisition Order, the Commission indicated that adoption of Kentucky ALLTEL's access rates by ALLTEL Kentucky "*should* result in lower access charge fees for interexchange carriers that they can, in turn, pass on to Kentucky ratepayers in the form of lower toll charges." (Emphasis supplied.) Even if the interexchange carriers ("IXCs") were to pass through the reductions, ALLTEL Kentucky's customers would see no measurable savings because long distance rates are determined on a statewide basis and not just for the ALLTEL Kentucky territory. ALLTEL Kentucky estimates that any such decrease resulting from its adoption of Kentucky ALLTEL's intrastate access rates, when spread across Kentucky, would result in infinitesimally small reductions. Alternative scenarios like expanding calling options would be more beneficial to customers.

STEPS NECESSARY TO MERGE KENTUCKY ALLTEL AND ALLTEL KENTUCKY

A legal merger of ALLTEL Kentucky and Kentucky ALLTEL would involve, at a minimum, the following actions:

a. A Kentucky Commission determination under K.R.S. 278.020(4), which provides that no person may acquire or transfer control or ownership of a utility without prior Commission approval (includes notice period to interested parties, intervention period, testimony, and final hearing);

b. FCC approval of the treatment of the companies' different forms of interstate regulation (including public notice filed in the *Federal Register*, comment period, and issuance of FCC final order);

c. Notice to Kentucky ALLTEL and ALLTEL Kentucky customers (including any required slamming notices);

d. Assignment of existing contracts by operation of law or as otherwise required under the contracts (including, but not limited to, interconnection agreements, franchise agreements, pole attachment agreements, vendor supply contracts, etc.);

e. Notice to Kentucky ALLTEL and ALLTEL Kentucky employees as necessary to alleviate confusion;

f. Filing and Kentucky Commission approval of a new local tariff that maintains the companies' existing separate local rate schedules; and

g. Filing and approval of appropriate documentation with the Secretary of State's Office.

In lieu of a legal merger that would trigger the need for such FCC approval and other administratively burdensome actions, another alternative could result in a more efficient and effective use of the Commission's and the ALLTEL companies' resources.

CONCLUSION

The merger of Kentucky ALLTEL and ALLTEL Kentucky would require administratively burdensome actions as well as an FCC determination of how to maintain the companies' separate study areas for interstate settlement purposes under one merged operating company. The Commission's goals in ordering the filing of this plan may be accomplished more effectively and efficiently through means other than a legal merger of the ALLTEL companies. Accordingly, alternative means should be explored in the context of an informal conference which would include participation by all interested parties and Commission Staff.

Dated: July 30, 2004.

Respectfully submitted,

KENTUCKY ALLTEL, INC.

By: Noelle M. Holladay

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