

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2016

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____
Commission File No. 001-03040

QWEST CORPORATION

(Exact name of registrant as specified in its charter)

Colorado

(State or other jurisdiction of incorporation or organization)

100 CenturyLink Drive, Monroe, Louisiana

(Address of principal executive offices)

84-0273800

(I.R.S. Employer Identification No.)

71203

(Zip Code)

(318) 388-9000

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
7.75% Notes Due 2030	New York Stock Exchange
7.375% Notes Due 2030	New York Stock Exchange
6.875% Notes Due 2033	New York Stock Exchange
7.125% Notes Due 2043	New York Stock Exchange
7.25% Notes Due 2025	New York Stock Exchange
7.25% Notes Due 2035	New York Stock Exchange
6.5% Notes Due 2017	New York Stock Exchange
7.5% Notes Due 2051	New York Stock Exchange
6.75% Notes Due 2021	New York Stock Exchange
7.00% Notes Due 2052	New York Stock Exchange
7.00% Notes Due 2052	New York Stock Exchange
6.125% Notes Due 2053	New York Stock Exchange
6.875% Notes Due 2054	New York Stock Exchange
6.625% Notes Due 2055	New York Stock Exchange
7% Notes Due 2056	New York Stock Exchange
6.5% Notes Due 2056	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

THE REGISTRANT, A WHOLLY OWNED SUBSIDIARY OF CENTURYLINK, INC., MEETS THE CONDITIONS SET FORTH IN GENERAL INSTRUCTIONS I(1) (a) AND (b) OF FORM 10-K AND IS THEREFORE FILING THIS FORM WITH REDUCED DISCLOSURE PURSUANT TO GENERAL INSTRUCTION I(2).

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☒
(Do not check if a
smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

On March 2, 2017, one share of common stock was outstanding. None of Qwest Corporation's common stock is held by non-affiliates.

DOCUMENTS INCORPORATED BY REFERENCE: None.

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Unless the context requires otherwise, references in this annual report to "QC" refer to Qwest Corporation, references to "Qwest," "we," "us," and "our" refer to Qwest Corporation and its consolidated subsidiaries, references to "QSC" refer to our direct parent company, Qwest Services Corporation and its consolidated subsidiaries, references to "QCII" refer to QSC's direct parent company and our indirect parent company, Qwest Communications International Inc., and its consolidated subsidiaries and references to "CenturyLink" refer to QCII's direct parent company and our ultimate parent company, CenturyLink, Inc. and its consolidated subsidiaries.

PART I

ITEM 1. BUSINESS

Overview

We are an integrated communications company engaged primarily in providing an array of communications services to our residential and business customers. Our communications services include local voice, broadband, private line (including special access), network access, Ethernet, information technology, video and other ancillary services. In certain local and regional markets, we also provide local access and fiber transport services to competitive local exchange carriers ("CLEC"). We strive to maintain our customer relationships by, among other things, bundling our service offerings to provide our customers with a complete offering of integrated communications services.

We generate the majority of our total consolidated operating revenues from services provided in the 14 -state region of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming . We refer to this region as our local service area.

We were incorporated under the laws of the State of Colorado in 1911. Our principal executive offices are located at 100 CenturyLink Drive, Monroe, Louisiana 71203 and our telephone number is (318) 388-9000.

On April 1, 2011, our indirect parent QCII became a wholly-owned subsidiary of CenturyLink, Inc. in a tax-free, stock-for-stock transaction. CenturyLink has agreed to acquire Level 3 Communications, Inc. ("Level 3") in a cash and stock transaction that is expected to substantially impact CenturyLink's operations and financial position upon being completed. For more information, see CenturyLink's annual report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 23, 2017.

To provide certain of our products and services and to conduct a variety of our internal communications functions, we use portions of CenturyLink's telecommunications network to transport data and voice traffic. Likewise, CenturyLink uses our telecommunications network to transport data and voice traffic in order to fulfill services to its customers and to conduct a variety of its internal communications functions.

For a discussion of certain risks applicable to our business, see "Risk Factors" in Item 1A of Part I of this annual report. The summary financial information in this section should be read in conjunction with, and is qualified by reference to, our consolidated financial statements and notes thereto in Item 8 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II of this annual report.

Financial and Operational Highlights

The following table summarizes the results of our consolidated operations:

	Years Ended December 31,		
	2016 ⁽¹⁾⁽²⁾	2015 ⁽¹⁾	2014
(Dollars in millions)			
Consolidated statements of operations summary results:			
Operating revenues	\$ 8,910	8,964	8,838
Operating expenses	6,588	6,704	6,726
Operating income	\$ 2,322	2,260	2,112
Net income	\$ 1,085	1,074	970

⁽¹⁾ During 2016 and 2015, we recognized an incremental \$95 million of revenue, for each period, associated with the Federal Communications Commission ("FCC") Connect America Fund Phase 2 support program as compared to the interstate USF program. For additional information, see Note 1—Basis of Presentation and Summary of Significant Accounting Policies to our consolidated financial statements in Item 8 of Part II of this annual report.

⁽²⁾ During 2016, we recognized \$90 million of severance expenses and other one-time termination benefits associated with workforce reductions.

The following table summarizes certain selected financial information from our consolidated balance sheets:

	As of December 31,	
	2016	2015
(Dollars in millions)		
Consolidated balance sheets summary information:		
Total assets	\$ 21,149	21,470
Total long-term debt ⁽¹⁾	7,261	7,239
Total stockholder's equity	8,692	8,907

⁽¹⁾ Total long-term debt is the sum of current maturities of long-term debt and long-term debt (excluding note payable-affiliate of \$914 million) on our consolidated balance sheets. For additional information on our total long-term debt, see Note 3—Long-Term Debt and Revolving Promissory Note to our consolidated financial statements in Item 8 of Part II of this annual report. For information on our total obligations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Future Contractual Obligations" in Item 7 of Part II of this annual report.

The following table summarizes certain of our operational metrics:

	As of December 31,		
	2016	2015	2014
(in thousands)			
Operational metrics:			
Total access lines ⁽¹⁾	6,611	6,997	7,334
Total broadband subscribers ⁽¹⁾	3,485	3,546	3,528

⁽¹⁾ Access lines are lines reaching from the customers' premises to a connection with the public network and broadband subscribers are customers that purchase broadband connection service through their existing telephone lines, stand-alone telephone lines, or fiber-optic cables. Our methodology for counting our access lines and broadband subscribers includes only those lines that we use to provide services to external customers and excludes lines used solely by us and our affiliates. It also excludes unbundled loops and includes stand-alone broadband subscribers. We count lines when we install the service.

Our methodology for counting access lines and broadband subscribers may not be comparable to those of other companies.

Substantially all of our long-lived assets are located in the United States and substantially all of our total consolidated operating revenues are from customers located in the United States.

Operations

We group our products and services among three major categories: strategic services, legacy services and affiliates and other services. See descriptions of these categories below in the section "Products and Services." The following table provides a summary of our operating revenues by category:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Strategic services	\$ 2,690	2,610	2,449
Legacy services	3,222	3,600	3,967
Affiliates and other services	2,998	2,754	2,422
Total operating revenues	\$ 8,910	8,964	8,838

Our operations are integrated into and reported as part of the segments of CenturyLink. CenturyLink's chief operating decision maker ("CODM") is our CODM, but reviews our financial information on an aggregate basis only in connection with our quarterly and annual reports that we file with the Securities and Exchange Commission ("SEC"). Consequently, we do not provide our discrete financial information to the CODM on a regular basis. As such, we have determined that we have one reportable segment.

Products and Services

From time to time, we change the categorization of our products and services, and we may make similar changes in the future. During the second quarter of 2016, we determined that because of declines due to customer migration to other strategic products and services, certain of our business low-bandwidth data services, specifically our private line (including special access) services in our business segment, are more closely aligned with our legacy services than with our strategic services. As described in greater detail in Note 9—Products and Services, these operating revenues are now reflected as legacy services.

Our products and services include local voice, broadband, private line (including special access), network access, Ethernet, information technology ("IT"), video and other ancillary services. We offer our customers the ability to bundle together several products and services, such as broadband, video (including DIRECTV through CenturyLink's strategic partnership), voice and Verizon Wireless (through CenturyLink's strategic partnership) services. We believe our customers value the convenience and price discounts associated with receiving multiple services through a single company.

Most of our products and services are provided using our telecommunications network, which consists of voice and data switches, copper cables, fiber-optic cables and other equipment. Our network serves approximately 6.6 million access lines in 14 states and forms a portion of the public switched telephone network, or PSTN. For more information on our network, see "Business—Network Architecture" below.

Described in greater detail below are our key products and services.

Strategic Services

We primarily focus our marketing and sales efforts on our "strategic" services, which are those services for which demand generally remains strong and that we believe are most important to our future performance. Generally speaking, our strategic services enable our customers to access the Internet, connect to private networks and transmit data, and enhance the security, reliability and efficiency of our customers' communications. Our strategic services are comprised of the following:

- *Broadband.* Our broadband services allow customers to connect at high speeds to the Internet through their existing telephone lines or fiber-optic cables. Substantially all of our broadband subscribers are located within the local service area of our wireline telephone operations;
- *Ethernet.* Ethernet services include point-to-point and multi-point equipment configurations that facilitate data transmissions across metropolitan areas and wide area networks. Ethernet services are also used to provide transmission services to wireless service providers that use our fiber-optic cables connected to their towers; and
- *Video.* Our video services include primarily satellite digital television under CenturyLink's arrangement with DIRECTV that allows us to market, sell and bill for its services under its brand name.

Legacy Services

Our "legacy" services represent our traditional voice, data and network services, which include the following:

- *Local Voice Services.* We offer local calling services for our residential and business customers within the local service area of our wireline markets, generally for a fixed monthly charge. These services include a number of enhanced calling features and other services, such as call forwarding, caller identification, conference calling, voice mail, selective call ringing and call waiting, for which we generally charge an additional monthly fee. We also generate revenues from non-recurring services, such as inside wire installation, maintenance services, service activation and reactivation. For our wholesale customers, our local calling service offerings include primarily the resale of our voice services and the sale of unbundled network elements ("UNEs"), which allow our wholesale customers to use all or part of our network to provide voice and data services to their customers. Local calling services provided to our wholesale customers allow other telecommunications companies the ability to originate or terminate telecommunications services on our network. Local calling services also include network transport, billing services and access to our network by other telecommunications providers and wireless carriers;
- *Private Line.* A private line (including special access) is a direct circuit or channel specifically dedicated for the purpose of directly connecting two or more sites. Private line service offers a high-speed, secure solution for frequent transmission of large amounts of data between sites, including wireless backhaul transmissions;
- *Switched Access Services.* As part of our wholesale services, we provide various forms of switched access services to wireline and wireless service providers for the use of our facilities to originate and terminate their interstate and intrastate voice transmissions;
- *ISDN.* We offer integrated services digital network ("ISDN") services, which use regular telephone lines to support voice, video and data applications; and
- *WAN.* We offer wide area network ("WAN") services, which allow a local communications network to link to networks in remote locations.

Affiliates and Other Services

Affiliates and other services consist primarily of Connect America Fund ("CAF") support payments, Universal Service Fund ("USF") support payments, USF surcharges and services we provide to our affiliates. We receive federal support payments from both Phase 1 and Phase 2 of the CAF program, and support payments from both federal and state USF programs. These support payments are government subsidies designed to reimburse us for various costs related to certain telecommunications services, including the costs of deploying, maintaining and operating voice and broadband infrastructure in high-cost rural areas where we are not able to fully recover our costs from our customers. We also collect USF surcharges based on specific items we list on our customers' invoices to fund the FCC universal service programs. We provide to our affiliates telecommunication services that we also provide to external customers. In addition, we provide to our affiliates computer system development and support services, network support and technical services.

Patents, Trade Names, Trademarks and Copyrights

Either directly or through our affiliates, we have rights in various patents, trade names, trademarks, copyrights and other intellectual property necessary to conduct our business. Our services often use the intellectual property of others, including licensed software. We also occasionally license our intellectual property to others as we deem appropriate.

We periodically receive offers from third parties to purchase or obtain licenses for patents and other intellectual property rights in exchange for royalties or other payments. We also periodically receive notices, or are named in lawsuits, alleging that our products or services infringe on patents or other intellectual property rights of third parties. In certain instances, these matters can potentially adversely impact our operations, operating results or financial position. For additional information, see "Risk Factors—Risks Affecting Our Business" in Item 1A of Part I of this annual report, and Note 15—Commitments and Contingencies to our consolidated financial statements in Item 8 of Part II of this annual report.

Sales and Marketing

We maintain local offices in most of the larger population centers within our local service area. These offices provide sales and customer support services in the community. We also rely on our call center personnel and a variety of channel partners to promote sales of services that meet the needs of our customers. Our sales and marketing strategy is to enhance our sales by offering solutions tailored to the needs of our various customers and promoting our brands. Our offerings include both stand-alone services and bundled services designed to meet the needs of different customer segments.

We conduct most of our operations under the brand name "CenturyLink." Our satellite television service is offered on a co-branded basis under the "DIRECTV" name. The wireless service that we offer under CenturyLink's agency agreement with Verizon Wireless is marketed under the "Verizon Wireless" brand name.

Our sales and marketing approach to our residential customers emphasizes customer-oriented sales, marketing and service with a local presence. Our marketing plans include marketing our products and services primarily through direct sales representatives, inbound call centers, local retail stores, telemarketing and third parties, including retailers, satellite television providers, door to door sales agents and digital marketing firms. We support our distribution with digital marketing, direct mail, bill inserts, newspaper and television advertising, website promotions, public relations activities and sponsorship of community events and sports venues.

Similarly, our sales and marketing approach to our business customers includes a commitment to provide comprehensive communications solutions for business, wholesale and governmental customers of all sizes, ranging from small offices to select enterprise customers. We strive to offer our customers stable, reliable, secure and trusted solutions. Our marketing plans include marketing our products and services primarily through digital advertising, direct sales representatives, inbound call centers, telemarketing and third parties, including telecommunications agents, system integrators, value-added resellers and other telecommunications firms. We support our distribution through digital advertising, events, television advertising, website promotions and public relations.

Network Architecture

Most of our products and services are provided using our telecommunications network, which consists of voice switches, data switches and routers, high-speed transport equipment, fiber-optic and copper cables and other equipment. Our local exchange carrier networks also include central offices and remote site assets. A substantial portion of our equipment operates with licensed software. As of December 31, 2016, we maintained approximately 419 thousand miles of copper plant and approximately 98 thousand miles of fiber-optic plant in our local exchange networks. We also maintain separate networks in connection with providing fiber transport and CLEC services.

We continue to enhance and expand our network by deploying broadband-enabled technologies to provide additional capacity to our customers. Rapid and significant changes in technology are expected to continue in the telecommunications industry. Our future success will depend, in part, on our ability to anticipate and adapt to changes in customer demands and technology. In particular, we anticipate that continued increases in broadband usage by our customers will require us to make significant capital expenditures to increase network capacity or to implement network management practices to alleviate network capacity shortages. The FCC's definition of "broadband service" could create additional requirements for higher capital spending to address marketing and competitive issues. Any such additional expenditures could adversely impact our results of operations and financial condition.

Similarly, we continue to take steps to simplify and modernize our network. To attain our objectives, we plan to continue to undertake several complex projects that we expect will be costly and take several years to complete. The costs of these projects could increase materially if we conclude that we need to replace any or all of our legacy systems.

Like other large telecommunications companies, we are a constant target of cyber-attacks of varying degrees, which has caused us to spend increasingly more time and money to deal with increasingly sophisticated attacks. Some of the attacks result in security breaches, and we periodically notify our customers, our employees or the public of these breaches when necessary or appropriate. None of these resulting security breaches to date have materially adversely affected our business, results of operations or financial condition.

We rely on several other communications companies to provide our offerings. We lease a significant portion of our core fiber network from our competitors and other third parties. Many of these leases will lapse in future years. All of our satellite television and wireless voice services are provided by other carriers under agency agreements, and some of our other services are reliant upon reselling arrangements with other carriers. Our future ability to provide services on the terms of our current offerings will depend in part upon our ability to renew or replace these leases, agreements and arrangements on terms substantially similar to those currently in effect.

For additional information regarding our systems, network, cyber risks, capital expenditure requirements and reliance upon third parties, see "Risk Factors," generally, in Item 1A of Part I of this annual report, and, in particular, "Risk Factors—Risks Affecting Our Business" and "Risk Factors—Risks Affecting Our Liquidity and Capital Resources." For more information on our properties, see "Properties" in Item 2 of Part I of this annual report.

Regulation

Overview

As discussed further below, our operations are subject to significant local, state and federal laws and regulations.

We are subject to significant regulation by the FCC, which regulates interstate communications, and state utility commissions, which regulate intrastate communications. These agencies (i) issue rules to protect consumers and promote competition, (ii) set the rates that telecommunication companies charge each other for exchanging traffic and (iii) have traditionally developed and administered support programs designed to subsidize the provision of services to high-cost rural areas. In most states, local voice service, switched and special access services and interconnection services are subject to price regulation, although the extent of regulation varies by type of service and geographic region. In addition, we are required to maintain licenses with the FCC and with state utility commissions. Laws and regulations in many states restrict the manner in which a licensed entity can interact with affiliates, transfer assets, issue debt and engage in other business activities. Many acquisitions and divestitures require approval by the FCC and some state commissions. These agencies typically have the authority to withhold their approval, or to request or impose substantial conditions upon the transacting parties in connection with granting their approvals.

Historically, incumbent local exchange carriers ("ILECs") operated as regulated monopolies having the exclusive right and responsibility to provide local telephone services in their franchised service territories. As we discuss in greater detail below, passage of the Telecommunications Act of 1996, coupled with state legislative and regulatory initiatives and technological change, fundamentally altered the telephone industry by generally reducing the regulation of ILECs and creating a substantial increase in the number of competitors. We are considered an ILEC. The following description discusses some of the major industry regulations that affect our traditional telephone operations, but numerous other regulations not discussed below could also impact us. Some legislation and regulations are currently the subject of judicial, legislative and administrative proceedings which could substantially change the manner in which the telecommunications industry operates and the amount of revenues we receive for our services. Neither the outcome of these proceedings, nor their potential impact on us, can be predicted at this time. For additional information, see "Risk Factors" in Item 1A of Part I of this annual report.

The laws and regulations governing our affairs are quite complex and occasionally in conflict with each other. From time to time, we are fined for failing to meet applicable regulations or service requirements.

Federal Regulation

General

We are required to comply with the Communications Act of 1934. Among other things, this law requires our ILECs to offer various of our legacy services at just and reasonable rates and on non-discriminatory terms. The Telecommunications Act of 1996 materially amended the Communications Act of 1934, primarily to promote competition.

The FCC regulates interstate services we provide, including the special access charges we bill for wholesale network transmission and the interstate access charges that we bill to long-distance companies and other communications companies in connection with the origination and termination of interstate phone calls. Additionally, the FCC regulates a number of aspects of our business related to privacy, homeland security and network infrastructure, including our access to and use of local telephone numbers and our provision of emergency 911 services. The FCC has responsibility for maintaining and administering support programs designed to expand nationwide access to communications services (which are described further below), as well as other programs supporting service to low-income households, schools and libraries, and rural health care providers. Changes in the composition of the five members of the FCC or its Chairman can have significant impacts on the regulation of our business.

In recent years, our operations and those of other telecommunications carriers have been further impacted by legislation and regulation imposing additional obligations on us, particularly with regards to providing voice and broadband service, bolstering homeland security, increasing disaster recovery requirements, minimizing environmental impacts and enhancing privacy. These laws include the Communications Assistance for Law Enforcement Act, and laws governing local telephone number portability and customer proprietary network information requirements. In addition, the FCC has heightened its focus on the reliability of emergency 911 services. The FCC has imposed fines on us and other companies for 911 outages and has adopted new compliance requirements for providing 911 service. We are incurring capital and operating expenses designed to comply with the FCC's new requirements and minimize future outages. All of these laws and regulations may cause us to incur additional costs and could impact our ability to compete effectively against companies not subject to the same regulations.

Over the past several years, the FCC has taken various actions and initiated certain proceedings designed to comprehensively evaluate the proper regulation of the provisions of data services to businesses. As part of its evaluation, the FCC has reviewed the rates, terms and conditions under which these services are provided. The FCC's proceedings remain pending, and their ultimate impact on us is currently unknown.

In 2015, the FCC issued an order regulating the manner in which ILECs can discontinue or reduce certain copper-based services. This order requires ILECs to provide prior notice to certain customers of their proposed change in services, and in certain cases to provide replacement offerings on reasonably comparable terms and conditions. We expect that this order will limit our flexibility to react to changing conditions in the communications industry.

Intercarrier Compensation and Universal Service

For decades, the FCC has regularly considered various intercarrier compensation reforms, generally with a goal to create a uniform mechanism to be used by the entire telecommunications industry for payments between carriers originating, terminating, or carrying telecommunications traffic. The FCC has also traditionally administered support programs designed to promote the deployment of voice and broadband services in high-cost rural areas of the country.

In October 2011, the FCC adopted the Connect America and Intercarrier Compensation Reform order ("the 2011 order"), intended to reform the existing regulatory regime to recognize ongoing shifts to new technologies, including VoIP, and to re-direct universal service funding to foster nationwide broadband coverage. The 2011 order provides for a multi-year transition as terminating intercarrier compensation charges are reduced, universal service funding is explicitly targeted to broadband deployment, and line charges paid by end user customers are increased. These changes have increased the pace of reductions in the amount of switched access revenues related to our wholesale services, while creating opportunities for increased federal USF support and retail revenue funding.

In late 2011, numerous parties filed a petition for reconsideration with the FCC seeking numerous revisions to the 2011 order. Future judicial challenges to the 2011 order are also possible, which could alter or delay the FCC's proposed changes. In addition, based on the outcome of the FCC proceedings, various state commissions may consider changes to their universal service funds or intrastate access rates. Rulemaking designed to implement the order is not complete, and several FCC proceedings relating to the 2011 order remain pending. For these and other reasons, we cannot predict the ultimate impact of these proceedings at this time.

As a result of the 2011 order, a new Universal Service program was created to deploy broadband to unserved and underserved rural areas utilizing the Connect America Fund or "CAF". The CAF substantially replaces interstate USF funding that we previously utilized to support voice services in high-cost rural markets. There are two phases to the CAF program, CAF Phase 1, a one-time broadband grant program, and CAF Phase 2, which is a multi-year recurring subsidy program for more extensive broadband deployment in price-cap ILEC territories.

In 2015, CenturyLink accepted CAF funding from the FCC of approximately \$500 million per year for six years to fund the deployment of voice and broadband capable infrastructure for approximately 1.2 million rural households and businesses in 33 states under the CAF Phase 2 high-cost support program. Of these amounts, approximately \$150 million is attributable to our service area, to provide service to approximately 0.3 million rural households and businesses in 13 states of the 14 states in which we are an ILEC. The funding from the CAF Phase 2 support program in these 13 states has substantially replaced the funding from the interstate USF high-cost program that we previously utilized to support voice services in high-cost rural markets in these 13 states. In late 2015, we began receiving these support payments from the FCC under the new CAF Phase 2 support program, which included (i) monthly support payments at a higher rate than under the interstate USF support program and (ii) a substantial one-time transitional payment designed to align the prior USF payments with the new CAF Phase 2 payments for the full year 2015. For additional information on the payments we have thus far received under this program, see "Management's Discussion and Analysis of Financial Conditions and Results of Operations" in Item 7 of Part II of this annual report.

As a result of accepting CAF Phase 2 support payments for 13 states, we will be obligated to make substantial capital expenditures to build infrastructure by certain specified milestone deadlines. Future funding is contingent upon our compliance with these infrastructure buildout commitments and certain other service requirements, including certain minimum upload and download transmission speed requirements. In addition, if we are not in compliance with FCC measures at the end of the six-year CAF Phase 2 period, we will have 12 months to attain full compliance. If we are not in full compliance after the additional 12 months, we would incur a penalty equal to 1.89 times the average amount of support per location received in the state over the six-year term, plus a potential penalty of 10% of the total CAF Phase 2 support over the six-year term for the state. For information on the risks associated with participating in this program, see "Risk Factors—Risks Relating to Legal and Regulatory Matters" in Item 1A of Part I of this annual report.

For additional information about the potential financial impact of the CAF Phase 2 program, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II of this annual report.

We received approximately \$206 million, \$223 million and \$135 million of revenues from federal and state universal service support programs for the years ended December 31, 2016, 2015 and 2014, respectively. Such amounts represented approximately 2.3% of our 2016, 2.5% of our 2015 and 1.5% of our 2014 total operating revenues.

Broadband Regulation

In February 2015, the FCC adopted new regulations that regulate Internet services as a public utility under Title II of the Communications Act of 1934. In 2016, that order was upheld by a court of appeals. We anticipate that these regulations and any related rules may be reviewed by Congress. In addition, the newly-constituted FCC may reconsider these regulations. At this time, we cannot estimate the impact this may have on our business.

In 2015, the FCC adopted a broadband standard of 25 megabits per second download speed and 3 megabits per second of upload speed. At this time, we are not aware of any regulatory mandates requiring us to deploy this target speed. The new target is simply a benchmark by which the FCC will evaluate broadband deployment progress in the future. However, the FCC could attempt to utilize this broadband speed target in future regulatory proceedings, and our failure to attain these speeds in certain markets could place us at a marketing disadvantage.

State Regulation

In recent years, most states have reduced their regulation of ILECs. Nonetheless, state regulatory commissions generally continue to regulate local service rates, intrastate access charges, state universal service funds and in some cases service quality. We are generally regulated under various forms of alternative regulation that typically limit our ability to increase rates for stand-alone, basic local voice service, but relieve us from the requirement to meet certain earnings tests. In a number of states, we have gained pricing freedom for the majority of retail services other than stand-alone basic consumer voice service. In most of the states in which we operate, we have gained pricing flexibility for certain enhanced calling services, such as caller identification and for bundled services that also include local voice service.

Under state law, we are typically governed by laws and regulations that (i) regulate the purchase and sale of ILECs, (ii) prescribe certain reporting requirements, (iii) require ILECs to provide service under publicly-filed tariffs setting forth the terms, conditions and prices of regulated services, (iv) limit ILECs' ability to borrow and pledge their assets, (v) regulate transactions between ILECs and their affiliates and (vi) impose various other service standards.

Unlike many of our competitors, as an ILEC we generally face "carrier of last resort" obligations which include an ongoing requirement to provide service to all prospective and current customers in our service area who request service and are willing to pay rates prescribed in our tariffs. In certain situations, this may constitute a competitive disadvantage to us if competitors can choose to focus on low-cost profitable customers and withhold service from high-cost unprofitable customers. In addition, strict adherence to carrier-of-last-resort requirements may force us to construct facilities with a low likelihood of attractive economic return.

We operate in states where traditional cost recovery mechanisms, including rate structures, are under evaluation or have been modified. As laws and regulations change, there can be no assurance that these mechanisms will continue to provide us with any cost recovery.

For several years, we have faced various carrier complaints, legislation or other investigations regarding our intrastate switched access rates in several of our states. The outcomes of these disputes cannot be determined at this time. If we are required to reduce our intrastate switched access rates as a result of any of these disputes or state initiatives, we will seek to recover displaced switched access revenues from state universal service funds or other services. However, the amount of such recovery, particularly from residential customers, is not assured.

Competition

General

Primarily as a result of regulatory and technological changes, competition has been introduced and encouraged in each sector of the communications industry over the past couple of decades. As a result, we currently compete in a rapidly evolving and highly competitive market, and we expect intense competition to continue. In addition to competition from larger national telecommunications providers, we are facing increasing competition from several other sources, including cable and satellite companies, wireless providers, technology companies, broadband providers, device providers, resellers, sales agents and facilities-based providers. Technological advances and regulatory and legislative changes have increased opportunities for a wide range of alternative communications service providers, which in turn have increased competitive pressures on our business. These alternate providers often face fewer regulations and have lower cost structures than we do.

As both residential and business customers increasingly demand high-speed connections for entertainment, communications and productivity, we expect the demands on our network will continue to increase over the next several years. To succeed, we must continue to invest in our networks to ensure that they can deliver competitive services that meet these increasing bandwidth and speed requirements. In addition, network reliability and security are increasingly important competitive factors in our business.

Although our status as an ILEC continues to provide us advantages in providing local services in our local service area, as noted above, we increasingly face significant competition as an increasing number of consumers are willing to substitute cable, wireless and electronic communications for traditional voice telecommunications services. This has led to an increase in the number and type of competitors within our industry, price compression and a decrease in our market share. As a result of this product substitution, we face greater competition in providing local services from wireless providers, resellers and sales agents (including ourselves), social media hosts and broadband service providers, including cable companies. We anticipate this trend will continue, particularly as wireless services providers continue to improve their service offerings and our older legacy customers are replaced over time with younger customers who are less accustomed to using traditional wireline voice services. We also continue to compete with traditional telecommunications providers, such as national carriers, smaller regional providers, CLECs and independent telephone companies.

Some of our competitors are subject to fewer regulations than we are, which affords them competitive advantages against us. Under federal regulations, telecommunication providers are able to interconnect their networks with ours, resell our services or lease separate parts of our network in order to provide competitive services. Generally, we have been required to provide these functions and services at wholesale rates to our competitors, which allow our competitors to sell their services at lower prices. However, these rules have been and continue to be reviewed by state and federal regulators. In addition, wireless and broadband service providers generally are subject to fewer regulations, which may allow them to operate with lower costs than we are able to operate. For additional discussion of regulations affecting our business, see "Regulation" above.

As discussed below, competition for many of our services is based in part on bundled offerings. We believe our customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. As such, we continue to focus on expanding and improving our bundled offerings.

Additional information about competitive pressures is located (i) under the heading "Risk Factors—Risks Affecting Our Business" in Item 1A of Part I of this annual report and (ii) in the discussion immediately below, which contains more specific information on how these trends in competition have impacted our services.

Strategic Services

With respect to providing our strategic services, competition is based on price, bandwidth, quality and speed of service, promotions and bundled offerings. Wireless carriers' latest generation technologies are allowing them to more directly compete with our strategic services. In providing broadband services, we compete primarily with cable companies, wireless providers and other broadband service providers and competition is primarily based on price, bandwidth and service. We face competition in Ethernet based services in the wholesale market from cable companies and fiber based providers. In reselling DIRECTV video services, we compete primarily with cable and other satellite companies as well as other sales agents and resellers. Competition here is based on price, content and quality.

The market for wireless services is highly competitive. We market and sell wireless services to customers who are buying these services as part of a bundle with one or more of our other services. In reselling Verizon Wireless services, we compete with national and regional carriers as well as other sales agents and resellers. Competition for our wireless services is based on the coverage area, price, services offered, features, handsets, technical quality and customer service.

Although we are experiencing intense competition in these markets, we believe we are favorably positioned due to our strong presence in our local service area. Many of our competitors for these strategic services are not subject to the same regulatory requirements as we are and therefore they are able to avoid significant regulatory costs and obligations. Throughout each of our competitive services, we continue to focus on expanding and improving our bundled offerings.

Legacy Services

The market for legacy services is highly competitive and is based primarily on pricing, packaging of services and features, quality of service and meeting customer care needs. We believe these customers value the convenience of, and price discounts associated with, receiving multiple services through a single company. Within the telecommunications industry, these services may include telephone, wireless, video and Internet access. Accordingly, we and our competitors continue to develop and deploy more innovative product bundling, enhanced features and combined billing options in an effort to retain and gain customers. While we rely on reseller or sales agency arrangements to provide some of our bundled services, some of our competitors are able to provide all of their bundled services directly, which may provide them a competitive advantage.

Our resale and UNE customers are experiencing the same competition with CLECs, for local services customers as we are, as discussed above. We also compete with some of our own customers that are deploying their own networks to provide customers with local services. By doing so, these competitors take traffic off of our network.

Significant competitive factors in the local telephone industry include pricing, packaging of services and features, quality and convenience of service and meeting customer needs such as simplified billing and timely response to services calls.

In providing private line services, we compete primarily with national telecommunications providers, such as AT&T Inc. and Verizon Communications Inc. Additionally, we are experiencing increased competition for private line services from cable companies. Competition for private line services is based primarily on price, as well as network reach, bandwidth, quality, reliability and customer service.

We provide access services to other telecommunications providers to connect their customers and their networks to our network so that they can provide local and long-distance voice, transport, data, wireless and Internet services. We face significant competition for access services from CLECs, cable companies, resellers and wireless service providers. Our access service customers face competitive pressures in their businesses that are similar to those we face with respect to strategic and legacy services. To the extent that these competitive pressures result in decreased demand for their services, demand for our access services also declines.

Wireless telephone services increasingly constitute a significant source of competition with ILEC services, especially since wireless carriers have begun to compete effectively on the basis of price with more traditional telephone services. As a result, some customers have chosen to completely forego use of traditional wireline phone service and instead rely solely on wireless service for voice services. This trend is more pronounced among consumer customers, which comprise 63% of our access line customers. We anticipate this trend will continue, particularly if wireless service providers continue to expand their coverage areas, reduce their rates, improve the quality of their services and offer enhanced new services. Substantially all of our access line customers are currently capable of receiving wireless services from at least one competitive service provider. Technological and regulatory developments in wireless services, personal communications services, digital microwave, satellite, coaxial cable, fiber optics, local multipoint distribution services, WiFi and other wired and wireless technologies are expected to further permit the development of alternatives to traditional landline services. Moreover, the growing prevalence of electronic mail, text messaging, social networking and similar digital communications continues to reduce the demand for traditional landline voice services.

Improvements in the quality of VoIP service have led several cable, Internet, data and other communications companies, as well as start-up companies, to substantially increase their offerings of VoIP service to business and residential customers. VoIP providers frequently offer features that cannot readily be provided by traditional ILECs and may price their services at or below those prices currently charged for traditional local and long-distance telephone services for several reasons, including lower operating costs and regulatory advantages. Although over the past several years the FCC has increasingly subjected portions of VoIP operations to federal regulation, VoIP services currently operate under fewer regulatory constraints than local exchange carriers services. For all these reasons, we cannot assure that VoIP providers will not successfully compete for our customers.

In providing other legacy services, such as traditional services and ISDN, we compete primarily with national telecommunications providers and cable companies. Competition for these other legacy services is based primarily on price and bundled offerings.

Environmental Compliance

From time to time we may incur environmental compliance and remediation expenses, mainly resulting from owning or operating of vehicle fleets or power supplies for our communications equipment. Although we cannot assess with certainty the impact of any future compliance and remediation obligations or provide you with any assurances regarding the ultimate impact thereof, we do not currently believe that future environmental compliance and remediation expenditures will have a material adverse effect on our financial condition or results of operations. For additional information, see "Risk Factors—Other Risks" in Item 1A of Part I of this annual report and Note 15—Commitments and Contingencies included in Item 8 of Part II of this annual report.

Seasonality

Overall, our business is not materially impacted by seasonality. Our network-related operating expenses are, however, generally higher in the second and third quarters of the year. From time to time, weather related problems have resulted in increased costs to repair our network and respond to service calls in some of our markets. The amount and timing of these costs are subject to the weather patterns of any given year.

Employees

At December 31, 2016, we had approximately 22,000 employees, of which approximately 11,000 are members of either the Communications Workers of America ("CWA") or the International Brotherhood of Electrical Workers ("IBEW"). See the discussion of risks relating to our labor relations in "Risk Factors—Risks Affecting Our Business" in Item 1A of Part I of this annual report and see Note 17—Labor Union Contracts to our consolidated financial statements in Item 8 of Part II of this annual report, for additional information on the timing of certain contract expirations.

Over the last several years, we have reduced our workforce primarily due to (i) increased competitive pressures, (ii) the loss of access lines and related legacy revenues, (iii) cost reduction initiatives, (iv) process improvements through automation and (v) integration efforts from CenturyLink's acquisition of us.

Website Access and Important Investor Information

Our website is the same as that of our ultimate parent company, CenturyLink, which is www.centurylink.com. We routinely post important investor information in the "Investor Relations" section of our website at ir.centurylink.com. The information contained on, or that may be accessed through, our website is not part of this annual report. You may obtain free electronic copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports in the "Investor Relations" section of our website (ir.centurylink.com) under the heading "SEC Filings." These reports are available on our website as soon as reasonably practicable after we electronically file them with the Securities and Exchange Commission ("SEC").

We have adopted CenturyLink's written code of conduct that serves as the code of ethics applicable to our directors, officers and employees, in accordance with applicable laws and rules promulgated by the SEC and the New York Stock Exchange. In the event that CenturyLink makes any changes (other than by a technical, administrative or non-substantive amendment) to, or provide any waivers from, the provisions of its code of conduct applicable to our directors or executive officers, CenturyLink intends to disclose these events on our website or in a report on Form 8-K filed with the SEC. The code of conduct, as well as copies of CenturyLink's guidelines on significant governance issues and the charters of their key board committees, are also available in the "Corporate Governance" section of our website at www.centurylink.com/Pages/AboutUs/Governance/ or in print to any shareholder who requests them by sending a written request to our Corporate Secretary at CenturyLink, Inc., 100 CenturyLink Drive, Monroe, Louisiana, 71203.

Investors may also read and copy any materials filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. For information on the operation of the Public Reference Room, you are encouraged to call the SEC at 1-800-SEC-0330. For all of our electronic filings, the SEC maintains a website at www.sec.gov that contains reports, proxy statements and other information regarding issuers that file electronically with the SEC.

In connection with filing this annual report, our chief executive officer and chief financial officer made the certifications regarding our financial disclosures required under the Sarbanes-Oxley Act of 2002, and its related regulations.

Special Note Regarding Forward-Looking Statements and Related Matters

This annual report and other documents filed by us under the federal securities law include, and future oral or written statements or press releases by us and our management may include, forward-looking statements about our business, financial condition, operating results and prospects. These statements constitute "forward-looking" statements as defined by, and are subject to the "safe harbor" protections under, the federal securities laws. These statements include, among others:

- forecasts of our anticipated future results of operations or financial position;
- statements concerning the impact of our transactions, investments, product development and other initiatives, including our participation in government programs;
- statements about our liquidity, tax position, tax rates, asset values, contingent liabilities, growth opportunities and growth rates, acquisition and divestiture opportunities, business prospects, regulatory and competitive outlook, investment and expenditure plans, business strategies, capital allocation plans, financing alternatives and sources and pricing plans; and
- other similar statements of our expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts, many of which are highlighted by words such as "may," "would," "could," "should," "plan," "believes," "expects," "anticipates," "estimates," "projects," "intends," "likely," "seeks," "hopes," or variations or similar expressions.

These forward-looking statements are based upon our judgment and assumptions as of the date such statements are made concerning future developments and events, many of which are beyond our control. These forward-looking statements, and the assumptions upon which they are based, (i) are not guarantees of future results, (ii) are inherently speculative and (iii) are subject to a number of risks and uncertainties. Actual events and results may differ materially from those anticipated, estimated, projected or implied by us in those statements if one or more of these risks or uncertainties materialize, or if our underlying assumptions prove incorrect. Factors that could affect actual results include but are not limited to:

- the effects of competition from a wide variety of competitive providers, including decreased demand for our legacy offerings and increased pricing pressures;
- the effects of new, emerging or competing technologies, including those that could make our products less desirable or obsolete;
- the effects of ongoing changes in the regulation of the communications industry, including the outcome of regulatory or judicial proceedings relating to intercarrier compensation, interconnection obligations, access charges, universal service, broadband deployment, data protection and net neutrality;
- our ability to effectively adjust to changes in the communications industry, and changes in the composition of our markets and product mix;
- possible changes in the demand for our products and services, including our ability to effectively respond to increased demand for high-speed broadband service;
- our ability to successfully maintain the quality and profitability of our existing product and service offerings, to provision them successfully to our customers and to introduce new offerings on a timely and cost-effective basis;
- the adverse impact on our business and network from possible equipment failures, service outages, security breaches or similar events impacting our network;
- our ability to generate cash flows sufficient to fund our financial commitments and objectives, including our capital expenditures, operating costs, dividends, pension and other benefits payments, and debt repayments;
- changes in our operating plans, corporate strategies, dividend payment plans or other capital allocation plans, whether based upon changes in our cash flows, cash requirements, financial performance, financial position, market conditions or otherwise;
- our ability to effectively retain and hire key personnel and to successfully negotiate collective bargaining agreements on reasonable terms without work stoppages;
- CenturyLink's ability to successfully complete its pending acquisition of Level 3 and to timely realize the anticipated benefits of the transaction;

- increases in the costs of CenturyLink's pension, health, post-employment or other benefits, including those caused by changes in markets, interest rates, mortality rates, demographics or regulations, which could, by negatively impacting CenturyLink, affect our business and liquidity;
- adverse changes in our access to credit markets on favorable terms, whether caused by changes in our financial position, lower debt credit ratings, unstable markets or otherwise;
- our ability to maintain favorable relations with our key business partners, suppliers, vendors, landlords and financial institutions;
- our ability to effectively manage our network buildout project and our other expansion opportunities;
- our ability to collect our receivables from financially troubled customers;
- any adverse developments in legal or regulatory proceedings involving us or our affiliates (including CenturyLink);
- changes in tax, communications, pension, healthcare or other laws or regulations, in governmental support programs, or in general government funding levels;
- the effects of changes in accounting policies or practices, including potential future impairment charges;
- the effects of adverse weather or other natural or man-made disasters;
- the effects of more general factors such as changes in interest rates, in operating costs, in general market, labor, economic or geo-political conditions, or in public policy; and
- other risks referenced in "Risk Factors" in Item 1A or elsewhere in this annual report or other of our filings with the SEC.

These factors should be considered in connection with any written or oral forward-looking statements that we or persons acting on our behalf may issue. Anticipated events may not occur and our actual results or performance may differ materially from those anticipated, estimated or projected if one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect. Additional factors or risks that we currently deem immaterial, that are not presently known to us or that arise in the future could also cause our actual results to differ materially from our expected results. Given these uncertainties, investors are cautioned not to unduly rely upon our forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements for any reason, whether as a result of new information, future events or developments, changed circumstances, or otherwise. Furthermore, any information about our intentions contained in any of our forward-looking statements reflects our intentions as of the date of such forward-looking statement, and is based upon, among other things, existing regulatory, technological, industry, competitive, economic and market conditions, and our assumptions as of such date. We may change our intentions, strategies or plans at any time and without notice, based upon any changes in such factors, in our assumptions or otherwise.

Investors should also be aware that while we do, at various times, address questions raised by securities analysts, it is against our policy to disclose to them selectively any material non-public information or other confidential information. Accordingly, investors should not assume that we agree with any statement or report issued by an analyst with respect to our past or projected performance. To the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not our responsibility.

Unless otherwise indicated, information contained in this annual report and other documents filed by us under the federal securities laws concerning our views and expectations regarding the communications industry are based on estimates made by us using data from industry sources, and on assumptions made by us based on our management's knowledge and experience in the markets in which we operate and the communications industry generally. You should be aware that we have not independently verified data from industry or other third-party sources and cannot guarantee its accuracy or completeness.

ITEM 1A. RISK FACTORS

The following discussion identifies the most significant risks or uncertainties that could (i) materially and adversely affect our business, financial condition, results of operations, liquidity or prospects or (ii) cause our actual results to differ materially from our anticipated results or other expectations. The following information should be read in conjunction with the other portions of this annual report, including "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II and our consolidated financial statements and related notes in Item 8 of Part II. Please note that the following discussion is not intended to comprehensively list all risks or uncertainties faced by us. Our operations or actual results could also be similarly impacted by additional risks and uncertainties that are not currently known to us, that we currently deem to be immaterial, that arise in the future or that are not specific to us, such as general economic conditions.

Risks Affecting Our Business

We may not be able to compete successfully against current or future competitors.

Each of our offerings to our residential and business customers face increasingly intense competition from a variety of sources under evolving market conditions. We expect these trends will continue. In addition to competition from larger national telecommunications providers, we are facing increasing competition from several other sources, including cable and satellite companies, wireless providers, technology companies, broadband providers, device providers, resellers, sales agents and facilities-based providers using their own networks as well as those leasing parts of our network. In particular, (i) intense competition from wireless and other communications providers has led to a long-term systemic decline in the number of our wireline voice customers, (ii) strong competition from cable companies and others has impacted the growth of our broadband operations and (iii) aggressive competition from a wide range of technology companies and other market entrants has limited the prospects for our cloud computing operations. For more detailed information, see "Business—Competition" in Item 1 of Part I of this annual report.

Some of our current and potential competitors (i) offer products or services that are substitutes for our legacy wireline voice services, including wireless voice and non-voice communication services, (ii) offer a more comprehensive range of communications products and services, (iii) offer products or services with features that we cannot readily match in some or all of our markets, (iv) offer shorter installation intervals, allowing customers to begin receiving services sooner after ordering, (v) have greater marketing, engineering, research, development, technical, financial and other resources, (vi) have larger or more diverse networks with greater transmission capacity, (vii) conduct operations or raise capital at a lower cost than us, (viii) are subject to less regulation, which we believe enables such competitors to operate more flexibly than us with respect to certain offerings, (ix) offer services nationally or internationally to a larger geographic area or larger base of customers, (x) have substantially stronger brand names, which may provide them with greater pricing power than ours, or (xi) have larger operations than ours, which may enable them to compete more successfully in recruiting top talent. Consequently, these competitors may be better equipped to provide more attractive offerings, to charge lower prices for their products and services, to develop and expand their communications and network infrastructure more quickly, to adapt more swiftly to changes in technologies or customer requirements, to devote greater resources to the marketing and sale of their products and services, to provide more comprehensive customer service, to provide greater resources to research and development initiatives and to take advantage of business or other opportunities more readily. In the past, several of our competitors and their operations have grown through acquisitions and aggressive product development. The continued growth of our competitors could further enhance their competitive positions.

Competition could adversely impact us in several ways, including (i) the loss of customers and market share, (ii) the possibility of customers terminating or reducing their usage of our services or shifting to less profitable services, (iii) reduced traffic on our networks, (iv) our need to expend substantial time or money on new capital improvement projects, (v) our need to lower prices or increase marketing expenses to remain competitive and (vi) our inability to diversify by successfully offering new products or services.

We are continually taking steps to respond to these competitive pressures, but these efforts may not be successful. Our operating results and financial condition would be adversely affected if these initiatives are unsuccessful or insufficient. If this occurred, our ability to pay our debt and other obligations and to re-invest in the business would also be adversely affected.

Rapid technological changes could significantly impact our competitive and financial position.

The communications industry has been and continues to be impacted by significant technological changes, which in general are enhancing wireless services and enabling a broader array of companies to compete with us. Many of these technological changes are (i) enabling customers to reduce or bypass use of our networks, (ii) displacing or reducing demand for our services, or (iii) enabling the development of competitive products or services. For years, improvements in wireless and Internet-based voice communications technologies have reduced demand for our legacy voice services, and these trends continue. More recently, continuous improvements in wireless data technologies have enabled wireless carriers to offer competing products, and we expect this trend to continue as technological advances enable these carriers to carry greater amounts of data faster and with less latency. Technological advancements have also permitted cable companies and other of our competitors to deliver faster average broadband transmission speeds than ours. To enhance the competitiveness of certain of our services, we will likely be required to spend additional capital to install more fiber optic cable or to augment the capabilities of our copper-based services.

We may not be able to accurately predict or respond to changes in technology or industry standards, or to the introduction of newly-offered services. Any of these developments could make some or all of our offerings less desirable or even obsolete, which would place downward pressure on our market share and revenues. These developments could also require us to (i) expend capital or other resources in excess of currently contemplated levels, (ii) forego the development or provision of products or services that others can provide more efficiently, or (iii) make other changes to our operating plans, corporate strategies or capital allocation plans, any of which could be contrary to the expectations of our security holders or could adversely impact our operations. Our inability to effectively respond to technological changes could adversely affect our operating results and financial condition, as well as our ability to service debt and fund other commitments or initiatives.

Even if we succeed in adapting to changes in technology or industry standards by developing new products or services, there is no assurance that the new products or services would have a positive impact on our profit margins or financial performance.

In addition to introducing new technologies and offerings, we may need, from time to time, to phase out outdated and unprofitable technologies and services. If we are unable to do so on a cost-effective basis, we could experience reduced profits.

For additional information on the risks of increased expenditures, see "Risk Factors—Risks Affecting our Liquidity and Capital Resources—Our business requires us to incur substantial capital and operating expenses, which reduces our available free cash flow."

Our legacy services continue to experience declining revenues, and our efforts to offset these declines may not be successful.

Primarily as a result of the competitive and technological changes discussed above, we have experienced a prolonged systemic decline in our local voice, long-distance voice, network access, private line and other legacy revenues. Consequently, we have experienced lower consolidated revenues in each of our last several years.

We have taken a variety of steps to counter these declines in our legacy services revenues, including:

- an increased focus on selling a broader range of higher-growth strategic services, which are described in detail elsewhere in this annual report;
- an increased focus on serving a broader range of business, governmental and wholesale customers; and
- greater use of service bundles.

However, for the reasons described elsewhere in this annual report, most of our strategic services generate lower profit margins than our legacy services, and some can be expected to experience slowing growth as increasing numbers of our existing or potential customers subscribe to our newer strategic product and service offerings. Moreover, we cannot assure you that the revenues generated from our new offerings will offset revenue losses associated with our legacy services. In addition, our reliance on third parties to provide certain of these strategic services could constrain our flexibility, as described further below.

Our failure to develop new products and services could adversely impact our competitive position.

In order to compete effectively and respond to the changing communication needs of our customers, we continuously develop, test and introduce new products and services. Our ability to successfully introduce new product or service offerings on a timely and cost-effective basis could be constrained by a range of factors, including network limitations, support system limitations, limited capital, an inability to attract key personnel with the necessary skills, intellectual property constraints, testing delays, technological limits or an inability to act as quickly or efficiently as other competitors. In addition, new product or service offerings may not be widely accepted by our customers. Our business could be materially adversely affected if we are unable to timely and successfully develop and introduce new products or services.

Our failure to continuously develop effective service support systems could adversely impact our competitive position.

For many of our services, we can effectively compete only if we can quickly and efficiently (i) quote and accept customer orders, (ii) provision and initiate ordered services, (iii) provide customers with adequate means to manage their services and (iv) accurately bill for our services. Development of systems designed to support these tasks is a significant undertaking that continuously requires our personnel and third-party vendors to adjust to changes in our offerings and customers' preferences, to eliminate inconsistencies between the practices of our legacy operations and newly-acquired operations, to eliminate older support systems that are costly or obsolete, to develop uniform practices and procedures, and to automate them as much as possible. Our failure to continuously develop service support systems that are satisfactory to our current and potential customers could adversely impact our competitive position.

We may not be able to successfully adjust to changes in our industry, our markets and our product mix.

Ongoing changes in the communications industry have fundamentally changed consumers' communications expectations and requirements. In response to these changes, we have substantially altered our product and service offerings through acquisitions and internal product development. Many of these changes have placed a higher premium on sales, marketing and product development functions, and necessitated ongoing changes in our processes and operating protocols, as well as periodic reorganizations of our sales and leadership teams. In addition, we now offer a more complex range of products and services, operate larger and more complex networks and serve a much larger and more diverse set of customers. Consequently, we now face greater challenges in effectively managing and administering our operations and allocating capital and other resources to our various offerings. For all these reasons, we cannot assure you that our efforts to adjust to these changes will be timely or successful.

We could be harmed by security breaches, damages or other significant disruptions or failures of our networks, information technology infrastructure or related systems, or of those we operate for certain of our customers.

We are materially reliant upon our networks, information technology infrastructure and related technology systems (including our billing and provisioning systems) to provide products and services to our customers and to manage our operations and affairs. We face the risk, as does any company, of a security breach or significant disruption of our information technology infrastructure and related systems. As a communications company that transmits large amounts of information over communications networks, we face an added risk that a security breach or other significant disruption of our public networks or information technology infrastructure and related systems that we develop, install, operate and maintain for certain of our business customers (which includes our wholesale and governmental customers) could lead to material interruptions or curtailments of service. Moreover, in connection with processing and storing sensitive and confidential customer data, we face a heightened risk that a security breach or disruption could result in unauthorized access to our customers' proprietary information on our public networks or internal systems or the systems that we operate and maintain for certain of our customers.

We strive to maintain the security and integrity of information and systems under our control, and maintain contingency plans in the event of security breaches or other system disruptions. Nonetheless, we cannot assure you that our security efforts and measures will prevent unauthorized access to our systems, loss or destruction of data (including confidential customer information), account takeovers, unavailability of service, computer viruses, malware, distributed denial-of-service attacks, or other forms of cyber-attacks or similar events. These threats may derive from human error, hardware or software vulnerabilities, fraud, malice or sabotage on the part of employees, third parties or foreign nations, or could result from aging equipment or accidental technological failure. These threats may also arise from failure or breaches of systems owned, operated or controlled by other unaffiliated operators to the extent we rely on such other systems to deliver services to our customers.

Similar to other large telecommunications companies, we are a constant target of cyber-attacks of varying degrees. Although some of these attacks have resulted in security breaches, to date, none of these breaches have resulted in a material adverse effect on our operating results or financial condition. You should be aware, however, that defenses against cyber-attacks currently available to U.S. companies are unlikely to prevent intrusions by a highly-determined, highly-sophisticated hacker. Consequently, you should assume that we will be unable to implement security barriers or other preventative measures that repel all future cyber-attacks. Any such future security breaches or disruptions could materially adversely affect our business, results of operations or financial condition, especially in light of the growing frequency, scope and well-documented sophistication of cyber-attacks and intrusions.

Although CenturyLink maintains insurance coverage that may, subject to policy terms and conditions (including self-insured deductibles, coverage restrictions and monetary coverage caps), cover certain aspects of our cyber risks, such insurance coverage may be unavailable or insufficient to cover our losses.

Additional risks to our network, infrastructure and related systems include:

- power losses or physical damage, whether caused by fire, flood, adverse weather conditions, terrorism, sabotage, vandalism or otherwise;
- capacity or system configuration limitations, including those resulting from changes in our customer's usage patterns, the introduction of new technologies or products, or incompatibilities between our newer and older systems;
- theft or failure of our equipment;
- software or hardware obsolescence, defects or malfunctions;
- deficiencies in our processes or controls;

- our inability to hire and retain personnel with the requisite skills to adequately maintain our systems;
- programming, processing and other human error; and
- service failures of our third-party vendors and other disruptions that are beyond our control.

Due to these factors, from time to time in the ordinary course of our business we experience disruptions in our service, and could experience more significant disruptions in the future.

Disruptions, security breaches and other significant failures of the above-described networks and systems could:

- disrupt the proper functioning of these networks and systems, which could in turn disrupt (i) our operational or administrative functions or (ii) the operations of certain of our customers who rely upon us to provide services critical to their operations;
- result in the unauthorized access to, and destruction, loss, theft, misappropriation or release of proprietary, confidential, sensitive, classified or otherwise valuable information of ours, our customers or our customers' end users, including trade secrets, which others could use for competitive, disruptive, destructive or otherwise harmful purposes and outcomes;
- require significant management attention or financial resources to remedy the resulting damages or to change our systems, including expenses to repair systems, add new personnel or develop additional protective systems;
- require us to notify customers, regulatory agencies or the public of data breaches;
- require us to provide credits for future service under certain service level commitments we have provided contractually to our customers or to offer expensive incentives to retain customers;
- subject us to claims for damages, fines, penalties, termination or other remedies under our customer contracts or service standards set by state regulatory commissions, which in certain cases could exceed our insurance coverage; or
- result in a loss of business, damage our reputation among our customers and the public generally, subject us to additional regulatory scrutiny or expose us to prolonged litigation.

We could experience difficulties in expanding and updating our technical infrastructure.

Our ability to expand and update our systems and information technology infrastructure in response to our growth and changing business needs is important to our ability to maintain and develop attractive product and service offerings. As discussed further under “Business—Network Architecture” in Item 1 of Part I of this annual report, we are currently undertaking several complex, costly and time-consuming projects to simplify and modernize our network, which combines our legacy network and CenturyLink's networks. Unanticipated delays in the completion of these projects may lead to increased project costs or operational inefficiencies. In addition, there may be issues related to our expanded or updated infrastructure that are not identified by our testing processes, and which may only become evident after we have started to fully utilize the redesigned systems. Our failure to modernize and upgrade our technology infrastructure could have adverse consequences, including the delayed implementation of new service offerings, decreased competitiveness of existing service offerings, network instabilities, increased operating or acquisition integration costs, service or billing interruptions, and the diversion of development resources.

Any or all of the foregoing developments could have a negative impact on our business, results of operations, financial condition and cash flows.

Market prices for many of our services have decreased in the past, and any similar price decreases in the future will adversely affect our revenues and margins.

Over the past several years, a range of competitive and technological factors, including robust network construction and intense competition, have lowered market prices for many of our products and services. If these market conditions persist, we may need to continue to reduce prices to retain customers and revenue. If future price reductions are necessary, we will suffer unless we are able to offset these reductions by reducing our operating expenses or increasing our sales volumes.

Our future growth potential will depend in part on the continued development and expansion of the Internet.

Our future growth potential will depend in part upon the continued development and expansion of the Internet as a communication medium and marketplace for the distribution of data, video and other products by businesses, consumers and governments. The use of the Internet for these purposes may not grow and expand at the rate anticipated by us or others, or may be restricted by factors outside of our control, including (i) actions by other carriers or governmental authorities that restrict us from delivering traffic over other parties' networks, (ii) changes in regulations, (iii) technological stagnation or (iv) changes in consumers' preferences or data usage.

If we fail to hire and retain qualified executives, managers and employees, our operating results could be harmed.

Our future success depends on our ability to identify, hire, train and retain executives, managers and employees with technological, engineering, product development, operational, provisioning, marketing, sales, administrative, managerial and other key skills. There is a shortage of qualified personnel in several of these fields. We compete with several other companies for this limited pool of potential employees. As our industry increasingly becomes more competitive, it could become especially difficult to attract and retain top personnel with skills in high demand. Our workforce reduction initiatives over the past couple of years have further increased the challenges of attracting and retaining talented individuals. In addition, subject to limited exceptions, none of our executives or domestic employees have long-term employment agreements. For all these reasons, there is no assurance that our efforts to recruit and retain qualified personnel will be successful.

Increases in broadband usage may cause network capacity limitations, resulting in service disruptions, reduced capacity or slower transmission speeds for our customers.

Video streaming services, gaming and peer-to-peer file sharing applications use significantly more bandwidth than other Internet activity such as web browsing and email. As use of these newer services continues to grow, our broadband customers will likely use much more bandwidth than in the past. If this occurs, we could be required to make significant capital expenditures to increase network capacity in order to avoid service disruptions, service degradation or slower transmission speeds for our customers. Alternatively, we could choose to implement network management practices to reduce the network capacity available to bandwidth-intensive activities during certain times in market areas experiencing congestion, which could negatively affect our ability to retain and attract customers in affected markets. While we believe demand for these services may drive broadband customers to pay for faster broadband speeds, competitive or regulatory constraints may preclude us from recovering the costs of the necessary network investments. This could result in an adverse impact to our operating margins, results of operations, financial condition and cash flows.

We have been accused of infringing the intellectual property rights of others and will likely face similar accusations in the future, which could subject us to costly and time-consuming litigation or require us to seek third-party licenses.

Like other communications companies, we have increasingly in recent years received a number of notices from third parties or have been named in lawsuits filed by third parties claiming we have infringed or are infringing upon their intellectual property rights. We are currently responding to several of these notices and claims and expect this industry-wide trend will continue. Responding to these claims may require us to expend significant time and money defending our use of the applicable technology, and divert management's time and resources away from other business. In certain instances, we may be required to enter into licensing agreements requiring royalty payments. In the case of litigation, we could be required to pay damages or cease using the applicable technology. If we are required to take one or more of these actions, our profit margins may decline or our operations could be impaired. In addition, in responding to these claims, we may be required to stop selling or redesign one or more of our products or services, which could significantly and adversely affect our business, results of operations, financial condition and cash flows.

Similarly, from time to time, we may need to obtain the right to use certain patents or other intellectual property from third parties to be able to offer new products and services. If we cannot license or otherwise obtain rights to use any required technology from a third party on reasonable terms, our ability to offer new products and services may be prohibited, restricted, made more costly or delayed.

Our operations, financial performance and liquidity are materially reliant on various third parties.

Reliance on other communications providers. To offer voice or data services in certain of our markets, we must either lease network capacity from, or interconnect our network with the infrastructure of, other communications carriers who typically compete against us in those markets. Our reliance on these lease or interconnection arrangements limits our control over the quality of our services and exposes us to the risk that our ability to market our services could be adversely impacted by changes in the plans or properties of the carriers upon which we are reliant. In addition, we are exposed to the risk that the other carriers may be unwilling to continue or renew these arrangements in the future on terms favorable to us, or at all. This risk is heightened when the other carrier is a competitor of ours and may benefit from terminating the agreement. If we lose these arrangements and cannot timely replace them, our ability to provide services to our customers and conduct our business could be materially adversely affected.

Conversely, certain of our operations carry a significant amount of voice or data traffic for other communications providers. Their reliance on our services exposes us to the risk that they may transfer all or a portion of this traffic from our network to networks built, owned or leased by them, thereby reducing our revenues. For additional information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Business Trends" included in Item 7 of Part II of this annual report.

We also rely on reseller and sales agency arrangements with our affiliates and other communications companies to provide some of the services that we offer to our customers, including video services. As a reseller or sales agent, we do not control the availability, retail price, design, function, quality, reliability, customer service or branding of these products and services, nor do we directly control all of the marketing and promotion of these products and services. Similar to the risks described above regarding our reliance upon other carriers, we could be adversely affected if these communication companies fail to maintain competitive products or services, or fail to continue to make them available to us on attractive terms, or at all.

Our operations and financial performance could be adversely affected if our relationships with any of these other communications companies are disrupted or terminated for any other reason, including if such other companies:

- become bankrupt or experience substantial financial difficulties;
- suffer work stoppages or other labor strife;
- challenge our right to receive payments or services under applicable regulations or the terms of our existing contractual arrangements; or
- are otherwise unable or unwilling to make payments or provide services to us.

Reliance on other key suppliers and vendors. We depend on a limited number of suppliers and vendors for equipment and services relating to our network infrastructure. Our local exchange carrier networks consist of central office and remote sites, all with advanced digital switches. If any of these suppliers experience interruptions or other problems delivering or servicing these network components on a timely basis, our operations could suffer significantly. To the extent that proprietary technology of a supplier is an integral component of our network, we may have limited flexibility to purchase key network components from alternative suppliers and may be adversely affected if third parties assert patent infringement claims against our suppliers or us. We also rely on a limited number of software vendors to support our business management systems and contractors to assist us in connection with our network construction and maintenance activities. In the event it becomes necessary to seek alternative suppliers and vendors, we may be unable to obtain satisfactory replacement supplies, services or utilities on economically attractive terms, on a timely basis, or at all, which could increase costs or cause disruptions in our services.

Reliance on governmental payments . We receive a material amount of revenue or government subsidies under various government programs, which are further described under the heading "Risk Factors—Risks Relating to Legal and Regulatory Matters." We also provide products or services to various federal, state and local agencies. Our failure to comply with complex governmental regulations and laws applicable to these programs, or the terms of our governmental contracts, could result in us being suspended or disbarred from future governmental programs or contracts for a significant period of time. Moreover, certain governmental agencies frequently reserve the right to terminate their contracts for convenience. If our governmental contracts are terminated for any reason, or if we are suspended or debarred from governmental programs or contracts, our results of operations and financial condition could be materially adversely affected.

If we fail to extend or renegotiate our collective bargaining agreements with our labor unions as they expire from time to time, or if our unionized employees were to engage in a strike or other work stoppage, our business and operating results could be materially harmed.

As of December 31, 2016, approximately 50% of our employees were members of various bargaining units represented by the Communications Workers of America or the International Brotherhood of Electrical Workers. From time to time, our labor agreements with unions expire. Approximately 11,000, or 50%, of our employees are subject to collective bargaining agreements that are scheduled to expire October 7, 2017. Although we typically are able to negotiate new bargaining agreements, we cannot predict the outcome of our future negotiations of these agreements. We may be unable to reach new agreements, and union employees may engage in strikes, work slowdowns or other labor actions, which could materially disrupt our ability to provide services and result in increased cost to us. In addition, new labor agreements may impose significant new costs on us, which could impair our financial condition or results of operations in the future. To the extent they contain benefit provisions, these agreements may also limit our flexibility to change benefits in response to industry or competitive changes. In particular, post-employment benefits provided under these agreements could cause us to incur costs not faced by many of our competitors, which could ultimately hinder our competitive position.

Portions of our property, plant and equipment are located on property owned by third parties.

We rely on rights-of-way, colocation agreements and other authorizations granted by governmental bodies, railway companies, carriers and other third parties to locate our cable, conduit and other network equipment on or under their respective properties. A significant number of these authorizations are scheduled to lapse over the next five to ten years, unless we are able to extend or renew them. Our operations could be adversely affected if any of these authorizations terminate or lapse, or if the landowner requests price increases.

Over the past few years, certain utilities, cooperatives and municipalities in certain of the states in which we operate have requested significant rate increases for attaching our plant to their facilities. To the extent that these entities are successful in increasing the amount we pay for these attachments, our future operating costs will increase.

Our business customers may seek to shift risk to us.

We furnish to and receive from our business customers indemnities relating to damages caused or sustained by us in connection with certain of our operations. Our customers' changing views on risk allocation could cause us to accept greater risk to win new business or could result in us losing business if we are not prepared to take such risks. To the extent that we accept such additional risk, and seek to insure against it, our insurance premiums could rise.

Unfavorable general economic conditions could negatively impact our operating results and financial condition.

Unfavorable general economic conditions, including unstable economic and credit markets, could negatively affect our business. Worldwide economic growth has been sluggish since 2008, and many experts believe that a confluence of global factors may result in a prolonged period of economic stagnation, slow growth or economic uncertainty. While it is difficult to predict the ultimate impact of these general economic conditions, they could adversely affect demand for some of our products and services and could cause customers to shift to lower priced products and services or to delay or forego purchases of our products and services. These conditions impact, in particular, our ability to sell discretionary products or services to business customers that are under pressure to reduce costs or to governmental customers that have suffered substantial budget cuts in recent years. Any one or more of these circumstances could continue to depress our revenues. Also, our customers may encounter financial hardships or may not be able to obtain adequate access to credit, which could negatively impact their ability to make timely payments to us. In addition, as discussed further below, unstable economic and credit markets may preclude us from refinancing maturing debt at terms that are as favorable as those from which we previously benefited, at terms that are acceptable to us, or at all. For these reasons, among others, if current economic conditions persist or decline, our operating results, financial condition, and liquidity could be adversely affected.

For additional information about our business and operations, see "Business" in Item 1 of Part I of this annual report.

Risks Relating to CenturyLink's Pending Acquisition of Level 3

We cannot assure you that our ultimate parent company, CenturyLink, will complete its pending acquisition of Level 3 and therefore attain the anticipated benefits of the transaction.

Our ultimate parent company, CenturyLink, expects to attain substantial benefits upon completing its pending acquisition of Level 3, including enhanced scale, cost savings and the receipt of Level 3's net operating loss carry-forwards. Attainment of these benefits is not assured. Moreover, the completion of the Level 3 acquisition is subject to a number of conditions. For these reasons, we cannot assure you that CenturyLink will be able to complete its pending acquisition of Level 3 or attain the anticipated benefits thereof.

The Level 3 acquisition poses various risks to CenturyLink.

CenturyLink expects to incur substantial expenses in connection with completing the acquisition and integrating its operations with Level 3's operations. For a variety of reasons, the integration process may not be successful. Moreover, in connection with the acquisition, CenturyLink will incur and assume a substantial amount of indebtedness, and the agreements that will govern such indebtedness are expected to contain various covenants and other provisions that will impose restrictions on CenturyLink's ability to operate.

CenturyLink's pending acquisition of Level 3 raises other risks.

CenturyLink's pending acquisition of Level 3 and, upon completion thereof, its ownership of Level 3 raise additional risks not described above. For additional information, see CenturyLink's (i) definitive joint proxy statement/prospectus filed with the SEC on February 13, 2017 and (ii) Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 23, 2017.

Risks Relating to Legal and Regulatory Matters

We operate in a highly regulated industry and are therefore exposed to restrictions on our operations and a variety of claims relating to such regulation.

General. We are subject to significant regulation by, among others, (i) the Federal Communications Commission ("FCC"), which regulates interstate communications, (ii) state utility commissions, which regulate intrastate communications, and (iii) various foreign governments and international bodies, which regulate our international operations. Generally, we must obtain and maintain certificates of authority or licenses from these bodies in most territories where we offer regulated services. We cannot assure you that we will be successful in obtaining or retaining all licenses necessary to carry out our business plan, and, even if we are, the prescribed service standards and conditions imposed on us in connection with obtaining or acquiring control of these licenses may impose on us substantial costs and limitations. We are also subject to numerous requirements and interpretations under various international, federal, state and local laws, rules and regulations, which are quite detailed and occasionally in conflict with each other. Accordingly, we cannot ensure that we are always considered to be in compliance with all these requirements at any single point in time. The agencies responsible for the enforcement of these laws, rules and regulations may initiate inquiries or actions based on customer complaints or on their own initiative. Even if we are ultimately found to have complied with applicable regulations, such actions or inquiries could create adverse publicity that negatively impacts our business.

Regulation of the telecommunications industry continues to change, and the regulatory environment varies substantially from jurisdiction to jurisdiction. A substantial portion of our local voice services revenue remains subject to FCC and state utility commission pricing regulation, which periodically exposes us to pricing or earnings disputes and could expose us to unanticipated price declines. In addition, from time to time carriers or other third parties refuse to pay for certain of our services, challenge our rights to receive certain service payments, file complaints requesting rate reductions or take other similar actions that have the potential to reduce our revenues. Our future revenues, costs, and capital investment could be adversely affected by material changes to or decisions regarding the applicability of government requirements, including, but not limited to, changes in rules governing intercarrier compensation, state and federal USF support, competition policies, pricing limitations or operational restrictions. There can be no assurance that future regulatory, judicial or legislative activities will not have a material adverse effect on our operations, or that regulators or third parties will not raise material issues with regard to our compliance or noncompliance with applicable regulations.

Changes in the composition and leadership of the FCC, state commissions and other agencies that regulate our business could have significant impacts on our revenues, expenses, competitive position and prospects. Changes in the composition and leadership of these agencies are often difficult to predict, and make future planning more difficult.

Risks associated with recent changes in regulation. Changes in regulation can have a material impact on our business, revenues or financial performance. Recent changes in federal regulations have substantially impacted our operations. In October 2011, the FCC adopted an order providing for a multi-year transition to a regulatory structure that reduces intercarrier compensation charges, redeploys universal service funding to newer technologies, and increases certain end-user charges. These changes, coupled with our participation in the new FCC support programs, has significantly impacted various aspects of our operations, financial results and capital expenditures, including the amount of revenues we collect from our wholesale customers and our receipt of federal support payments. We expect these impacts will continue in the future. For more information, see "Business—Regulation" in Item 1 of Part I of this annual report, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II of this annual report.

In addition, during the last few years Congress or the FCC has initiated various other changes, including various broadband and Internet regulation initiatives including “network neutrality” regulations (as discussed further below) and actions that will restrict our ability to discontinue or reduce certain services, even if unprofitable. In 2016, the FCC initiated rulemaking regarding the regulation of business data services. This rulemaking, which remains pending, could adversely affect our operations or financial results. Many of the FCC’s regulations adopted in recent years remain subject to judicial review and additional rulemakings, thus increasing the difficulty of determining the ultimate impact of these changes on us and our competitors.

Certain states have recently taken steps that could reduce the amount of their universal service support payments to incumbent local exchange companies. If these trends continue, we would suffer a reduction in our revenues from state support programs.

Risks of higher costs. Regulations continue to create significant operating and capital costs for us. Challenges to our tariffs by regulators or third parties or delays in obtaining certifications and regulatory approvals could cause us to incur substantial legal and administrative expenses, and, if successful, such challenges could adversely affect the rates that we are able to charge our customers.

Our business also may be impacted by legislation and regulation imposing new or greater obligations related to regulations or laws related to regulating broadband services, storing records, bolstering homeland security or cyber security, increasing disaster recovery requirements, minimizing environmental impacts, enhancing privacy, restricting data collection, protecting intellectual property rights of third parties, or addressing other issues that impact our business, including (i) the Communications Assistance for Law Enforcement Act, which requires communications carriers to ensure that their equipment, facilities, and services are able to facilitate authorized electronic surveillance, (ii) the USA Freedom Act, which requires communication companies to store records of communications of their customers, and (iii) laws that have significantly enhanced our responsibilities relating to data security in certain jurisdictions. We expect our compliance costs to increase if future laws or regulations continue to increase our obligations.

Increased risks of fines. We have recently paid certain regulatory fines associated with network or service outages, particularly with respect to outages impacting the availability of emergency - 911 services. Over the past couple of years, we believe that regulators have assessed substantially higher fines than in the past for these types of incidents, and it is possible this trend will continue.

Risks of reduced flexibility . As a diversified full service incumbent local exchange carrier in many of our key operating markets, we have traditionally been subject to significant regulation that does not apply to many of our competitors. This regulation in many instances restricts our ability to change rates, to compete and to respond rapidly to changing industry conditions. In particular, cable television companies in recent years have been able to exploit differences in regulatory oversight, which we believe has helped them to develop service offerings competitive with ours. As our business becomes increasingly competitive, regulatory disparities between us and our competitors could increasingly impede our ability to compete.

Risks posed by other regulations. All of our operations are also subject to a variety of environmental, safety, health and other governmental regulations. We monitor our compliance with federal, state and local regulations governing the management, discharge and disposal of hazardous and environmentally sensitive materials. Although we believe that we are in compliance with these regulations in all material respects, our management, discharge or disposal of hazardous and environmentally sensitive materials might expose us to claims or actions that could potentially have a material adverse effect on our business, financial condition and operating results.

Our participation in the FCC's Connect America Fund ("CAF") Phase 2 support program poses certain risks.

Our participation in the FCC's CAF Phase 2 support program subjects us to certain financial risks. If we fail to attain certain specified infrastructure buildout requirements, the FCC could withhold future CAF support payments until these shortcomings are rectified. In addition, if we are not in compliance with FCC measures by the end of the CAF Phase 2 program, we would incur substantial penalties. To comply with the FCC's buildout requirements, we believe we will need to dedicate a substantial portion of our future capital expenditure budget to the construction of new infrastructure. The CAF-related expenditures could reduce the amount of funds we are willing or able to allocate to other initiatives or projects.

Regulation of the Internet could limit our ability to operate our broadband business profitably and to manage our broadband facilities efficiently.

In order to continue to provide quality broadband service at attractive prices, we believe we need the continued flexibility to respond to changing consumer demands, to manage bandwidth usage efficiently for the benefit of all customers and to invest in our networks. In 2015, the FCC adopted new regulations that regulate broadband services as a public utility under Title II of the Communications Act. The ultimate impact of the new regulations will depend on several factors, including manner in which the new regulations are implemented and enforced and whether those regulations are altered by the newly-constituted FCC or Congress. Although it is premature for us to determine the ultimate impact of the new regulations upon our operations, we currently anticipate that implementation of the proposed rules could hamper our ability to operate our data networks efficiently, restrict our ability to implement network management practices necessary to ensure quality service, increase the cost of network extensions and upgrades, and otherwise negatively impact our current operations. Our service offerings could become subject to additional laws and regulations as they are adopted or applied to the Internet. As the significance of the Internet expands, federal, state, or local governments may adopt new laws or regulations, or apply existing laws and regulations to the Internet. We cannot predict the outcome of any such changes.

We may be liable for the material that content providers distribute over our network.

Although we believe our liability for third party information stored on or transmitted through our networks is limited, the liability of private network operators is impacted both by changing technology and evolving legal principles that remain unsettled in many jurisdictions. As a private network provider, we could be exposed to legal claims relating to third party content stored or transmitted on our networks. Such claims could involve, among others, allegations of defamation, invasion of privacy, copyright infringement, or aiding and abetting restricted activities such as online gambling or pornography. If we decide to implement additional measures to reduce our exposure to these risks, or if we are required to defend ourselves against these kinds of claims, our operations and financial results could be negatively affected.

Any adverse outcome in any material litigation of CenturyLink or its affiliates could have a material adverse impact on our financial condition and operating results, on the trading price of our debt securities and on our ability to access the capital markets.

There are several material proceedings pending against CenturyLink and its affiliates, as described in Note 16—Commitments and Contingencies to the consolidated financial statements included in Item 8 of Part II of CenturyLink's annual report on Form 10-K for the year ended December 31, 2016. Depending on their outcome, any of these matters could have a material adverse effect on our financial position or operating results. We can give you no assurances as to the impact of these matters on our operating results or financial condition.

We are subject to franchising requirements that could impede our expansion opportunities or result in potential fines or penalties.

We may be required to obtain from municipal authorities operating franchises to install or expand certain facilities related to our fiber transport operations, our competitive local exchange carrier operations, and our facilities-based video services. Some of these franchises may require us to pay franchise fees. Many of our franchise agreements have compliance obligations and failure to comply may result in fines or penalties. In some cases, certain franchise requirements could delay us in expanding our operations or increase the costs of providing these services.

We are exposed to risks arising out of recent legislation affecting U.S. public companies.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act, and related regulations implemented thereunder, have increased our legal and financial compliance costs and made some activities more time consuming. Any failure to successfully or timely complete annual assessments of our internal controls required by Section 404 of the Sarbanes-Oxley Act could subject us to sanctions or investigation by regulatory authorities. Any such action could adversely affect our financial results or our reputation with investors, lenders or others.

Changes in any of the above-described laws or regulations may limit our ability to plan, and could subject us to further costs or constraints.

From time to time, the laws or regulations governing us or our customers, or the government's policy of enforcing those laws or regulations, have changed frequently and materially. The variability of these laws could hamper the ability of us and our customers to plan for the future or establish long-term strategies. Moreover, future changes in these laws or regulations could further increase our operating or compliance costs, or further restrict our operational flexibility, any of which could have a material adverse effect on our results of operations, competitive position, financial condition or prospects.

For a more thorough discussion of the regulatory issues that may affect our business, see "Business—Regulation" in Item 1 of Part I of this annual report.

Risks Affecting Our Liquidity and Capital Resources

CenturyLink's and our high debt levels expose us to a broad range of risks.

Our ultimate parent, CenturyLink, and we continue to carry significant debt. As of December 31, 2016, the aggregate principal amount of our consolidated long-term debt, excluding unamortized premiums, net, unamortized debt issuance costs and capital lease and other obligations, was \$7.359 billion (excluding our note payable - affiliate of \$914 million), which was included in CenturyLink's consolidated long-term debt of \$19.993 billion as of that date. As of the date of this annual report, \$2.715 billion aggregate principal amount of CenturyLink's consolidated debt securities (which includes \$500 million of our debt securities), is scheduled to mature prior to December 31, 2019. While we currently believe that CenturyLink and we will have the financial resources to meet or refinance our obligations when they come due, we cannot fully anticipate our future performance or financial condition, the future condition of CenturyLink, the credit markets or the economy generally. We may incur unexpected expenses or liabilities, and we may have limited access to financing.

Our significant levels of debt can adversely affect us in several other respects, including:

- limiting our ability to obtain additional financing for working capital, capital expenditures, refinancings or other general corporate purposes, particularly if, as discussed further in the risk factor disclosure below, (i) the ratings assigned to our debt securities by nationally recognized credit rating organizations are revised downward or (ii) we seek capital during periods of turbulent or unsettled market conditions;
- requiring us to dedicate a substantial portion of our cash flow from operations to the payment of interest and principal on our debt, thereby reducing the funds available to us for other purposes, including acquisitions, capital expenditures, strategic initiatives, dividends, marketing and other potential growth initiatives;
- hindering our ability to capitalize on business opportunities and to plan for or react to changing market, industry, competitive or economic conditions;
- increasing our future borrowing costs;
- increasing the risk that third parties will be unwilling or unable to engage in hedging or other financial or commercial arrangements with us;
- making us more vulnerable to economic or industry downturns, including interest rate increases;
- placing us at a competitive disadvantage compared to less leveraged competitors;
- increasing the risk that we will need to sell assets, possibly on unfavorable terms, or take other unfavorable actions to meet payment obligations; or
- increasing the risk that we may not meet the financial covenants contained in our debt agreements or timely make all required debt payments, either of which could result in the acceleration of some or all of our outstanding indebtedness.

The effects of each of these factors could be intensified if we increase our borrowings.

Any failure to make required debt payments could, among other things, adversely affect our ability to conduct operations or raise capital.

We expect to periodically require financing to meet our debt obligations as they come due. Due to the unstable economy and credit markets, we may not be able to refinance maturing debt on terms that are as favorable as those from which we previously benefited, on terms that are acceptable to us, or at all. See below "Risk Factors—Risks Affecting our Liquidity and Capital Resources—CenturyLink and we plan to access the public debt markets, and we cannot assure you that these markets will remain free of disruptions."

We may also need to obtain additional financing or capital, or to investigate other methods to generate cash (such as further cost reductions or the sale of assets) under a variety of other circumstances, including if revenues and cash provided by operations decline, if economic conditions weaken, if competitive pressures increase, if regulatory requirements change, if CenturyLink is required to contribute a material amount of cash to its pension plans, if CenturyLink is required to begin to pay other post-retirement benefits significantly earlier than is anticipated, or if CenturyLink becomes subject to significant judgments or settlements in one or more of the matters discussed in Note 15—Commitments and Contingencies to our consolidated financial statements in Item 8 of Part II of this annual report and Note 16—Commitments and Contingencies to the consolidated financial statements in Item 8 of Part II of CenturyLink's annual report on Form 10-K for the year ended December 31, 2016. For all the reasons mentioned above, we can give no assurance that additional financing for any of these purposes will be available on terms that are acceptable to us, or at all.

Certain of CenturyLink's and our debt instruments have cross payment default or cross acceleration provisions. When present, these provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. Any such event could adversely affect our ability to conduct business or access the capital markets and could adversely impact our credit ratings. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources" in CenturyLink's quarterly and annual reports filed with the SEC for additional information about CenturyLink's indebtedness.

In addition, our ability to borrow funds in the future will depend in part on the satisfaction of the covenants in our term loan and other debt instruments. If we are unable to satisfy the covenants contained in those instruments, or are unable to generate cash sufficient to make required debt payments, the parties to whom we are indebted could accelerate the maturity of some or all of our outstanding indebtedness. Certain of our debt instruments have cross-default or cross-acceleration provisions. When present, these provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument.

As noted above, if we are unable to make required debt payments or refinance our debt, we would likely have to consider other options, such as selling assets, issuing additional securities, cutting costs or otherwise reducing our cash requirements, or negotiating with our lenders to restructure our applicable debt. The indentures governing our senior notes may restrict, or market or business conditions may limit, our ability to do some of these things on favorable terms, or at all.

Our debt agreements and the debt agreements of CenturyLink and its other subsidiaries allow us to incur significantly more debt, which could exacerbate the other risks described in this annual report.

The terms of our debt instruments and the debt instruments of CenturyLink and its other subsidiaries permit us to incur additional indebtedness. Additional debt may be necessary for many reasons, including those discussed above. Incremental borrowings that impose additional financial risks could exacerbate the other risks described in this annual report.

Any downgrade in our credit ratings could limit our ability to obtain future financing, increase our borrowing costs and adversely affect the market price of our existing debt securities or otherwise impair our business, financial condition and results of operations.

As noted below in Item 7 of Part II of this annual report, our long-term debt is currently rated (i) BBB- by Standard and Poor's Ratings Services and BBB- by Fitch Ratings, both of which are the lowest investment grade ratings issued by each of these agencies and (ii) Ba1 by Moody's Investors Service, Inc., which is a non-investment grade rating. If either Standard and Poor's Rating Services or Fitch Ratings assigned us a non-investment grade, we would no longer be viewed as an "investment grade" issuer and would lose the benefits attendant thereto. As noted elsewhere in this report, Fitch Ratings placed our current unsecured senior debt rating on negative watch and Moody's Investors Service, Inc. placed our current unsecured senior debt rating on review for downgrade following CenturyLink's announcement of the Level 3 acquisition. Credit rating agencies continually review their ratings for the companies that they follow, including us. Credit rating agencies also evaluate the industries in which we operate as a whole and may change their credit rating for us based on their overall view of such industries. There can be no assurance that any rating assigned to any of these debt securities will remain in effect for any given period of time or that any such ratings will not be lowered, suspended or withdrawn entirely by a rating agency if, in that rating agency's judgment, circumstances so warrant. A downgrade of our credit ratings could adversely affect the market price of some or all of our outstanding debt securities, limit our access to the capital markets or otherwise adversely affect the availability of other new financing on favorable terms, if at all, trigger the application of restrictive covenants in certain of our debt agreements or result in new or more restrictive covenants in agreements governing the terms of any future indebtedness that we may incur, increase our cost of borrowing, and impair our business, financial condition and results of operations.

Our business requires us to incur substantial capital and operating expenses, which reduce our available free cash flow.

Our business is capital intensive, and we anticipate that our capital requirements will continue to be significant in the coming years.

We expect to invest additional capital to expand and enhance our network infrastructure as a result of several factors, including:

- our regulatory commitments, including infrastructure construction requirements arising out of our participation in the FCC's CAF Phase 2 program, which are discussed further herein;
- increased demands by customers to transmit larger amounts of data at faster speeds;
- changes in customers' service requirements;
- technological advances of our competitors; or
- the development and launch of new services.

We may be unable to expand or adapt our network infrastructure to respond to these developments in a timely manner, at a commercially reasonable cost or on terms producing satisfactory returns on our investment.

In addition to investing in expanded networks, new products or new technologies, we must from time to time invest capital to (i) replace some of our aging equipment that supports many of our legacy services that are experiencing revenue declines or (ii) convert older systems to simplify and modernize our network. While we believe that our currently planned level of capital expenditures will meet both our maintenance and core growth requirements, this may not be the case if demands on our network continue to accelerate or other circumstances underlying our expectations change. Increased spending could, among other things, adversely affect our operating margins, cash flows, results of operations and financial position.

Similarly, we continue to anticipate incurring substantial operating expenses to support our incumbent services and growth initiatives. We may be unable to sufficiently manage or reduce these costs, even if revenues in some of our lines of business are decreasing. If so, our operating margins will be adversely impacted.

Adverse changes in the value of assets or obligations associated with CenturyLink's qualified pension plan could negatively impact CenturyLink's liquidity, which may in turn affect our business and liquidity.

A substantial amount of our employees participate in a qualified pension plan sponsored by CenturyLink that has assumed the obligations under Qwest Communications International Inc.'s ("QCII") predecessor pension plan.

The funded status of CenturyLink's qualified pension plan is the difference between the value of the plan's assets and the benefit obligation. The accounting unfunded status of CenturyLink's qualified pension plan was \$2.352 billion as of December 31, 2016. Adverse changes in interest rates or market conditions, among other assumptions and factors, could cause a significant increase in CenturyLink's benefit obligation or a significant decrease in the value of the plan's assets. These adverse changes could require CenturyLink to contribute a material amount of cash to its pension plan or could accelerate the timing of required cash payments. The amounts contributed by us through CenturyLink are not segregated or restricted and may be used to provide benefits to employees of CenturyLink's other subsidiaries. Based on current laws and circumstances, CenturyLink does not expect it will be required to make a contribution to its plan in 2017. The actual amount of required contributions to its plan in 2017 and beyond will depend on earnings on plan investments, prevailing interest and discount rates, demographic experience, changes in plan benefits and changes in funding laws and regulations. Any future material cash contributions could have a negative impact on CenturyLink's liquidity by reducing their cash flows, which in turn could affect our liquidity.

CenturyLink and we plan to access the public debt markets, and we cannot assure you that these markets will remain free of disruptions.

CenturyLink and we have a significant amount of indebtedness that we both intend to refinance over the next several years, principally we expect through the issuance of debt securities of CenturyLink, us or both. CenturyLink's and our ability to arrange additional financing will depend on, among other factors, the financial position, performance, and credit ratings of CenturyLink and Qwest Corporation, as well as prevailing market conditions and other factors beyond its or our control. Prevailing market conditions could be adversely affected by the ongoing disruptions in domestic or overseas sovereign or corporate debt markets, contractions or limited growth in the economy or other similar adverse economic developments in the U.S. or abroad. Instability in the global financial markets has from time to time resulted in periodic volatility in the capital markets. This volatility could limit CenturyLink's and our access to the credit markets, leading to higher borrowing costs or, in some cases, the inability to obtain financing on terms that are acceptable to it, or at all. Any such failure to obtain additional financing could jeopardize its and our ability to repay, refinance or reduce its or our debt obligations.

Other Risks

We regularly transfer our cash to CenturyLink, which exposes us to certain risks.

Under our cash management arrangement with CenturyLink, we regularly transfer our cash to CenturyLink, which we recognize on our consolidated balance sheets as advances to affiliates. Although CenturyLink periodically repays these advances to fund our cash requirements throughout the year, at any given point in time CenturyLink may owe us a substantial sum under this arrangement. Accordingly, developments that adversely impact CenturyLink could adversely impact our ability to collect these advances.

If conditions or assumptions differ from the judgments, assumptions or estimates used in our critical accounting policies, our consolidated financial statements and related disclosures could be materially affected.

The preparation of financial statements and related disclosures in conformity with U.S. generally accepted accounting principles requires management to make judgments, assumptions and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our critical accounting policies, which are described in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Critical Accounting Policies and Estimates" in Item 7 of Part II of this annual report, describe those significant accounting policies and methods used in the preparation of our consolidated financial statements that are considered "critical" because they require judgments, assumptions and estimates that materially impact our consolidated financial statements and related disclosures. As a result, if future events or assumptions differ significantly from the judgments, assumptions and estimates in our critical accounting policies, these events or assumptions could have a material impact on our consolidated financial statements and related disclosures.

Lapses in disclosure controls and procedures or internal control over financial reporting could materially and adversely affect our operations, profitability or reputation.

There can be no assurance that our disclosure controls and procedures will be effective in the future or that we will not experience a material weakness or significant deficiency in internal control over financial reporting. Any such lapses or deficiencies may materially and adversely affect our business, operating results or financial condition, restrict our ability to access the capital markets, require us to expend significant resources to correct the lapses or deficiencies, expose us to regulatory or legal proceedings, including litigation brought by private individuals, subject us to fines, penalties or judgments, harm our reputation, or otherwise cause a decline in investor confidence.

We have a significant amount of goodwill, customer relationships and other intangible assets on our consolidated balance sheet. If our goodwill or other intangible assets become impaired, we may be required to record a significant charge to earnings and reduce our stockholders' equity.

As of December 31, 2016, approximately 55% of our total consolidated assets reflected on the consolidated balance sheet included in this annual report consisted of goodwill, customer relationships and other intangible assets. Under U.S. generally accepted accounting principles, most of these intangible assets must be tested for impairment on an annual basis or more frequently whenever events or circumstances indicate that their carrying value may not be recoverable. From time to time, our affiliates or predecessors have recorded large non-cash charges to earnings in connection with required reductions of the value of their intangible assets. If our intangible assets are determined to be impaired in the future, we may similarly be required to record significant, non-cash charges to earnings during the period in which the impairment is determined to have occurred.

Tax audits or changes in tax laws could adversely affect us.

We are included in the consolidated federal income tax return of CenturyLink. As such, we could be severally liable for tax examinations and adjustments attributable to other members of the CenturyLink affiliated group, as applicable. Significant taxpayers (such as CenturyLink) are subject to frequent and regular audits by the Internal Revenue Service as well as state and local tax authorities. These audits could subject us to tax liabilities if adverse positions are taken by these tax authorities.

We believe that we have adequately provided for tax contingencies. However, CenturyLink's tax audits and examinations may result in tax liabilities that differ materially from those that we have recognized in our consolidated financial statements. Because the ultimate outcomes of all of these matters are uncertain, we can give no assurance as to whether an adverse result from one or more of them will have a material effect on our financial results.

Legislators and regulators at all levels of government may from time to time change existing tax laws or regulations or enact new laws or regulations that could negatively impact our operating results or financial condition.

For information on risk faced by CenturyLink that could weaken its financial position (and thereby indirectly impact us), see the risk factor disclosures set forth in CenturyLink's annual and quarterly reports filed with the SEC.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

Our property, plant and equipment consists principally of telephone lines, cable, central office equipment, land and buildings related to our operations. Our gross property, plant and equipment consisted of the following components:

	As of December 31,	
	2016	2015
Land	3%	3%
Fiber, conduit and other outside plant ⁽¹⁾	45%	44%
Central office and other network electronics ⁽²⁾	29%	30%
Support assets ⁽³⁾	20%	21%
Construction in progress ⁽⁴⁾	3%	2%
Gross property, plant and equipment	100%	100%

(1) Fiber, conduit and other outside plant consists of fiber and metallic cable, conduit, poles and other supporting structures.

(2) Central office and other network electronics consists of circuit and packet switches, routers, transmission electronics and electronics providing service to customers.

(3) Support assets consist of buildings, computers and other administrative and support equipment.

(4) Construction in progress includes inventory held for construction and property of the aforementioned categories that has not been placed in service as it is still under construction.

We own substantially all of our telecommunications equipment required for our business. However, we lease from third parties certain facilities, plant, equipment and software under various capital and operating lease arrangements when the leasing arrangements are more favorable to us than purchasing the assets. We also own and lease administrative offices in major metropolitan locations primarily within our local service area. Substantially all of our network electronics equipment is located in buildings or on land that we own or lease within our local service area. Outside of our local service area, our assets are generally located on real property pursuant to an agreement with the property owner or another person with rights to the property. It is possible that we may lose our rights under one or more of these agreements, due to their termination or expiration or in connection with legal challenges to our rights under such agreements.

Our net property, plant and equipment was approximately \$7.6 billion and \$7.4 billion at December 31, 2016 and 2015, respectively. For additional information, see Note 5—Property, Plant and Equipment to our consolidated financial statements in Item 8 of Part II of this annual report.

ITEM 3. LEGAL PROCEEDINGS

The information contained under the subheadings "Pending Matters" and "Other Proceedings and Disputes" in Note 15—Commitments and Contingencies to our consolidated financial statements included in Item 8 of Part II of this annual report is incorporated herein by reference.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Not Applicable.

ITEM 6. SELECTED FINANCIAL DATA

The following tables of selected consolidated financial data should be read in conjunction with, and are qualified by reference to, our consolidated financial statements and notes thereto in Item 8 of Part II and "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Item 7 of Part II of this annual report.

The tables of selected financial data shown below are derived from our audited consolidated financial statements. These historical results are not necessarily indicative of results that you can expect for any future period.

Selected financial information from our consolidated statements of operations is as follows:

	Years Ended December 31, ⁽¹⁾				
	2016 ⁽²⁾⁽³⁾	2015 ⁽²⁾	2014	2013	2012
	(Dollars in millions)				
Operating revenues	\$ 8,910	8,964	8,838	8,753	8,848
Operating expenses	6,588	6,704	6,726	6,675	6,943
Operating income	\$ 2,322	2,260	2,112	2,078	1,905
Income before income tax expense	\$ 1,763	1,733	1,609	1,566	1,391
Net income	\$ 1,085	1,074	970	964	849

⁽¹⁾ See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations" in Item 7 of Part II of this annual report for a discussion of unusual items affecting the results for the years ended December 31, 2016, 2015 and 2014.

⁽²⁾ During 2016 and 2015, we recognized an incremental \$95 million of revenue, for each period, associated with the Federal Communications Commission ("FCC") Connect America Fund Phase 2 support program as compared to the interstate USF program. For additional information, see Note 1—Basis of Presentation and Summary of Significant Accounting Policies to our consolidated financial statements in Item 8 of Part II of this annual report.

⁽³⁾ During 2016, we recognized \$90 million of severance expenses and other one-time termination benefits associated with workforce reductions.

Selected financial information from our consolidated balance sheets is as follows:

	As of December 31,				
	2016	2015	2014	2013	2012
	(Dollars in millions)				
Net property, plant and equipment	\$ 7,645	7,374	7,201	7,208	7,231
Goodwill	9,354	9,354	9,354	9,354	9,354
Total assets ⁽¹⁾	21,149	21,470	22,185	22,965	23,710
Total long-term debt ⁽¹⁾⁽²⁾	7,261	7,239	7,269	7,464	7,553
Total stockholder's equity	8,692	8,907	9,183	9,613	9,974

- (1) In 2015, we adopted both ASU 2015-03 "Simplifying the Presentation of Debt Issuance Costs" and ASU 2015-17 "Balance Sheet Classification of Deferred Taxes" by retrospectively applying the requirements of the ASUs to our previously issued consolidated financial statements. The adoption of both ASU 2015-03 and ASU 2015-17 reduced total assets by \$272 million, \$253 million and \$237 million in each year for the three years ended December 31, 2014, respectively, and ASU 2015-03 reduced total long-term debt by \$110 million, \$94 million and \$72 million in each year for the three years ended December 31, 2014, respectively.
- (2) Total long-term debt is the sum of current maturities of long-term debt and long-term debt (excluding the note payable-affiliate balance) on our consolidated balance sheets. For additional information on our total long-term debt, see Note 3—Long-Term Debt and Revolving Promissory Note to our consolidated financial statements in Item 8 of Part II of this annual report. For total contractual obligations, see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Future Contractual Obligations" in Item 7 of Part II of this annual report.

Selected financial information from our consolidated statements of cash flows is as follows:

	Years Ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in millions)				
Other data:					
Net cash provided by operating activities	\$ 2,652	2,591	2,801	2,713	2,774
Net cash used in investing activities	(1,334)	(1,220)	(1,251)	(1,381)	(1,528)
Net cash used in financing activities	(1,316)	(1,374)	(1,558)	(1,326)	(1,241)
Payments for property, plant and equipment and capitalized software	(1,259)	(1,247)	(1,165)	(1,264)	(1,266)

The following table presents certain of our selected operational metrics:

	As of December 31,				
	2016	2015	2014	2013	2012
	(in thousands)				
Operational metrics:					
Total access lines ⁽¹⁾	6,611	6,997	7,334	7,641	8,058
Total broadband subscribers ⁽¹⁾	3,485	3,546	3,528	3,429	3,318

- (1) Access lines are lines reaching from the customers' premises to a connection with the public network and broadband subscribers are customers that purchase broadband connection service through their existing telephone lines, stand-alone telephone lines, or fiber-optic cables. Our methodology for counting our access lines and broadband subscribers includes only those lines that we use to provide services to external customers and excludes lines used solely by us and our affiliates. It also excludes unbundled loops and includes stand-alone broadband subscribers. We count lines when we install the service.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

All references to "Notes" in this Item 7 of Part II refer to the Notes to Consolidated Financial Statements included in Item 8 of Part II of this annual report. Certain statements in this annual report constitute forward-looking statements. See "Special Note Regarding Forward-Looking Statements and Related Matters" in Item 1 of Part I of this annual report for factors relating to these statements and "Risk Factors" in Item 1A of Part I of this annual report for a discussion of certain risk factors applicable to our business, financial condition, results of operations, liquidity or prospects.

Overview

We are an integrated communications company engaged primarily in providing an array of communications services to our residential and business customers. Our communications services include local voice, broadband, private line (including special access), network access, Ethernet, information technology, video and other ancillary services. In certain local and regional markets, we also provide local access and fiber transport services to competitive local exchange carriers. We strive to maintain our customer relationships by, among other things, bundling our service offerings to provide our customers with a complete offering of integrated communications services.

We generate the majority of our total consolidated operating revenues from services provided in the 14 -state region of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming . We refer to this region as our local service area.

Our ultimate parent company, CenturyLink, Inc. ("CenturyLink"), has cash management arrangements between certain of its subsidiaries that include lines of credit, affiliate obligations, capital contributions and dividends. As part of these cash management arrangements, affiliates provide lines of credit to certain other affiliates. Amounts outstanding under these lines of credit and intercompany obligations vary from time to time. Under these arrangements, the majority of our cash balance is advanced on a daily basis to CenturyLink. From time to time we may declare and pay dividends to Qwest Services Corporation ("QSC"), our direct parent, using cash owed to us under these advances, which has the net effect of reducing the amount of these advances. We report the balance of these transfers on our consolidated balance sheet as advances to affiliates.

For the reasons noted in Note 9—Products and Services Revenues to our consolidated financial statements in Item 8 of Part II of this annual report, we have determined that we have one reportable segment.

At December 31, 2016 , we operated approximately 6.6 million access lines and served approximately 3.5 million broadband subscribers. Our methodology for counting access lines and broadband subscribers, which is described further in the operational metrics table below under "Results of Operations", may not be comparable to those of other companies.

From time to time, we change the categorization of our products and services, and we may make similar changes in the future. During the second quarter of 2016, we determined that because of declines due to customer migration to other strategic products and services, certain of our services, specifically our private line (including special access) services, are more closely aligned with our legacy services than with our strategic services. As described in greater detail in Note 9 —Products and Services Revenues, these operating revenues are now reflected as legacy services.

We categorize our products, services and revenues among the following three categories:

- *Strategic services* , which include primarily broadband, Ethernet, video and other ancillary services;
- *Legacy services* , which include primarily local voice, private line (including special access), Integrated Services Digital Network ("ISDN") (which use regular telephone lines to support voice, video and data applications), switched access, traditional wide area network ("WAN") (which allow a local communications network to link to networks in remote locations) and other ancillary services; and
- *Affiliates and other services* , which consist primarily of Connect America Fund ("CAF") support payments, Universal Service Fund ("USF") support payments, USF surcharges and services we provide to our affiliates. We receive federal support payments from both Phase 1 and Phase 2 of the CAF program, and support payments from both federal and state USF programs. These support payments are government subsidies designed to reimburse us for various costs related to certain telecommunications services, including the costs of deploying, maintaining and operating voice and broadband infrastructure in high-cost rural areas where we are not able to fully recover our costs from our customers. We also collect USF surcharges based on specific items we list on our customers' invoices to fund the FCC's universal service programs. We provide to our affiliates, telecommunication services that we also provide to external customers. In addition, we provide to our affiliates, computer system development and support services, network support and technical services.

The following analysis is organized to provide the information we believe will be useful for understanding material trends affecting our business.

Business Trends

Our financial results were impacted by several significant trends, which are described below. We expect that these trends will continue to affect our results of operations, cash flows or financial position.

- *Strategic services.* We continue to see shifts in the makeup of our total revenues as customers move to lower margin strategic services, such as broadband and video services, from higher margin legacy services. Revenues from our strategic services represented 30% , 29% and 28% of our total revenues for the years ended December 31, 2016 , 2015 and 2014 , respectively. We continue to experience price compression due to competition, which has negatively impacted the growth of our strategic revenues. We continue to focus on increasing subscribers of our broadband services, particularly among consumer and small business customers. We believe that continually increasing the scope and connection speeds of our broadband services is important to remaining competitive in our industry. As a result, we continue to invest in our broadband network, which allows for the delivery of higher speed broadband services to a greater number of customers. We compete in a maturing broadband market in which most customers already have broadband services and growth rates in new subscribers have slowed. Moreover, as described further in "Risk Factors" in Item 1A of Part I of this annual report, demand for our broadband services could be adversely affected by competitors continuing to provide services at higher average broadband speeds than ours or expanding their advanced wireless data service offerings. We face competition in Ethernet-based services in the wholesale market from cable companies and fiber based telecommunications providers;
- *Legacy services.* Revenues from our legacy services represented 36% , 40% and 45% of our total revenues for the years ended December 31, 2016 , 2015 and 2014 , respectively. We expect these percentages to continue to decline. Our legacy services revenues have been, and we expect they will continue to be adversely affected by access line losses and price compression. Intense competition and product substitution continue to drive our access line losses. For example, many consumers are replacing traditional voice telecommunications service with substitute services, including (i) cable and wireless voice services and (ii) electronic mail, texting and social networking services. We expect that these factors will continue to negatively impact our business. As a result of the expected loss of revenue associated with access lines, we continue to offer our customers service bundling and other product promotions to help mitigate this trend, as described below. Demand for our private line services (including special access) continues to decline due to customers' optimization of their networks, industry consolidation and technological migration to higher-speed services;
- *Affiliates and other services.* Revenues from our affiliates and other services represented 34%, 31% and 27% of our total revenues for the years ended December 31, 2016, 2015 and 2014, respectively. We expect these percentages to continue to grow. Our affiliates continue to purchase additional services from us versus purchasing from third-party suppliers, which include telecommunications services that we also provide to external customers, computer system development, including support services, network support and technical services. We have also seen a recent increase in payments from both federal and state support programs, principally from the CAF Phase 2 high-cost support program. These support payments have increased significantly in 2016 and 2015, but are expected to remain flat or decrease slightly in the future.
- *Service bundling and product promotions.* We offer our customers the ability to bundle multiple products and services. These customers can bundle local services with other services such as broadband and video. While we believe our bundled service offerings can help retain customers, they also tend to lower our profit margins due to the related discounts;
- *Operating efficiencies.* We continue to evaluate our operating structure and focus. This involves balancing our workforce in response to our workload requirements, productivity improvements and changes in industry, competitive, technological and regulatory conditions;
- *Pension and post-retirement benefits expenses.* Our ultimate parent company, CenturyLink, is required to recognize in its consolidated financial statements certain income and expenses relating to its pension and post-retirement health care and life insurance benefits plans. These income and expenses are calculated based on several assumptions, including among other things, discount rates, mortality rates and expected rates of return on plan assets that are generally reset at December 31 of each year. CenturyLink allocates the service costs of these plans to us and certain of its other affiliates. The allocation of service costs to us is based upon the number of our employees who are currently earning benefits under the plans; and

- *Disciplined capital expenditures.* Our capital expenditures continue to be focused primarily on our strategic broadband services.

While these trends are important to understanding and evaluating our financial results, the other transactions, events, uncertainties and trends discussed in "Risk Factors" in Item 1A of Part I of this annual report may also materially impact our business operations and financial results.

Results of Operations

The following table summarizes the results of our consolidated operations for the years ended December 31, 2016, 2015 and 2014 :

	Years Ended December 31,		
	2016 ⁽¹⁾⁽²⁾	2015 ⁽¹⁾	2014
	(Dollars in millions)		
Operating revenues	\$ 8,910	8,964	8,838
Operating expenses	6,588	6,704	6,726
Operating income	2,322	2,260	2,112
Other expense, net	559	527	503
Income tax expense	678	659	639
Net income	\$ 1,085	1,074	970

⁽¹⁾ During 2016 and 2015, we recognized an incremental \$95 million of revenue, for each period, associated with the FCC's Connect America Fund Phase 2 support program as compared to the interstate USF program. For additional information, see Note 1—Basis of Presentation and Summary of Significant Accounting Policies to our consolidated financial statements in Item 8 of Part II of this annual report.

⁽²⁾ During 2016, we recognized \$90 million of severance expenses and other one-time termination benefits associated with workforce reductions.

The following table summarizes our access lines, broadband subscribers and number of employees:

	As of December 31,		
	2016	2015	2014
	(in thousands)		
Operational metrics:			
Total access lines ⁽¹⁾	6,611	6,997	7,334
Total broadband subscribers ⁽¹⁾	3,485	3,546	3,528
Total employees	22.0	22.0	23.0

⁽¹⁾ Access lines are lines reaching from the customers' premises to a connection with the public network and broadband subscribers are customers that purchase broadband connection service through their existing telephone lines, stand-alone telephone lines, or fiber-optic cables. Our methodology for counting our access lines and broadband subscribers includes only those lines that we use to provide services to external customers and excludes lines used solely by us and our affiliates. It also excludes unbundled loops and includes stand-alone broadband subscribers. We count lines when we install the service.

Operating Revenues

The following tables summarize our consolidated operating revenues recorded under our three revenue categories:

	Years Ended December 31,		Increase / (Decrease)	% Change
	2016	2015		
(Dollars in millions)				
Strategic services	\$ 2,690	2,610	80	3 %
Legacy services	3,222	3,600	(378)	(11)%
Affiliates and other services	2,998	2,754	244	9 %
Total operating revenues	<u>\$ 8,910</u>	<u>8,964</u>	<u>(54)</u>	<u>(1)%</u>

	Years Ended December 31,		Increase / (Decrease)	% Change
	2015	2014		
(Dollars in millions)				
Strategic services	\$ 2,610	2,449	161	7 %
Legacy services	3,600	3,967	(367)	(9)%
Affiliates and other services	2,754	2,422	332	14 %
Total operating revenues	<u>\$ 8,964</u>	<u>8,838</u>	<u>126</u>	<u>1 %</u>

Strategic Services

Strategic services revenues increased by \$80 million , or 3% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 . The increase in strategic services revenues for the year ended December 31, 2016 was primarily due to rate increases in broadband cost recovery fees, price increases for broadband services and volume increases in Ethernet services, which were partially offset by a decline in the number of broadband subscribers. Strategic service revenues increased by \$161 million , or 7% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 . The increase in strategic services revenues for the year ended December 31, 2015 was principally due to increases in the number of broadband subscribers, volume increases in Ethernet services and from rate increases on various services.

Legacy Services

Legacy services revenues decreased by \$378 million , or 11% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 and decreased by \$367 million , or 9% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 . The decline in legacy services revenues for both periods was primarily due to lower local voice services resulting from access line loss, reduced access services usage and reductions in the volumes of our private line (including special access) services, which were the result of the trends as further described in "Business Trends—Legacy services" above.

Affiliates and Other Services

Affiliates and other services revenues increased by \$244 million , or 9% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 . The increase in affiliates and other services revenues for the year ended December 31, 2016 was primarily due to increases in volume and in the rates we charge for our support services we provide to affiliates. Affiliates and other revenue increased by \$332 million , or 14% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 . The increase in affiliates and other services revenues for the year ended December 31, 2015 was primarily due to the additional revenue recorded under the FCC's CAF Phase 2 high-cost support program and increases in volume and in the rates we charge for our support services we provided to affiliates. During 2015, we recorded \$95 million more revenue than projected amounts we would have otherwise recorded during the same period under the interstate USF support program. For additional information about the CAF Phase 2 support program, see the discussion below in "Liquidity and Capital Resources—Connect America Fund."

We are aggressively marketing our strategic services in an effort to partially offset the continuing declines in our legacy services.

Operating Expenses

The following tables summarize our consolidated operating expenses:

	Years Ended December 31,		Increase / (Decrease)	% Change
	2016	2015		
(Dollars in millions)				
Cost of services and products (exclusive of depreciation and amortization)	\$ 2,934	2,872	62	2 %
Selling, general and administrative	1,022	1,015	7	1 %
Operating expenses-affiliates	941	960	(19)	(2)%
Depreciation and amortization	1,691	1,857	(166)	(9)%
Total operating expenses	\$ 6,588	6,704	(116)	(2)%

	Years Ended December 31,		Increase /	
	2015	2014	(Decrease)	% Change
	(Dollars in millions)			
Cost of services and products (exclusive of depreciation and amortization)	\$ 2,872	2,879	(7)	— %
Selling, general and administrative	1,015	1,086	(71)	(7)%
Operating expenses-affiliates	960	756	204	27 %
Depreciation and amortization	1,857	2,005	(148)	(7)%
Total operating expenses	\$ 6,704	6,726	(22)	— %

These expense classifications may not be comparable to those of other companies.

Cost of Services and Products (exclusive of depreciation and amortization)

Cost of services and products (exclusive of depreciation and amortization) are expenses incurred in providing products and services to our customers. These expenses include: employee-related expenses directly attributable to operating and maintaining our network (such as salaries, wages, benefits and professional fees); facilities expenses (which include third-party telecommunications expenses we incur for using other carriers' networks to provide services to our customers); rents and utilities expenses; equipment sales expenses (such as modem expenses); payments to universal service funds (which are federal and state funds that are established to promote the availability of telecommunications services to all consumers at reasonable and affordable rates, among other things, and to which we are often required to contribute); certain litigation expenses associated with our operations; and other expenses directly related to our operations.

Cost of services and products (exclusive of depreciation and amortization) increased by \$62 million , or 2% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to increases in network expense, facility costs and allocated corporate costs from affiliates, which were partially offset by reductions in customer premises equipment costs and payment processing fees. Costs of services and products (exclusive of depreciation and amortization) decreased by \$7 million , or less than 1%, for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to decreases in salaries and wages from lower headcount, professional fees and contract labor. These decreases were substantially offset by an increase in allocated corporate costs from affiliates.

Selling, General and Administrative

Selling, general and administrative expenses are expenses incurred in selling products and services to our customers, corporate overhead and other operating expenses. These expenses include: employee-related expenses (such as salaries, wages, internal commissions, benefits and professional fees) directly attributable to selling products or services and employee-related expenses for administrative functions; marketing and advertising; property and other operating taxes and fees; external commissions; litigation expenses associated with general matters; bad debt expense; and other selling, general and administrative expenses.

Selling, general and administrative expenses increased by \$7 million , or 1%, for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to increases in severance expenses associated with workforce reductions and marketing and advertising, which were substantially offset by reductions in professional fees and property and other taxes. Selling, general and administrative expenses decreased by \$71 million , or 7% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to decreases in salaries and wages from lower headcount, marketing and advertising, insurance and fees, and an impairment charge related to an office building, which was sold in the fourth quarter of 2014. These decreases were partially offset by increases in professional fees and bad debt expense.

In 2015, CenturyLink changed its allocation methodology related to pension and post-retirement costs. In 2016, we recorded \$59 million of service costs allocated to us from CenturyLink's centrally managed pension and post-retirement benefit plans based upon our employees who are currently earning benefits under the plans, and in 2015, we recorded \$74 million of service costs using the same allocation methodology. In 2014, we recorded combined net periodic benefit expense of \$30 million for the qualified pension and post-retirement plans. Based on current circumstances, we expect to record service costs, allocated from CenturyLink, of approximately \$58 million in 2017. Pension expense is allocated to cost of services and products (exclusive of depreciation and amortization) and to selling, general and administrative in our consolidated statements of operations. For additional information on CenturyLink's change in allocation methodology, see Note 1—Basis of Presentation and Summary of Significant Accounting Policies to our consolidated financial statements and for additional information on our participation in CenturyLink's pension and post-retirement benefit plans, see Note 7—Employee Benefits to our consolidated financial statements, both of which are in Item 8 of Part II of this annual report.

Operating Expenses-Affiliates

Since CenturyLink's acquisition of us, we have incurred affiliate expenses related to our use of telecommunication services, marketing and employee related support services provided by CenturyLink and its subsidiaries.

Operating expenses-affiliates decreased by \$19 million , or 2% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to decreases in the level of services provided to us by our affiliates. Operating expenses-affiliates increased by \$204 million , or 27% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 . The increase was primarily due to increases in the rates we are charged for support services and higher levels of services provided to us by affiliates.

Depreciation and Amortization

The following tables provide detail of our depreciation and amortization expense:

	Years Ended December 31,		Increase /	
	2016	2015	(Decrease)	% Change
	(Dollars in millions)			
Depreciation	\$ 924	986	(62)	(6)%
Amortization	767	871	(104)	(12)%
Total depreciation and amortization	\$ 1,691	1,857	(166)	(9)%

	Years Ended December 31,		Increase /	
	2015	2014	(Decrease)	% Change
	(Dollars in millions)			
Depreciation	\$ 986	1,048	(62)	(6)%
Amortization	871	957	(86)	(9)%
Total depreciation and amortization	\$ 1,857	2,005	(148)	(7)%

Annual depreciation expense is impacted by several factors, including changes in our depreciable cost basis, changes in our estimates of the remaining economic life of certain network assets and the addition of new plant. Depreciation expense decreased by \$62 million , or 6% , for each of the years ended December 31, 2016 and 2015 as compared to the respective prior years. The depreciation expense related to our plant was lower for both periods due to full depreciation and retirement of certain plant placed in service prior to 2016 and 2015. The decrease in both periods was partially offset by an increase in depreciation expense attributable to new plant placed in service during these respective years.

Amortization expense decreased by \$104 million , or 12% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 and decreased by \$86 million , or 9% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 . The decrease in amortization expense for both periods was primarily due to the use of accelerated amortization for a portion of our customer relationship assets. The effect of using an accelerated amortization method results in an incremental decline in expense each period as the intangible assets amortize. In addition, amortization of capitalized software was lower in both periods due to software becoming fully amortized faster than new software was acquired or developed.

Other Consolidated Results

The following tables summarize our total other expense, net and income tax expense:

	Years Ended December 31,		Increase /	
	2016	2015	(Decrease)	% Change
	(Dollars in millions)			
Interest expense	\$ (478)	(473)	5	1%
Interest expense-affiliates	(59)	(53)	6	11%
Other (expense) income, net	(22)	(1)	21	nm
Total other expense, net	<u>\$ (559)</u>	<u>(527)</u>	32	6%
Income tax expense	\$ 678	659	19	3%

	Years Ended December 31,		Increase / (Decrease)	
	2015	2014		% Change
	(Dollars in millions)			
Interest expense	\$ (473)	(464)	9	2%
Interest expense-affiliates	(53)	(40)	13	33%
Other (expense) income, net	(1)	1	(2)	nm
Total other expense, net	<u>\$ (527)</u>	<u>(503)</u>	24	5%
Income tax expense	\$ 659	639	20	3%

nm-Percentages greater than 200% and comparisons between positive and negative values or to/from zero values are considered not meaningful.

Interest Expense

Interest expense increased by \$5 million , or 1% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to a reduction in the amount of net premium amortization recorded at acquisition due to the early retirement of several issuances of debt during 2016 , which had the effect of increasing expense. Interest expense increased by \$9 million , or 2% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to a reduction in the amortization of debt premiums, which was partially offset by lower bond coupon rates. See Note 3—Long-Term Debt and Revolving Promissory Note to our consolidated financial statements in Item 8 of Part II of this annual report and Liquidity and Capital Resources below for additional information about our debt.

Interest Expense-Affiliates, Net

Affiliate interest expense increased by \$6 million , or 11% , for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to the increase in the average amount outstanding on our intercompany revolving indebtedness. Affiliate interest expense increased by \$13 million , or 33% , for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to an accounting adjustment in 2014.

Other (Expense) Income, Net

Other (expense) income, net increased by \$21 million for the year ended December 31, 2016 as compared to the year ended December 31, 2015 substantially due to losses on early retirement of debt. Other (expense) income, net remained relatively unchanged for the year ended December 31, 2015 as compared to the year ended December 31, 2014 .

Income Tax Expense

Income tax expense for the year ended December 31, 2016, was \$678 million, or an effective tax rate of 38.5%, compared to \$659 million, or an effective tax rate of 38.0%, for the year ended December 31, 2015. The increase in the 2016 effective tax rate is primarily due to a reduction in research and development credits generated. Income tax expense for the year ended December 31, 2014 was \$639 million, or an effective tax rate of 39.7%. The decrease in the 2015 effective tax rate is primarily due to a benefit from research and development credits, a smaller tax on a dividend from a foreign subsidiary and a smaller change to state income taxes from changes in apportionment.

For additional information on income taxes, see Note 11—Income Taxes to our consolidated financial statements in Item 8 of Part II of this annual report.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with accounting principles that are generally accepted in the United States. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of our assets, liabilities, revenues and expenses. We have identified certain policies and estimates as critical to our business operations and the understanding of our past or present results of operations related to (i) goodwill, customer relationships and other intangible assets; (ii) property, plant and equipment; (iii) pension and post-retirement benefits; (iv) affiliate transactions; (v) Connect America Fund; and (vi) income taxes. These policies and estimates are considered critical because they had a material impact, or they have the potential to have a material impact, on our consolidated financial statements and because they require us to make significant judgments, assumptions or estimates. We believe that the estimates, judgments and assumptions made when accounting for the items described below were reasonable, based on information available at the time they were made. However, there can be no assurance that actual results will not differ from those estimates.

CenturyLink's 2011 acquisition of us resulted in the assignment of the aggregate consideration to the assets acquired and liabilities assumed based on estimates of their acquisition date fair values. The fair value of the aggregate consideration transferred exceeded the acquisition date fair value of the recorded tangible and intangible assets and assumed liabilities by an estimated \$ 9.354 billion, which has been recognized as goodwill. This goodwill is attributable to strategic benefits, including enhanced financial and operational scale, market diversification and leveraged combined networks that we expect to realize. None of the goodwill associated with this acquisition is deductible for income tax purposes. The aggregate consideration assignment was based on our final analysis of enterprise value of \$18.639 billion.

Goodwill, Customer Relationships and Other Intangible Assets

We amortize customer relationships primarily over estimated lives of ten years, using either the sum-of-the-years-digits or the straight-line methods, depending on the type of customer. We amortize capitalized software using the straight-line method over estimated lives ranging up to seven years. We annually review the estimated lives and methods used to amortize our other intangible assets, primarily capitalized software. The amount of future amortization expense may differ materially from current amounts, depending on the results of our annual reviews.

We are required to assess goodwill for impairment at least annually, or more frequently, if an event occurs or circumstances change that would indicate an impairment may have occurred. We are required to write-down the value of goodwill in periods in which the recorded amount of goodwill exceeds the implied fair value of goodwill. Our annual assessment date for testing goodwill impairment is October 31. The impairment assessment is done at the reporting unit level; in reviewing the criteria for reporting units when assigning the goodwill resulting from CenturyLink's acquisition of us, we determined that we are one reporting unit.

At October 31, 2016, we performed our annual impairment assessment and concluded that our goodwill was not impaired and the estimated fair value of our equity was substantially in excess of our carrying value of equity as of that date.

We may be required to assess our goodwill for impairment before our next required assessment date of October 31, 2017 under certain circumstances, including any failure to meet our forecasted future operating results or any significant increases in our weighted average cost of capital. In addition, we cannot assure that adverse conditions will not trigger future goodwill impairment assessments or impairment charges. A number of factors, many of which we cannot control, could affect our financial condition, operating results and business prospects and could cause our actual results to differ from the estimates and assumptions we employed in our goodwill impairment assessment. These factors include, but are not limited to, (i) further weakening in the overall economy; (ii) a significant decline in our ultimate parent's, CenturyLink, stock price and resulting market capitalization as a result of an adverse change to our overall business operations; (iii) changes in the discount rate we use in our testing; (iv) successful efforts by our competitors to gain market share in our markets; (v) adverse changes as a result of regulatory or legislative actions; and (vi) a significant adverse change in our legal affairs or in the overall business climate. For additional information, see "Risk Factors" in Item 1A of Part I of this annual report. We will continue to monitor certain events that impact our operations to determine if an interim assessment of goodwill impairment should be performed prior to the next required assessment date of October 31, 2017 .

Property, Plant and Equipment

As a result of our indirect acquisition by CenturyLink, property, plant and equipment owned at the time of acquisition was recorded based on its estimated fair value as of the acquisition date. Subsequently purchased and constructed property, plant and equipment is recorded at cost. Renewals and betterments of plant and equipment are capitalized while repairs, as well as renewals of minor items, are charged to operating expense. Depreciation of property, plant and equipment is provided on the straight-line method using class or overall group rates. The group method provides for the recognition of the remaining net investment, less anticipated net salvage value, over the remaining useful life of the assets. This method requires the periodic revision of depreciation rates.

Normal retirements of property, plant and equipment are charged against accumulated depreciation, with no gain or loss recognized. We depreciate such property on the straight-line method over estimated service lives ranging from 4 to 45 years.

We perform annual internal reviews to evaluate the reasonableness of the depreciable lives for our property, plant and equipment. Our reviews utilize models that take into account actual usage, physical wear and tear, replacement history, assumptions about technology evolution and, in certain instances, actuarially determined probabilities to estimate the remaining life of our asset base.

Due to rapid changes in technology and the competitive environment, determining the estimated economic life of telecommunications plant and equipment requires a significant amount of judgment. We regularly review data on utilization of equipment, asset retirements and salvage values to determine adjustments to our depreciation rates. The effect of a hypothetical one year increase or decrease in the estimated remaining useful lives of our property, plant and equipment would have decreased depreciation expense by approximately \$110 million annually or increased depreciation expense by approximately \$150 million annually, respectively.

Pension and Post-retirement Benefits

A substantial number of our employees participate in the CenturyLink pension and post-retirement benefit plans. CenturyLink allocates service costs relating to pension and post-retirement health care and life insurance benefits to us based upon the number of our employees who are currently earning benefits under the plans. Any amounts contributed by us through CenturyLink are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to employees of other CenturyLink affiliates.

In computing the periodic pension and post-retirement benefits income and expense, the most significant assumptions CenturyLink makes are the discount rate and the expected rate of return on plan assets. Changes in either of these assumptions could significantly impact our general, administrative and other operating expenses. For further discussion of the qualified pension and post-retirement benefit plans and the critical accounting estimates, see CenturyLink's annual report on Form 10-K for the year ended December 31, 2016 .

Affiliate Transactions

We recognize intercompany charges at the amounts billed to us by our affiliates and we recognize intercompany revenue for services we bill to our affiliates. Regulatory rules require certain expenses to be recorded at market price or fully distributed cost. Our compliance with regulations is subject to review by regulators. Adjustments to intercompany charges that result from these reviews are recorded in the period they become known.

Because of the significance of the services we provide to our affiliates and our other affiliate transactions, the results of operations, financial position and cash flows presented herein are not necessarily indicative of the results of operations, financial position and cash flows we would have achieved had we operated as a stand-alone entity during the periods presented. See Note 10—Affiliate Transactions to our consolidated financial statements in Item 8 of Part II of this annual report for additional information.

Connect America Fund

In 2015, CenturyLink accepted CAF funding from the FCC of approximately \$500 million per year for six years to fund the deployment of voice and broadband capable infrastructure for approximately 1.2 million rural households and businesses (living units) in 33 states under the CAF Phase 2 high-cost support program. Of these amounts, approximately \$150 million is attributable to our service area, to provide service to approximately 0.3 million rural households and businesses in 13 states. This program provides a monthly high-cost subsidy similar to the support provided by the FCC's previous cost reimbursement programs. Although we believe that there is no specific authoritative U.S. GAAP guidance for the treatment of government assistance, we identified three acceptable methods to account for these funds: (1) recognize revenue when entitled to receive cash, (2) defer cash received until the living units are enabled to receive the service at the FCC specified level, or (3) record the cash received as contra capital. After assessing these alternatives, we have determined that we will recognize CAF Phase 2 funds each month as revenue when we are entitled to receive the cash less a deferred amount. The amount of revenue deferred in 2016 was approximately \$4 million. We believe our recognition methodology is consistent with other companies in our industry in the United States, but may not necessarily be consistent with companies outside the United States that receive similar government funding, and we cannot provide assurances to this effect.

In computing the amount of revenue to recognize, we assume that we will not be able to economically enable 100% of the required living units in every state with voice and broadband capabilities under the CAF Phase 2 program. We defer recognition of the funds related to potential living units that we estimate we will not enable until we can with reasonable assurance determine that we can fully meet the enablement targets. As disclosed elsewhere herein, in some limited instances, a portion of the funds must be returned if enablement targets are not attained. Based on estimated enablement, the effect of a hypothetical 1% decrease in our estimate of living units we will not enable with voice and broadband capabilities under the CAF Phase 2 program would have increased our revenue by \$1 million in 2016 and a 1% increase would have decreased our revenue by \$3 million in 2016.

For additional information about the CAF Phase 2 support program, see the discussion below in "Liquidity and Capital Resources—Connect America Fund."

Income Taxes

We are included in the consolidated federal income tax return of CenturyLink. Under CenturyLink's tax allocation policy, CenturyLink treats our consolidated results as if we were a separate taxpayer. The policy requires us to settle our tax liabilities through a change in our general intercompany obligation based upon our separate return taxable income. We are also included in the combined state tax returns filed by CenturyLink and the same payment and allocation policy applies. Our reported deferred tax assets and liabilities are primarily determined as a result of the application of the separate return allocation method and therefore the settlement of these amounts is dependent upon our parent, CenturyLink, rather than tax authorities. CenturyLink does have the right to change their policy regarding settlement of these assets and liabilities at any time.

Our provision for income taxes includes amounts for tax consequences deferred to future periods. We record deferred income tax assets and liabilities reflecting future tax consequences attributable to tax credit carryforwards and differences between the financial statement carrying value of assets and liabilities and the tax bases of those assets and liabilities. Deferred taxes are computed using enacted tax rates expected to apply in the year in which the differences are expected to affect taxable income. The effect on deferred income tax assets and liabilities of a change in tax rate is recognized in earnings in the period that includes the enactment date.

The measurement of deferred taxes often involves the exercise of considerable judgment related to the realization of tax basis. Our deferred tax assets and liabilities reflect our assessment that tax positions taken in filed tax returns and the resulting tax basis, are more likely than not to be sustained if they are audited by taxing authorities. Assessing tax rates that we expect to apply and determining the years when the temporary differences are expected to affect taxable income requires judgment about the future apportionment of our income among the states in which we operate. Any changes in our practices or judgments involved in the measurement of deferred tax assets and liabilities could materially impact our financial condition or results of operations. See Note 11—Income Taxes to our consolidated financial statements in Item 8 of Part II of this annual report for additional information.

Liquidity and Capital Resources

Overview

We are an indirectly wholly-owned subsidiary of CenturyLink. As such, factors relating to, or affecting, CenturyLink's liquidity and capital resources could have material impacts on us, including impacts on our credit ratings, our access to capital markets and changes in the financial market's perception of us.

CenturyLink has cash management arrangements between certain of its subsidiaries that include lines of credit, affiliate advances and obligations, capital contributions and dividends. As part of these cash management arrangements, affiliates provide lines of credit to certain other affiliates. Amounts outstanding under these lines of credit and intercompany obligations vary from time to time. Under these arrangements, the majority of our cash balance is advanced on a daily basis to CenturyLink. From time to time we may declare and pay dividends to our stockholder, QSC, sometimes in excess of our earnings to the extent permitted by applicable law, using cash owed to us under these advances, which has the net effect of reducing the amount of these advances. Our debt covenants do not currently limit the amount of dividends we can pay to QSC. Given our cash management arrangement with our ultimate parent, CenturyLink, and the resulting amounts due to us from CenturyLink, a significant component of our liquidity is dependent upon CenturyLink's ability to repay its obligation to us.

As of December 31, 2016, we had a working capital deficit of \$1.090 billion, reflecting current liabilities of \$2.796 billion and current assets of \$1.706 billion, compared to a working capital deficit of \$820 million as of December 31, 2015. We have historically operated with a working capital deficit due to our practice of declaring and paying regular cash dividends to QSC. As long as we continue declaring and paying cash dividends to QSC, it is likely that we will continue to operate with a working capital deficit in the future. We anticipate that our future liquidity needs will be met through (i) our cash provided by our operating activities, (ii) amounts due to us from CenturyLink, (iii) our ability to refinance QC's debt securities at maturity and (iv) capital contributions, advances or loans from CenturyLink or its affiliates if and to the extent they have available funds that they are willing and able to contribute, advance or loan to us.

Capital Expenditures

We incur capital expenditures on an ongoing basis in order to enhance and modernize our networks, compete effectively in our markets and expand our service offerings. CenturyLink evaluates capital expenditure projects based on a variety of factors, including expected strategic impacts (such as forecasted impact on revenue growth, productivity, expenses, service levels and customer retention) and the expected return on investment. The amount of CenturyLink's consolidated capital investment is influenced by, among other things, demand for CenturyLink's services and products, cash flow generated by operating activities, cash required for other purposes and regulatory considerations (such as our CAF Phase 2 infrastructure buildout requirements). Based on the type and volume of services we provide, approximately 38% to 43% of CenturyLink's annual consolidated capital expenditures have been attributed over the last two years to us for use in our operations. For more information on CenturyLink's total capital expenditures, please see its annual and quarterly reports filed with the SEC.

Our capital expenditures continue to be focused on our strategic services. For more information on our capital spending, see "Business" and "Risk Factors" in Items 1 and 1A, respectively, of Part I of this annual report.

Debt and Other Financing Arrangements

CenturyLink has a revolving credit facility (the "Credit Facility") maturing December 2019 that allows CenturyLink to borrow up to \$2 billion, including \$400 million of letter of credit capacity, for the general corporate purposes of itself and its subsidiaries. CenturyLink also maintains a separate letter of credit arrangement with a financial institution amounting to \$160 million to which we have access. As of December 31, 2016, CenturyLink had approximately \$1.630 billion available for future use under the Credit Facility.

Under the Credit Facility, CenturyLink and we, must maintain a debt to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in our Credit Facility) ratio of not more than 4.0:1.0 and 2.85:1.0, respectively, as of the last day of each fiscal quarter for the four quarters then ended. The Credit Facility also contains a negative pledge covenant, which generally requires CenturyLink to secure equally and ratably any advances under the Credit Facility if they pledge assets or permit liens on our property for the benefit of other debtholders. The Credit Facility also has a cross payment default provision, and the Credit Facility and certain of our debt securities also have cross acceleration provisions. When present, these provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. Our debt to EBITDA ratios could be adversely affected by a wide variety of events, including unforeseen expenses or contingencies. This could reduce our financing flexibility due to potential restrictions on incurring additional debt under certain provisions of our debt agreements or, in certain circumstances, could result in a default under certain provisions of such agreements.

Subject to market conditions, and to the extent feasible, we expect to continue to issue debt securities from time to time in the future to refinance a substantial portion of our maturing debt. The availability, interest rate and other terms of any new borrowings will depend on the ratings assigned to us by credit rating agencies, among other factors. For further information on our debt maturities, see "Future Contractual Obligations" below.

We believe we were in compliance with all provisions and covenants of our debt agreements as of December 31, 2016 . See Note 3—Long-Term Debt to our consolidated financial statements in Item 8 of Part II of this annual report for additional information about our long-term debt.

As of the date of this annual report, the credit ratings for Qwest Corporation's senior unsecured debt were as follows:

Agency	QC
Standard & Poor's	BBB-
Moody's Investors Service, Inc. ⁽¹⁾	Ba1
Fitch Ratings	BBB-

⁽¹⁾ On March 15, 2016, Moody's Investors Service, Inc. downgraded CenturyLink, Inc.'s rating from Ba2 to Ba3 and downgraded Qwest Corporation's rating from Baa3 to Ba1.

Qwest Corporation's credit ratings are reviewed and adjusted from time to time by the rating agencies, and downgrades could impact CenturyLink's and Qwest Corporation's access to debt capital or further raise CenturyLink's and Qwest Corporation's borrowing costs. Any such downgrades of CenturyLink's senior unsecured debt ratings could, under certain circumstances, incrementally increase the cost of CenturyLink's borrowing under its revolving credit facility, which could indirectly impact us. See "Risk Factors—Risks Affecting our Liquidity and Capital Resources" in Item 1A of Part I of this annual report.

Following the announcement of CenturyLink, Inc.'s pending acquisition of Level 3 Communications, Inc. ("Level 3"), Standard & Poor's indicated that CenturyLink, Inc.'s current unsecured senior debt rating of BB has been placed on watch with negative implications, Moody's Investors Service, Inc. indicated that CenturyLink, Inc.'s current senior unsecured debt rating of Ba3 has been placed on review for downgrade and Fitch Ratings indicated that CenturyLink, Inc.'s current unsecured senior debt rating of BB+ has been placed on negative watch. Additionally, Qwest Corporation's current unsecured senior debt rating of Ba1 has been placed on review for downgrade by Moody's Investors Service, Inc. and Qwest Corporation's current unsecured senior debt rating of BBB- has been placed on negative watch by Fitch Ratings. It is expected that any downgrades would be made only following the completion of the Level 3 acquisition.

Term Loan

In 2015, Qwest Corporation entered into a term loan in the amount of \$100 million with CoBank, ACB. The outstanding unpaid principal amount of this term loan plus any accrued and unpaid interest is due on February 20, 2025. Interest is paid monthly based upon either the London Interbank Offered Rate ("LIBOR") or the base rate (as defined in the credit agreement) plus an applicable margin between 1.50% to 2.50% per annum for LIBOR loans and 0.50% to 1.50% per annum for base rate loans depending on our then current senior unsecured long-term debt rating. At both December 31, 2016 and 2015 , the outstanding principal balance on this term loan was \$100 million .

Revolving Promissory Note

Qwest Corporation is currently indebted to an affiliate of CenturyLink under a revolving promissory note that provides Qwest Corporation with a funding commitment of up to \$1.0 billion in aggregate principal amount through June 30, 2022, of which \$914 million was outstanding as of December 31, 2016 . The revolving promissory note is due on demand and ranks equally to Qwest Corporation's outstanding Senior Notes. Interest is accrued on the outstanding balance using a weighted average per annum interest rate of CenturyLink's outstanding borrowings for the interest period. As of December 31, 2016 , the weighted average interest rate was 6.678% . As of December 31, 2016 and 2015 , this revolving promissory note is reflected on our consolidated balance sheets as a current liability under note payable-affiliate. As of December 31, 2016 , \$5 million of accrued interest is reflected in other current liabilities on our consolidated balance sheets.

Dividends

We periodically pay dividends to our direct parent company. See Note 13—Stockholder's Equity to our consolidated financial statements in Item 8 of Part II of this annual report.

Future Contractual Obligations

The following table summarizes our estimated future contractual obligations as of December 31, 2016 :

	2017	2018	2019	2020	2021	2022 and thereafter	Total
(Dollars in millions)							
Long-term debt ⁽¹⁾⁽²⁾	\$ 514	10	4	—	951	5,912	7,391
Interest on long-term debt and capital leases ⁽²⁾	477	463	463	463	429	10,579	12,874
Note payable-affiliate	914	—	—	—	—	—	914
Interest on note payable-affiliate	5	—	—	—	—	—	5
Operating leases	51	47	40	33	17	38	226
Purchase commitments ⁽³⁾	55	29	11	4	1	3	103
Affiliate obligations, net ⁽⁴⁾	87	75	70	65	61	621	979
Other	3	2	1	1	1	14	22
Total future contractual obligations ⁽⁵⁾	\$ 2,106	626	589	566	1,460	17,167	22,514

(1) Includes current maturities and capital lease obligations, but excludes unamortized discounts, net and unamortized debt issuance costs and excludes note payable-affiliate.

(2) Actual principal and interest paid in all years may differ due to future refinancing of outstanding debt or issuance of new debt.

(3) We have various long-term, non-cancelable purchase commitments for advertising and promotion services, including advertising and marketing at sports arenas and other venues and events. We also have service-related commitments with various vendors for data processing, technical and software support services. Future payments under certain service contracts will vary depending on our actual usage. In the table above, we estimated payments for these service contracts based on estimates of the level of services we expect to receive.

(4) The affiliate obligations, net primarily represents the cumulative allocation of expense attributable to our employees, net of payments, associated with QCII's pension plans and post-retirement benefit plans prior to the plans being merged into CenturyLink's benefit plans. See additional information on CenturyLink's employee benefit plans in Note 7—Employee Benefits to the consolidated financial statements in Item 8 of Part II of CenturyLink's annual report on Form 10-K for the year ended December 31, 2016 ;

(5) The table is limited solely to contractual payment obligations and does not include:

- contingent liabilities;
- our open purchase orders as of December 31, 2016 . These purchase orders are generally issued at fair value, and are generally cancelable without penalty;
- other long-term liabilities, such as accruals for legal matters and other taxes that are not contractual obligations by nature. We cannot determine with any degree of reliability the years in which these liabilities might ultimately settle;
- contract termination fees. These fees are non-recurring payments, the timing and payment of which, if any, is uncertain. In the ordinary course of business and to optimize our cost structure, we enter into contracts with terms greater than one year to purchase other goods and services. Assuming we terminate these contracts in 2017 , termination fees for these contracts to purchase goods and services would be \$81 million . In the normal course of business, we do not believe payment of these fees is likely;
- service level commitments to our customers, the violation of which typically results in service credits rather than cash payments; and
- potential indemnification obligations to counterparties in certain agreements entered into in the normal course of business. The nature and terms of these arrangements vary.

Pension and Post-retirement Benefit Obligations

CenturyLink is subject to material obligations under its existing defined benefit pension plans and post-retirement benefit plans. At December 31, 2016 , the accounting unfunded status of CenturyLink's qualified and non-qualified defined benefit pension plans and qualified post-retirement benefit plans was \$2.409 billion and \$3.360 billion , respectively. See Note 7—Employee Benefits to our consolidated financial statements in Item 8 of Part II of this annual report and Note 9—Employee Benefits to the consolidated financial statements in Item 8 of Part II of CenturyLink's annual report on Form 10-K for the year ended December 31, 2016 , for additional information about our and CenturyLink's pension and post-retirement benefit arrangements.

A substantial portion of our active and retired employees participate in CenturyLink's qualified pension and post-retirement benefit plans. On December 31, 2014, the QCII pension plan and a pension plan of an affiliate were merged into the CenturyLink Retirement Plan, which was renamed the CenturyLink Combined Pension Plan. Our contributions are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of our affiliates. Prior to the pension plan merger, the above-noted employees participated in the QCII pension plan.

Benefits paid by CenturyLink's qualified pension plan are paid through a trust that holds all of the plan's assets. Based on current laws and circumstances, CenturyLink does not expect any contributions to be required for their qualified pension plan during 2017. The amount of required contributions to CenturyLink's qualified pension plan in 2018 and beyond will depend on a variety of factors, most of which are beyond their control, including earnings on plan investments, prevailing interest rates, demographic experience, changes in plan benefits and changes in funding laws and regulations. CenturyLink occasionally makes voluntary contributions in addition to required contributions, including voluntary contributions in the amount of \$100 million made in the third quarter of both 2016 and 2015. CenturyLink currently expects to make a voluntary contribution of \$100 million to the trust in 2017.

Substantially all of CenturyLink's post-retirement health care and life insurance benefits plans are unfunded. Several trusts hold assets that have been used to help cover the health care costs of certain retirees. Assets in the post-retirement trusts have been substantially depleted as of December 31, 2016; however, CenturyLink plans to continue to pay certain benefits through the trusts. The fair value of these trust assets was approximately \$53 million at December 31, 2016, with a portion comprised of investments with restricted liquidity. Benefits not paid through the trusts are expected to be paid directly by CenturyLink.

The affiliate obligations, net in current and noncurrent liabilities on our consolidated balance sheets primarily represents the cumulative allocation of expense, net of payments, associated with QCII's pension plans and post-retirement benefits plans prior to the plan mergers. In 2015, we agreed to a plan to settle the outstanding pension and post-retirement affiliate obligations, net balance with QCII over a 30 year term. Payments will be made on a monthly basis. For the year ended December 31, 2016, we made settlement payments in the aggregate of \$97 million to QCII on our affiliate obligations, net balance. Changes in the affiliate obligations, net are reflected in operating activities on our consolidated statements of cash flows. For the year ended December 31, 2017, we expect to make settlement payments in the aggregate of \$87 million to QCII on our affiliate obligations, net balance.

For 2017, CenturyLink's estimated annual long-term rates of return are 6.5% and 5.0% for the pension plan trust assets and post-retirement plans' trust assets, respectively, based on the assets currently held. However, actual returns could be substantially different.

For additional information, see "Risk Factors—Risks Affecting Our Liquidity and Capital Resources—Adverse changes in the value of assets or obligations associated with CenturyLink's qualified pension plan could negatively impact CenturyLink's liquidity, which may in turn affect our business and liquidity" in Item 1A of Part I of this annual report.

Workforce Reductions

In response to the continued decline of CenturyLink's and our legacy services revenues and to better align our workforce with our workload requirements, CenturyLink periodically implements workforce reduction programs. In the third quarter of 2016, CenturyLink announced plans to reduce its workforce, which included our workforce, initially through voluntary severance packages and the balance through involuntary reductions. We recognized in the fourth quarter of 2016 a charge for severance expenses and other one-time termination benefits of \$78 million, \$52 million of which remained to be paid as of December 31, 2016.

In 2015, CenturyLink accepted CAF funding from the FCC of approximately \$500 million per year for six years to fund the deployment of voice and broadband capable infrastructure for approximately 1.2 million rural households and businesses in 33 states under the CAF Phase 2 high-cost support program. Of these amounts, approximately \$150 million is attributable to our service area, to provide service to approximately 0.3 million rural households and businesses in 13 states. The funding from the CAF Phase 2 support program has substantially replaced the funding from the interstate USF program that we previously utilized to support voice services in high-cost rural markets in these 13 states. In late 2015, we began receiving these monthly support payments from the FCC under the new CAF Phase 2 support program, which included (i) monthly support payments at a higher rate than under the interstate USF support program and (ii) a substantial one-time transitional payment designed to align the prior USF payments with the new CAF Phase 2 payments for the full year 2015. For 2016, we continued to receive monthly support payments at the higher rate than under the interstate USF support program. We received \$99 million and \$92 million more cash from the CAF Phase 2 program for the years ended December 31, 2016 and 2015, respectively, than the projected amounts we would have otherwise received during the same periods under the interstate USF support program.

As a result of accepting CAF Phase 2 support payments for 13 states, we will be obligated to make substantial capital expenditures to build broadband infrastructure over the next several years. See "Capital Expenditures" above.

In 2013, under the CAF Phase 1 Round 2 program, CenturyLink received \$40 million in funding, of which \$15 million was attributed to our service areas, for deployment of broadband services in rural areas. In compliance with program terms, during the second half of 2016 we returned \$8 million for failing to meet interim buildout milestones within the FCC specified time frames. As of December 31, 2016, we have included the remaining \$7 million of funding in deferred credits and other liabilities on our consolidated balance sheet. At the conclusion of the CAF 1 Round 2 program in the first quarter 2017, we will have an opportunity to reclaim a majority of the interim refund if we ultimately meet the CAF 1 Round 2 buildout targets.

For additional information on the FCC's CAF order and the USF program, see "Business—Regulation" in Item 1 of Part I of this annual report.

Historical Information

The following tables summarize our consolidated cash flow activities:

	Years Ended December 31,		Increase /
	2016	2015	(Decrease)
	(Dollars in millions)		
Net cash provided by operating activities	\$ 2,652	2,591	61
Net cash used in investing activities	(1,334)	(1,220)	114
Net cash used in financing activities	(1,316)	(1,374)	(58)
	(Dollars in millions)		
	Years Ended December 31,		Increase /
	2015	2014	(Decrease)
	(Dollars in millions)		
Net cash provided by operating activities	\$ 2,591	2,801	(210)
Net cash used in investing activities	(1,220)	(1,251)	(31)
Net cash used in financing activities	(1,374)	(1,558)	(184)

Operating Activities

Net cash provided by operating activities increased by \$61 million for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to positive variances in the changes in accounts payable, other current assets and liabilities, net and other non-current assets and liabilities, net, which were partially offset by a decrease in net income adjusted for non-cash items and a negative variance in the change in accounts receivable. Net cash provided by operating activities decreased by \$210 million for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to negative variances in the changes in affiliate obligations, net and accounts payable. During the years ended December 31, 2016 and 2015, we made a settlement payment of \$97 million and \$105 million, respectively, to QCII on our affiliate obligations, net balance. Our net cash provided by operating activities in 2016 and 2015 were positively impacted by the cash received from the CAF Phase 2 support program, which was \$99 million and \$92 million greater in 2016 and 2015, respectively, than the projected amounts of cash we would have otherwise received during the same periods under the interstate USF support program. For additional information about our operating results, see "Results of Operations" above.

Investing Activities

Net cash used in investing activities increased by \$114 million for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to a negative variance in the change in the amount of funds advanced to our affiliates. Net cash used in investing activities decreased by \$31 million for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to a positive variance in the change in the amount of funds advanced to our affiliates, which was substantially offset by an increase in payments for property, plant and equipment.

Financing Activities

Net cash used in financing activities decreased by \$58 million for the year ended December 31, 2016 as compared to the year ended December 31, 2015 primarily due to a decrease in the amount of dividends paid to Qwest Service Corporation. Net cash used in financing activities decreased by \$184 million for the year ended December 31, 2015 as compared to the year ended December 31, 2014 primarily due to decreases in the amount of net debt paydowns on long-term debt and dividend payments. For additional information regarding our financing activities, see Note 3—Long-Term Debt and Revolving Promissory Note to our consolidated financial statements in Item 8 of Part II of this annual report.

On September 15, 2016, QC redeemed \$287 million of its 7.5% Notes due 2051, which resulted in a loss of \$9 million .

On August 29, 2016, QC redeemed all \$661 million of its 7.375% Notes due 2051, which resulted in a loss of \$18 million .

On August 22, 2016, QC issued \$978 million aggregate principal amount of 6.5% Notes due 2056, including \$128 million principal amount that was sold pursuant to an over-allotment option, in exchange for net proceeds, after deducting underwriting discounts and other expenses, of \$946 million .

On May 2, 2016, QC paid at maturity the \$235 million principal amount and accrued and unpaid interest due under its 8.375% Notes.

On January 29, 2016, QC issued \$235 million aggregate principal amount of 7% Notes due 2056, in exchange for net proceeds, after deducting underwriting discounts and other expenses, of \$227 million .

See Note 3—Long-Term Debt and Revolving Promissory Note to our consolidated financial statements in Item 8 of Part II of this annual report, for additional information on our outstanding debt securities.

Other Matters

In February 2015, the FCC adopted new regulations that regulate broadband services as a public utility service under Title II of the Communications Act. In light of pending litigation and changes in the composition of the FCC, we believe it is premature for us to determine the ultimate impact of the new regulations on our operations. For additional information, see “Risk Factors—Risks Relating to Legal and Regulatory Matters” in Item 1A of Part I of this annual report.

CenturyLink and its affiliates are involved in several legal proceedings to which we are not a party that, if resolved against them, could have a material adverse effect on their business and financial condition. As a wholly-owned subsidiary of CenturyLink, our business and financial condition could be similarly affected. You can find descriptions of these legal proceedings in CenturyLink's quarterly and annual reports filed with the SEC. Because we are not a party to any of the matters, we have not accrued any liabilities for these matters as of December 31, 2016 .

Market Risk

We are exposed to market risk from changes in interest rates on our variable rate long-term debt obligations and revolving promissory note. We seek to maintain a favorable mix of fixed and variable rate debt in an effort to limit interest costs and cash flow volatility resulting from changes in rates.

Management periodically reviews our exposure to interest rate fluctuations and periodically implements strategies to manage the exposure. From time to time, we have used derivative instruments to (i) lock-in or swap our exposure to changing or variable interest rates for fixed interest rates or (ii) to swap obligations to pay fixed interest rates for variable interest rates. As of December 31, 2016 , we had no such instruments outstanding. We have established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative instrument activities. We do not hold or issue derivative financial instruments for trading or speculative purposes.

At December 31, 2016 , we had approximately \$7.259 billion (excluding capital lease and other obligations) of long-term debt outstanding, which bears interest at fixed rates and is therefore not exposed to interest rate risk. At December 31, 2016 , we had \$100 million floating rate debt exposed to changes in the London InterBank Offered Rate (LIBOR). A hypothetical increase of 100 basis points in LIBOR relative to this debt would decrease our annual pre-tax earnings by \$1 million . At December 31, 2016 , we had approximately \$914 million in debt, which was owed to an affiliate of our ultimate parent, CenturyLink. The note payable-affiliate bears interest at a variable rate, which is based on a weighted average per annum interest rate of CenturyLink's outstanding borrowings for the interest period and therefore is exposed to potential interest rate risk.

Certain shortcomings are inherent in the method of analysis presented in the computation of exposures to market risks. Actual values may differ materially from those disclosed by us from time to time if market conditions vary from the assumptions used in the analyses performed. These analyses only incorporate the risk exposures that existed at December 31, 2016 .

Off-Balance Sheet Arrangements

We have no special purpose or limited purpose entities that provide off-balance sheet financing, liquidity, or market or credit risk support and we do not engage in leasing, hedging or other similar activities that expose us to any significant liabilities that are not (i) reflected on the face of the consolidated financial statements, (ii) disclosed in Note 15—Commitments and Contingencies to our consolidated financial statements in Item 8 of Part II of this annual report, or in the Future Contractual Obligations table included in this Item 7 of Part II above, or (iii) discussed under the heading "Market Risk" above.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The information in "Management's Discussion and Analysis of Financial Condition and Results of Operations—Market Risk" in Item 7 of Part II of this annual report is incorporated herein by reference.

ITEM 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholder
Qwest Corporation:

We have audited the accompanying consolidated balance sheets of Qwest Corporation and subsidiaries (the Company) as of December 31, 2016 and 2015 , and the related consolidated statements of operations, cash flows, and stockholder's equity for each of the years in the three-year period ended December 31, 2016 . These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2016 and 2015 , and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2016 , in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Shreveport, Louisiana
March 2, 2017

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
OPERATING REVENUES			
Operating revenues	\$ 6,247	6,557	6,676
Operating revenues - affiliates	2,663	2,407	2,162
Total operating revenues	8,910	8,964	8,838
OPERATING EXPENSES			
Cost of services and products (exclusive of depreciation and amortization)	2,934	2,872	2,879
Selling, general and administrative	1,022	1,015	1,086
Operating expenses - affiliates	941	960	756
Depreciation and amortization	1,691	1,857	2,005
Total operating expenses	6,588	6,704	6,726
OPERATING INCOME	2,322	2,260	2,112
OTHER (EXPENSE) INCOME			
Interest expense	(478)	(473)	(464)
Interest expense - affiliates, net	(59)	(53)	(40)
Other (expense) income, net	(22)	(1)	1
Total other expense, net	(559)	(527)	(503)
INCOME BEFORE INCOME TAX EXPENSE	1,763	1,733	1,609
Income tax expense	678	659	639
NET INCOME	\$ 1,085	1,074	970

See accompanying notes to consolidated financial statements.

QWEST CORPORATION
CONSOLIDATED BALANCE SHEETS

	December 31,	
	2016	2015
	(Dollars in millions)	
<u>ASSETS</u>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 5	3
Accounts receivable, less allowance of \$53 and \$47	700	688
Advances to affiliates	872	788
Other	129	123
Total current assets	1,706	1,602
NET PROPERTY, PLANT AND EQUIPMENT		
Property, plant and equipment	13,247	12,182
Accumulated depreciation	(5,602)	(4,808)
Net property, plant and equipment	7,645	7,374
GOODWILL AND OTHER ASSETS		
Goodwill	9,354	9,354
Customer relationships, net	1,877	2,435
Other intangible assets, net	471	613
Other, net	96	92
Total goodwill and other assets	11,798	12,494
TOTAL ASSETS	\$ 21,149	21,470
<u>LIABILITIES AND STOCKHOLDER'S EQUITY</u>		
CURRENT LIABILITIES		
Current maturities of long-term debt	\$ 514	242
Accounts payable	398	369
Note payable - affiliate	914	855
Accrued expenses and other liabilities		
Salaries and benefits	273	211
Income and other taxes	175	189
Other	122	135
Current affiliate obligations, net	87	97
Advance billings and customer deposits	313	324
Total current liabilities	2,796	2,422
LONG-TERM DEBT	6,747	6,997
DEFERRED CREDITS AND OTHER LIABILITIES		
Deferred revenues	131	137
Deferred income taxes, net	1,773	1,896
Affiliate obligations, net	944	1,051
Other	66	60
Total deferred credits and other liabilities	2,914	3,144
COMMITMENTS AND CONTINGENCIES (Note 15)		
STOCKHOLDER'S EQUITY		
Common stock - one share without par value, owned by Qwest Services Corporation	10,050	10,050
Accumulated deficit	(1,358)	(1,143)
Total stockholder's equity	8,692	8,907
TOTAL LIABILITIES AND STOCKHOLDER'S EQUITY	\$ 21,149	21,470

See accompanying notes to consolidated financial statements.

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
OPERATING ACTIVITIES			
Net income	\$ 1,085	1,074	970
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	1,691	1,857	2,005
Deferred income taxes	(123)	(189)	(228)
Provision for uncollectible accounts	80	78	64
Net long-term debt issuance costs and premium amortization	(12)	(18)	(38)
Accrued interest on affiliate note	59	59	42
Net loss on early retirement of debt	27	—	—
Impairment of asset	11	—	17
Changes in current assets and liabilities:			
Accounts receivable	(92)	(26)	(66)
Accounts payable	5	(79)	(9)
Accrued income and other taxes	(14)	(8)	(9)
Other current assets and liabilities, net	47	1	34
Other current assets and liabilities - affiliates	—	(4)	9
Changes in other noncurrent assets and liabilities, net	1	(30)	1
Changes in affiliate obligations, net	(117)	(123)	8
Other, net	4	(1)	1
Net cash provided by operating activities	2,652	2,591	2,801
INVESTING ACTIVITIES			
Payments for property, plant and equipment and capitalized software	(1,259)	(1,247)	(1,165)
Changes in advances to affiliates	(84)	24	(100)
Proceeds from sale of property	9	3	14
Net cash used in investing activities	(1,334)	(1,220)	(1,251)
FINANCING ACTIVITIES			
Net proceeds from issuance of long-term debt	1,173	495	483
Payments of long-term debt	(1,189)	(517)	(641)
Early retirement of debt costs	—	(2)	—
Dividends paid to Qwest Services Corporation	(1,300)	(1,350)	(1,400)
Net cash used in financing activities	(1,316)	(1,374)	(1,558)
Net increase (decrease) in cash and cash equivalents	2	(3)	(8)
Cash and cash equivalents at beginning of period	3	6	14
Cash and cash equivalents at end of period	\$ 5	3	6
Supplemental cash flow information:			
Income taxes paid, net	\$ (801)	(848)	(861)
Interest paid (net of capitalized interest of \$19, \$18 and \$17)	\$ (488)	(497)	(505)

See accompanying notes to consolidated financial statements.

QWEST CORPORATION
CONSOLIDATED STATEMENTS OF STOCKHOLDER'S EQUITY

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
COMMON STOCK			
Balance at beginning of period	\$ 10,050	10,050	10,050
Balance at end of period	10,050	10,050	10,050
ACCUMULATED DEFICIT			
Balance at beginning of period	(1,143)	(867)	(437)
Net income	1,085	1,074	970
Dividends declared to Qwest Services Corporation	(1,300)	(1,350)	(1,400)
Balance at end of period	(1,358)	(1,143)	(867)
TOTAL STOCKHOLDER'S EQUITY	\$ 8,692	8,907	9,183

See accompanying notes to consolidated financial statements.

QWEST CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless the context requires otherwise, references in this annual report to "QC" refer to Qwest Corporation, references to "Qwest," "we," "us," and "our" refer to Qwest Corporation and its consolidated subsidiaries, references to "QSC" refer to our direct parent company, Qwest Services Corporation, and its consolidated subsidiaries, references to "QCII" refer to QSC's direct parent company and our indirect parent company, Qwest Communications International Inc., and its consolidated subsidiaries, and references to "CenturyLink" refer to QCII's direct parent company and our ultimate parent company, CenturyLink, Inc., and its consolidated subsidiaries.

(1) Background and Summary of Significant Accounting Policies

General

We are an integrated communications company engaged primarily in providing an array of communications services to our residential and business customers. Our communications services include local voice, broadband, private line (including special access), network access, Ethernet, information technology, video and other ancillary services. In certain local and regional markets, we also provide local access and fiber transport services to competitive local exchange carriers.

We generate the majority of our total consolidated operating revenues from services provided in the 14 -state region of Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington and Wyoming . We refer to this region as our local service area.

On April 1, 2011, our indirect parent QCII became a wholly-owned subsidiary of CenturyLink, Inc. in a tax-free, stock-for-stock transaction.

Basis of Presentation

The accompanying consolidated financial statements include our accounts and the accounts of our subsidiaries. Intercompany amounts and transactions with our consolidated subsidiaries have been eliminated. Transactions with our non-consolidated affiliates (referred to herein as affiliates) have not been eliminated.

In 2015, our ultimate parent company, CenturyLink, Inc. ("CenturyLink"), changed their allocation methodology with respect to their now centrally managed pension and post-retirement plans. Specifically, under this new methodology, CenturyLink will allocate current service costs to subsidiaries relative to employees which are currently earning benefits under the pension and post-retirement benefit plans. The net periodic benefit cost allocated to us is now paid on a monthly basis through CenturyLink's intercompany cash management process. The change in methodology resulted in a decrease of \$7 million to our net periodic benefit cost for the year ended December 31, 2015.

We reclassified certain prior period amounts to conform to the current period presentation, including the categorization of our revenues. See Note 9—Products and Services Revenues for additional information. These changes had no impact on total operating revenues, total operating expenses or net income for any period presented.

Connect America Fund

In 2015, CenturyLink accepted Connect America Fund ("CAF") funding from the Federal Communications Commission ("FCC") of approximately \$500 million per year for six years to fund the deployment of voice and broadband capable infrastructure for approximately 1.2 million rural households and businesses in 33 states under the CAF Phase 2 high-cost support program. The funding from the CAF Phase 2 support program has substantially replaced the funding from the interstate Universal Service Fund ("USF") program that we previously utilized to support voice services in high-cost rural markets in these 33 states. Of these amounts, approximately \$150 million is attributable to our service area, to provide service to approximately 0.3 million rural households and businesses in 13 states. In late 2015, we began receiving these monthly support payments from the FCC under the new CAF Phase 2 support program, which included (i) monthly support payments at a higher rate than under the interstate USF support program and (ii) a substantial one-time transitional payment, designed to align the prior USF payments with the new CAF Phase 2 payments for the full year 2015. For 2016, we continued to receive the monthly support payments at the higher rate than under the interstate USF support program. We recorded \$95 million more revenue from the CAF Phase 2 program for each of the years ended December 31, 2016 and 2015 than the projected amounts we would have otherwise recorded during the same periods under the interstate USF support program.

Summary of Significant Accounting Policies

Use of Estimates

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles. These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions we make when accounting for specific items and matters, including, but not limited to, long-term contracts, customer retention patterns, allowance for doubtful accounts, depreciation, amortization, asset valuations, rates used for affiliate cost allocations, internal labor capitalization rates, recoverability of assets (including deferred tax assets), impairment assessments, taxes, certain liabilities and other provisions and contingencies, are reasonable, based on information available at the time they are made. Our accounting for CenturyLink's indirect acquisition of us required extensive use of estimates in determining the acquisition date fair values of our assets and liabilities. These estimates, judgments and assumptions can materially affect the reported amounts of assets, liabilities and components of stockholder's equity as of the dates of the consolidated balance sheets, as well as the reported amounts of revenues, expenses and components of cash flows during the periods presented in our other consolidated financial statements. We also make estimates in our assessments of potential losses in relation to threatened or pending tax and legal matters. See Note 11—Income Taxes and Note 15—Commitments and Contingencies for additional information.

For matters not related to income taxes, if a loss is considered probable and the amount can be reasonably estimated, we recognize an expense for the estimated loss. If we have the potential to recover a portion of the estimated loss from a third party, we make a separate assessment of recoverability and reduce the estimated loss if recovery is also deemed probable.

For matters related to income taxes, if we determine that the impact of an uncertain tax position is more likely than not to be sustained upon audit by the relevant taxing authority, then we recognize a benefit for the largest amount that is more likely than not to be sustained. No portion of an uncertain tax position will be recognized if the position has less than a 50% likelihood of being sustained. Interest is recognized on the amount of unrecognized benefit from uncertain tax positions.

For all of these and other matters, actual results could differ materially from our estimates.

Revenue Recognition

We recognize revenue for services when the related services are provided. Recognition of certain payments received in advance of services being provided is deferred until the service is provided. These advance payments include activation and installation charges, which we recognize as revenue over the expected customer relationship period, which ranges from two to thirteen years depending on the service. We also defer costs for customer activations and installations. The deferral of customer activation and installation costs is limited to the amount of revenue deferred on advance payments. Costs in excess of advance payments are recorded as expense in the period such costs are incurred. Expected customer relationship periods are estimated using historical experience. In most cases, termination fees or other fees on existing contracts that are negotiated in conjunction with new contracts are deferred and recognized over the new contract term.

We offer bundle discounts to our customers who receive certain groupings of services. These bundle discounts are recognized concurrently with the associated revenue and are allocated to the various services in the bundled offering based on the estimated selling price of services included in each bundled combination.

Customer arrangements that include both equipment and services are evaluated to determine whether the elements are separable. If the elements are deemed separable and separate earnings processes exist, the revenue associated with the customer arrangement is allocated to each element based on the relative estimated selling price of the separate elements. We have estimated the selling prices of each element by reference to vendor-specific objective evidence of selling prices when the elements are sold separately. The revenue associated with each element is then recognized as earned. For example, if we receive an advance payment when we sell equipment and continuing service together, we immediately recognize as revenue the amount allocated to the equipment as long as all the conditions for revenue recognition have been satisfied. The portion of the advance payment allocated to the service based upon its relative selling price is recognized ratably over the longer of the contractual period or the expected customer relationship period.

In connection with offering products and services provided by third-party vendors, we review the relationship between us, the vendor and the end customer to assess whether revenue should be reported on a gross or net basis. In assessing whether revenue should be reported on a gross or net basis, we consider whether we act as a principal in the transaction, take title to the products, have risk and rewards of ownership or act as an agent or broker. Based on CenturyLink's agreements with DIRECTV and Verizon Wireless, we offer these services through sales agency relationships which are reported on a net basis.

Affiliate Transactions

We provide to our affiliates telecommunications services that we also provide to external customers. In addition, we provide to our affiliates computer system development and support services. Services provided by us to our affiliates are recognized as operating revenue-affiliates in our consolidated statements of operations. We also purchase services from our affiliates including telecommunications services, marketing and employee-related support services. Services provided to us from our affiliates are recognized as operating expenses-affiliates on our consolidated statements of operations. Because of the significance of the services we provide to our affiliates and our affiliates provide to us, the results of operations, financial position and cash flows presented herein are not necessarily indicative of the results of operations, financial position and cash flows we would have achieved had we operated as a stand-alone entity during the periods presented.

We recognize intercompany charges at the amounts billed to us by our affiliates and we recognize intercompany revenue for services we bill to our affiliates. Regulatory rules require certain revenues and expenses to be recorded at market price or fully distributed cost. Our compliance with regulations is subject to review by regulators. Adjustments to intercompany charges that result from these reviews are recorded in the period they become known.

CenturyLink has cash management arrangements between certain of its subsidiaries that include lines of credit, affiliate obligations, capital contributions and dividends. As part of these cash management arrangements, an affiliate provides lines of credit to certain other affiliates. Amounts outstanding under these lines of credit and intercompany obligations vary from time to time. Under these arrangements, the majority of our cash balance is transferred on a daily basis to CenturyLink and most affiliate transactions are deemed to be settled at the time the transactions are recorded in our accounting records, with the resulting net balance at the end of each period reflected as advances to affiliates on the accompanying consolidated balance sheets. From time to time we declare and pay dividends to our parent, QSC, which are settled through the advances to affiliates, which has the net effect of reducing the amount of these advances. Dividends declared are reflected on our consolidated statements of stockholder's equity and the consolidated statements of cash flows reflects the changes in advances to affiliates as investing activities and changes in advances from affiliates as financing activities. Interest is assessed on the advances to/from affiliates on either the three-month U.S T-bill rate (for advances to affiliates) or CenturyLink's weighted average borrowing rate (for advances from affiliates).

The affiliate obligations, net in current and noncurrent liabilities on our consolidated balance sheets primarily represents the cumulative allocation of expense, net of payments, associated with QCII's pension plans and post-retirement benefits plans prior to the plan mergers. In 2015, we agreed to a plan to settle the outstanding affiliate obligations, net balance with QCII over a 30 year term. Payments will be made on a monthly basis. For the years ended December 31, 2016 and 2015, we made settlement payments of \$97 million and \$105 million, respectively, to QCII on our affiliate obligations, net balance. Changes in the affiliate obligations, net are reflected in operating activities on our consolidated statements of cash flows.

In the normal course of business, we transfer assets to and from various affiliates through our parent, QSC, which are recorded through our equity. It is our policy to record asset transfers based on carrying values.

USF Surcharges, Gross Receipts Taxes and Other Surcharges

In determining whether to include in our revenues and expenses the taxes and surcharges collected from customers and remitted to government authorities, including USF surcharges, sales, use, value added and some excise taxes, we assess, among other things, whether we are the primary obligor or principal taxpayer for the taxes assessed in each jurisdiction where we do business. In jurisdictions where we determine that we are the principal taxpayer, we record the surcharges on a gross basis and include them in our revenues and costs of services and products. In jurisdictions where we determine that we are merely a collection agent for the government authority, we record the taxes on a net basis and do not include them in our revenues and costs of services and products.

Advertising Costs

Costs related to advertising are expensed as incurred and included in selling, general and administrative expenses in our consolidated statements of operations. Our advertising expense was \$91 million, \$84 million and \$83 million for the years ended December 31, 2016, 2015 and 2014, respectively.

Legal Costs

In the normal course of our business, we incur costs to hire and retain external legal counsel to advise us on regulatory, litigation and other matters. We expense these costs as the related services are received.

Income Taxes

Our results are included in the CenturyLink consolidated federal income tax return and certain combined state income tax returns. CenturyLink allocates income tax expense to us based upon a separate return allocation method which results in income tax expense that approximates the expense that would result if we were a stand-alone entity. Our reported deferred tax assets and liabilities, as discussed below and in Note 11—Income Taxes, are primarily determined as a result of the application of the separate return allocation method and therefore the settlement of these amounts is dependent upon our parent, CenturyLink, rather than tax authorities. Our current expectation is that the vast majority of deferred tax assets and liabilities will be settled through our general intercompany obligation based upon the current CenturyLink policy. CenturyLink has the right to change their policy regarding settlement of these assets and liabilities at any time.

The provision for income taxes consists of an amount for taxes currently payable, an amount for tax consequences deferred to future periods and adjustments to our liabilities for uncertain tax positions. We record deferred income tax assets and liabilities reflecting future tax consequences attributable to differences between the financial statement carrying value of assets and liabilities and the tax bases of those assets and liabilities. Deferred taxes are computed using enacted tax rates expected to apply in the year in which the differences are expected to affect taxable income. The effect on deferred income tax assets and liabilities of a change in tax rate is recognized in earnings in the period that includes the enactment date.

We establish valuation allowances when necessary to reduce deferred income tax assets to the amounts that we believe are more likely than not to be recovered. Each quarter we evaluate the need to retain all or a portion of the valuation allowance on our deferred tax assets. See Note 11—Income Taxes for additional information.

Cash and Cash Equivalents

Cash and cash equivalents include highly liquid investments that are readily convertible into cash and are not subject to significant risk from fluctuations in interest rates. As a result, the value at which cash and cash equivalents are reported in our consolidated financial statements approximates their fair value. Our cash collections are transferred to CenturyLink on a daily basis and our ultimate parent funds our cash disbursement needs. The net cash transferred to CenturyLink has been reflected as advances to affiliates in our consolidated balance sheets.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recognized based upon the amount due from customers for the services provided or at cost for purchased and other receivables less an allowance for doubtful accounts. The allowance for doubtful accounts receivable reflects our best estimate of probable losses inherent in our receivable portfolio determined on the basis of historical experience, specific allowances for known troubled accounts and other currently available evidence. We generally consider our accounts past due if they are outstanding over 30 days. Our collection process varies by the customer segment, amount of the receivable, and our evaluation of the customer's credit risk. Our past due accounts are written off against our allowance for doubtful accounts when collection is considered to be not probable. Any recoveries of accounts previously written off are generally recognized as a reduction in bad debt expense in the period received. The carrying value of accounts receivable, net of the allowance for doubtful accounts, approximates fair value.

Property, Plant and Equipment

As a result of our indirect acquisition by CenturyLink, property, plant and equipment acquired at the time of acquisition was recorded based on its estimated fair value as of the acquisition date. Subsequently purchased and constructed property, plant and equipment is recorded at cost. Property, plant and equipment is depreciated primarily using the straight-line group method. Under the straight-line group method, assets dedicated to providing telecommunications services (which comprise the majority of our property, plant and equipment) that have similar physical characteristics, use and expected useful lives are pooled for purposes of depreciation and tracking. The equal life group procedure is used to establish each pool's average remaining useful life. Generally, under the straight-line group method, when an asset is sold or retired in the course of normal business activities, the cost is deducted from property, plant and equipment and charged to accumulated depreciation without recognition of a gain or loss. A gain or loss is recognized in our consolidated statements of operations only if a disposal is unusual. Leasehold improvements are amortized over the shorter of the useful lives of the assets or the expected lease term. Expenditures for maintenance and repairs are expensed as incurred. Interest is capitalized during the construction phase of network and other internal-use capital projects. Employee-related costs for construction of network and other internal use assets are also capitalized during the construction phase. Property, plant and equipment supplies used internally are carried at average cost, except for significant individual items for which cost is based on specific identification.

We perform annual internal reviews to evaluate the reasonableness of the depreciable lives for our property, plant and equipment. Our reviews utilize models that take into account actual usage, physical wear and tear, replacement history, assumptions about technology evolution and, in certain instances, actuarially determined probabilities to estimate the remaining useful life of our asset base. Our remaining useful life assessments anticipate the loss in service value of assets that may precede the physical retirement. Assets shared among many customers may lose service value as those customers leave the network. However, the asset is not retired until all customers no longer utilize the asset and we determine there is no alternative use for the asset.

We review long-lived tangible assets for impairment whenever facts and circumstances indicate that the carrying amounts of the assets may not be recoverable. For assessment purposes, long-lived assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities, absent a material change in operations. An impairment loss is recognized only if the carrying amount of the asset group is not recoverable and exceeds its fair value. Recoverability of the asset group to be held and used is assessed by comparing the carrying amount of the asset group to the estimated undiscounted future net cash flows expected to be generated by the asset group. If the asset group's carrying value is not recoverable, an impairment charge is recognized for the amount by which the carrying amount of the asset group exceeds its fair value. We determine fair values by using a combination of comparable market values and discounted cash flows, as appropriate.

Goodwill, Customer Relationships and Other Intangible Assets

Intangible assets arising from business combinations, such as goodwill, customer relationships and capitalized software are initially recorded at estimated fair value. We amortize customer relationships primarily over an estimated life of ten years, using either the sum-of-the-years-digits or the straight-line methods, depending on the type of customer. We amortize capitalized software using the straight-line method over estimated lives ranging up to seven years. Other intangible assets not arising from business combinations are initially recorded at cost.

Internally used software, whether purchased or developed by us, is capitalized and amortized using the straight-line method over its estimated useful life. We have capitalized certain costs associated with software such as costs of employees devoting time to the projects and external direct costs for materials and services. Costs associated with software to be used for internal purposes are expensed until the point at which the project has reached the development stage. Subsequent additions, modifications or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance, data conversion and training costs are expensed in the period in which they are incurred. We review the remaining economic lives of our capitalized software annually. Capitalized software is included in other intangible assets, net, in our consolidated balance sheets.

We are required to assess goodwill for impairment at least annually, or more frequently, if an event occurs or circumstances change that would indicate an impairment may have occurred. We are required to write-down the value of goodwill in periods in which the recorded amount of goodwill exceeds the implied fair value of goodwill. The impairment assessment is performed annually at the reporting unit level. We have determined that our operations consist of one reporting unit, consistent with our determination that our business consists of one operating segment. See Note 2—Goodwill, Customer Relationships and Other Intangible Assets for additional information.

Pension and Post-Retirement Benefits

A substantial portion of our active and retired employees participate in the CenturyLink Combined Pension Plan. On December 31, 2014, the QCII pension plan and a pension plan of an affiliate were merged into the CenturyLink Retirement Plan. The CenturyLink Retirement Plan was renamed the CenturyLink Combined Pension Plan. Prior to the pension plan merger, the above-noted employees participated in the QCII pension plan. In addition, certain of our employees participate in CenturyLink's post-retirement health care and life insurance benefit plans. CenturyLink allocates service costs relating to pension and post-retirement health care and life insurance benefits to us and its other affiliates. The amounts contributed by us through CenturyLink are not segregated or restricted to pay amounts due to our employees and may be used to provide benefits to other employees of CenturyLink. The allocation of the service costs to us is based upon our employees who are currently earning benefits under the plans.

For further information on qualified pension, post-retirement and other post-employment benefit plans, see CenturyLink's annual report on Form 10-K for the year ended December 31, 2016.

Recent Accounting Pronouncements

Income Taxes

On October 24, 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-16, "Intra-Entity Transfers of Assets Other Than Inventory" ("ASU 2016-16"). ASU 2016-16 eliminates the current prohibition on the recognition of the income tax effects on the transfer of assets among our subsidiaries. After adoption of this ASU, the income tax effects associated with these asset transfers, except for the transfer of inventory, will be recognized in the period the asset is transferred versus the current deferral and recognition upon either the sale of the asset to a third party or over the remaining useful life of the asset. We are currently reviewing the requirements of this ASU and evaluating the impact on our consolidated financial statements.

We are required to adopt the provisions of ASU 2016-16 on January 1, 2018, but have the option to early adopt as of January 1, 2017. We plan to adopt the provision of ASU 2016-16 on January 1, 2018. The impact of adopting ASU 2016-16, if any, will be recognized through a cumulative adjustment to retained earnings as of the date of adoption.

Financial Instruments

On June 16, 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). The primary impact of ASU 2016-13 for us is a change in the model for the recognition of credit losses related to our financial instruments from an incurred loss model, which recognized credit losses only if it was probable that a loss had been incurred, to an expected loss model, which requires our management team to estimate the total credit losses expected on the portfolio of financial instruments. We are currently reviewing the requirements of the standard and evaluating the impact on our consolidated financial statements.

We are required to adopt the provisions of ASU 2016-13 effective January 1, 2020, but could elect to early adopt the provisions as of January 1, 2019. We expect to recognize any impacts of adopting ASU 2016-13 through a cumulative adjustment to retained earnings as of the date of adoption. As of the date of this annual report, we have not yet determined the date we will adopt ASU 2016-13.

Share-based Compensation

On March 30, 2016, the FASB issued ASU 2016-09, "Improvement to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 modifies the accounting and associated income tax accounting for share-based compensation in order to reduce the cost and complexity associated with current generally accepted accounting principles. ASU 2016-09 became effective as of January 1, 2017. ASU 2016-09 includes different transition requirements for the different changes implemented, including some provisions which allow retrospective application. We will implement this new standard on its effective date.

The primary provisions of ASU 2016-09 that we expect will affect our financial statements are: (1) a reclassification of the tax effect associated with the difference between the expense recognized for share-based payments and the associated tax deduction from additional paid-in capital to income tax expense; (2) a reclassification of the tax effect associated with the difference between compensation expense and associated deduction from financing cash flow to operating cash flow; and (3) a change in our accounting policy to account for forfeitures of share-based payment grants as they occur as opposed to our current policy of estimating the forfeitures on the grant date. The adoption of this accounting policy change will result in an immaterial increase in our retained earnings as of January 1, 2017. Although the provisions would not have had a material impact on our previously-issued financial statements, we cannot provide any assurance regarding their future impacts. Adoption of ASU 2016-09 may increase the volatility of income tax expense and cash flow from operating activities.

Leases

On February 25, 2016, the FASB issued ASU 2016-02, "Leases" ("ASU 2016-02"). The core principle of ASU 2016-02 will require lessees to present right-of-use assets and lease liabilities on their balance sheets for operating leases, which are currently not reflected on their balance sheets.

ASU 2016-02 is effective for annual and interim periods beginning January 1, 2019. Early adoption of ASU 2016-02 is permitted. Upon adoption of ASU 2016-02, we are required to recognize and measure leases at the beginning of the earliest period presented in our consolidated financial statements using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that we may elect to apply. We will implement this new standard on its effective date, but we have not yet decided which practical expedient options we will elect.

We are currently evaluating our existing lease accounting systems to determine whether our current systems will support the new accounting requirements or if upgrades or new systems will be required, and we are in the process of developing an implementation plan. We are also currently evaluating and assessing the impact ASU 2016-02 will have on us and our consolidated financial statements. As of the date of this annual report, we cannot provide any estimate of the impact of adopting ASU 2016-02.

Revenue Recognition

On May 28, 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 replaces virtually all existing generally accepted accounting principles (“GAAP”) on revenue recognition and replaces them with a principles-based approach for determining revenue recognition using a new five step model. The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also includes new accounting principles related to the deferral and amortization of contract acquisition and fulfillment costs. We currently do not defer any contract acquisition costs but we expect we will defer certain contract acquisition costs in the future which could have the impact of lowering our operating expenses. We currently defer contract fulfillment costs only up to the extent of any revenue deferred. Under ASU 2014-09, in certain transactions our deferred contract fulfillment costs could exceed our deferred revenues, which could result in an increase in deferred costs and could also have the impact of lowering our operating expenses.

On July 9, 2015, the FASB approved the deferral of the effective date of ASU 2014-09 by one year until January 1, 2018, which is the date we plan to adopt this standard. ASU 2014-09 may be adopted by applying the provisions of this standard on a retrospective basis to the periods included in the financial statements or on a modified retrospective basis which would result in the recognition of a cumulative effect of adopting ASU 2014-09 in the first quarter of 2018. We have completed our initial assessment of our business and systems requirements and we are currently developing and implementing a new revenue recognition system to comply with the requirements of ASU 2014-09. Based on this initial assessment, we currently plan to adopt the new revenue recognition standard under the modified retrospective transition method. Until we are further along in implementing our new revenue recognition system, we do not anticipate being able to provide reasonably accurate estimates of the impact of ASU 2014-09 on the timing of our revenue recognition.

(2) Goodwill, Customer Relationships and Other Intangible Assets

Goodwill, customer relationships and other intangible assets consisted of the following:

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Goodwill	\$ 9,354	9,354
Customer relationships, less accumulated amortization of \$3,822 and \$3,264	\$ 1,877	2,435
Other intangible assets subject to amortization:		
Capitalized software, less accumulated amortization of \$1,510 and \$1,383	\$ 471	613

As of December 31, 2016, the gross carrying amount of goodwill, customer relationships and other intangible assets was \$17.034 billion.

Total amortization expense for intangible assets was as follows:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Amortization expense for intangible assets	\$ 767	871	957

We estimate that total amortization expense for intangible assets for the years ending December 31, 2017 through 2021 will be as follows:

	(Dollars in millions)	
Year ending December 31,		
2017	\$	652
2018		584
2019		509
2020		440
2021		127

We annually review the estimated lives and methods used to amortize our other intangible assets. The actual amounts of amortization expense may differ materially from our estimates, depending on the results of our annual reviews.

Our goodwill was derived from CenturyLink's acquisition of us where the purchase price exceeded the fair value of the net assets acquired.

We assess our goodwill for impairment annually, or, under certain circumstances, more frequently, such as when events or changes in circumstances indicate there may be impairment. We are required to write down the value of goodwill only when our assessment determines the recorded amount of goodwill exceeds the fair value. Our annual impairment assessment date for goodwill is October 31, at which date we assessed goodwill at our reporting units. In reviewing the criteria for reporting units, we have determined that we are one reporting unit.

We compare our estimated fair value of equity to our carrying value of equity. If the estimated fair value of our equity is greater than the carrying value of our equity, we conclude that no impairment exists. If the estimated fair value of our equity is less than our carrying value of our equity, a second calculation is required in which the implied fair value of goodwill is compared to our carrying value of goodwill. If the implied fair value of goodwill is less than our carrying value of goodwill, goodwill must be written down to the implied fair value.

At October 31, 2016, we utilized a level 3 fair valuation technique to estimate the fair value of our equity by considering both a market approach and a discounted cash flow method. The market approach method includes the use of comparable multiples of publicly traded companies whose services are comparable to ours. The discounted cash flow method is based on the present value of projected cash flows and a terminal value, which represents the expected normalized cash flows of the reporting unit beyond the cash flows from the discrete projection period. We discounted the estimated cash flows using a rate that represents our estimated weighted average cost of capital, which we determined to be approximately 6.0% as of the assessment date (which was comprised of an after-tax cost of debt of 2.8% and a cost of equity of 6.2%). Based on our assessment performed with respect to our reporting unit as described above, we concluded that our goodwill was not impaired as of that date.

(3) Long-Term Debt and Revolving Promissory Note

Long-term debt, including unamortized premiums and discounts, unamortized debt issuance costs and note payable-affiliate, were as follows:

	Interest Rates	Maturities	As of December 31,	
			2016	2015
			(Dollars in millions)	
Senior notes	6.125% - 7.750%	2017 - 2056	\$ 7,259	7,229
Term loan	2.520%	2025	100	100
Capital lease and other obligations	Various	Various	32	17
Unamortized premiums, net			4	16
Unamortized debt issuance costs			(134)	(123)
Total long-term debt			7,261	7,239
Less current maturities			(514)	(242)
Long-term debt, excluding current maturities			\$ 6,747	6,997
Note payable-affiliate	6.678%	2022	\$ 914	855

New Issuances

2016

On August 22, 2016, QC issued \$978 million aggregate principal amount of 6.5% Notes due 2056, including \$128 million principal amount that was sold pursuant to an over-allotment option, in exchange for net proceeds, after deducting underwriting discounts and other expenses, of \$946 million . All of the 6.5% Notes are unsecured obligations and may be redeemed by QC, in whole or in part, on or after September 1, 2021, at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to the redemption date.

On January 29, 2016, QC issued \$235 million aggregate principal amount of 7% Notes due 2056, in exchange for net proceeds, after deducting underwriting discounts and other expenses, of \$227 million . All of the 7% Notes are unsecured obligations and may be redeemed by QC, in whole or in part, on or after February 1, 2021, at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to the redemption date.

2015

On September 21, 2015 , QC issued \$400 million aggregate principal amount of 6.625% Notes due 2055 , in exchange for net proceeds, after deducting underwriting discounts and other expenses, of approximately \$386 million . On September 30, 2015 , QC issued an additional \$10 million aggregate principal amount of the 6.625% Notes under an over-allotment option granted to the underwriter for this offering. All of the 6.625% Notes are unsecured obligations and may be redeemed by QC, in whole or in part, on or after September 15, 2020 , at a redemption price equal to 100% of the principal amount redeemed plus accrued and unpaid interest to the redemption date.

Repayments

2016

On September 15, 2016, QC redeemed \$287 million of its 7.5% Notes due 2051, which resulted in a loss of \$9 million .

On August 29, 2016, QC redeemed all \$661 million of its 7.375% Notes due 2051, which resulted in a loss of \$18 million .

On May 2, 2016, QC paid at maturity the \$235 million principal amount and accrued and unpaid interest due under its 8.375% Notes.

2015

On October 13, 2015 , QC redeemed all \$250 million of its 7.2% Notes due 2026, which resulted in an immaterial gain, and redeemed \$150 million of its 6.875% Notes due 2033, which resulted in an immaterial loss.

On June 15, 2015 , QC paid at maturity the \$92 million principal amount of its 7.625% Notes.

Term Loan

In 2015, QC entered into a term loan in the amount of \$100 million with CoBank, ACB. The outstanding unpaid principal amount of this term loan plus any accrued and unpaid interest is due on February 20, 2025. Interest is paid monthly based upon either the London Interbank Offered Rate ("LIBOR") or the base rate (as defined in the credit agreement) plus an applicable margin between 1.50% to 2.50% per annum for LIBOR loans and 0.50% to 1.50% per annum for base rate loans depending on QC's then current senior unsecured long-term debt rating. At both December 31, 2016 and 2015 , the outstanding principal balance on this term loan was \$100 million .

Aggregate Maturities of Long-Term Debt

Set forth below is the aggregate principal amount of our long-term debt (excluding unamortized premiums and discounts and unamortized debt issuance costs and other and excluding note payable-affiliate) maturing during the following years:

	(Dollars in millions) ⁽¹⁾
2017	\$ 514
2018	10
2019	4
2020	—
2021	951
2022 and thereafter	5,912
Total long-term debt	<u>\$ 7,391</u>

⁽¹⁾ Actual principal paid in any year may differ due to the possible future refinancing of outstanding debt or the issuance of new debt.

Revolving Promissory Note

QC is currently indebted to an affiliate of our ultimate parent company, CenturyLink, under a revolving promissory note that provides QC with a funding commitment of up to \$1.0 billion aggregate principal amount through June 30, 2022, of which \$914 million was outstanding as of December 31, 2016. As of December 31, 2016, the weighted average interest rate was 6.678%. As of December 31, 2016 and 2015, this revolving promissory note is reflected on our consolidated balance sheets as a current liability under “Note payable - affiliate”. As of December 31, 2016, \$5 million of accrued interest is reflected in other current liabilities on our consolidated balance sheets. In accordance with the note agreement, all accrued and unpaid interest is capitalized to the unpaid principal balance on June 1 and December 1 of each year.

Interest Expense

Interest expense includes interest on total long-term debt. The following table presents the amount of gross interest expense, net of capitalized interest and interest expense-affiliates, net:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Interest expense:			
Gross interest expense	\$ 497	491	481
Capitalized interest	(19)	(18)	(17)
Total interest expense	<u>\$ 478</u>	<u>473</u>	<u>464</u>
Interest expense-affiliates, net	<u>\$ 59</u>	<u>53</u>	<u>40</u>

Covenants

Our senior notes were issued under indentures dated April 15, 1990 and October 15, 1999. These indentures contain certain covenants including, but not limited to: (i) a prohibition on certain liens on our assets; and (ii) a limitation on mergers or sales of all, or substantially all, of our assets, which limitation requires that a successor assume the obligation with regard to these notes. These indentures do not contain any cross-default provisions. These indentures do not contain any financial covenants or restrictions on our ability to issue new securities thereunder.

Under the QC term loan, QC must maintain a debt to EBITDA (earnings before interest, taxes, depreciation and amortization, as defined in CenturyLink's Credit Facility) ratio of not more than 2.85 :1.0, as of the last day of each fiscal quarter for the four quarters then ended. The term loan also contains a negative pledge covenant, which generally requires us to secure equally and ratably any advances under the term loan if we pledge assets or permit liens on our property for the benefit of other debtholders. The term loan also has a cross payment default and cross acceleration provisions. When present, these provisions could have a wider impact on liquidity than might otherwise arise from a default or acceleration of a single debt instrument. Our debt to EBITDA ratio could be adversely affected by a wide variety of events, including unforeseen expenses or contingencies. This could reduce our financing flexibility due to potential restrictions on incurring additional debt under certain provisions of our debt agreements or, in certain circumstances, could result in a default under certain provisions of such agreements.

At December 31, 2016, we believe we were in compliance with all of the provisions and covenants contained in our debt agreements.

(4) Accounts Receivable

The following table presents details of our accounts receivable balances:

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Trade and purchased receivables	\$ 634	620
Earned and unbilled receivables	115	111
Other	4	4
Total accounts receivable	753	735
Less: allowance for doubtful accounts	(53)	(47)
Accounts receivable, less allowance	\$ 700	688

We are exposed to concentrations of credit risk from residential and business customers within our local service area and from other telecommunications service providers. No customers individually represented more than 10% of our accounts receivable for all periods presented herein. We generally do not require collateral to secure our receivable balances. We have agreements with other telecommunications service providers whereby we agree to bill and collect on their behalf for services rendered by those providers to our customers within our local service area. We purchase accounts receivable from other telecommunications service providers primarily on a recourse basis and include these amounts in our accounts receivable balance. We have not experienced any significant loss associated with these purchased receivables.

The following table presents details of our allowance for doubtful accounts:

	Beginning Balance	Additions	Deductions	Ending Balance
	(Dollars in millions)			
2016	\$ 47	80	(74)	53
2015	\$ 38	78	(69)	47
2014	\$ 43	64	(69)	38

(5) Property, Plant and Equipment

Net property, plant and equipment is composed of the following:

	Depreciable Lives	As of December 31,	
		2016	2015
(Dollars in millions)			
Property, plant and equipment:			
Land	N/A	\$ 348	349
Fiber, conduit and other outside plant ⁽¹⁾	15-45 years	5,980	5,362
Central office and other network electronics ⁽²⁾	4-10 years	3,855	3,614
Support assets ⁽³⁾	5-30 years	2,633	2,584
Construction in progress ⁽⁴⁾	N/A	431	273
Gross property, plant and equipment		13,247	12,182
Accumulated depreciation		(5,602)	(4,808)
Net property, plant and equipment		\$ 7,645	7,374

(1) Fiber, conduit and other outside plant consists of fiber and metallic cable, conduit, poles and other supporting structures.

(2) Central office and other network electronics consists of circuit and packet switches, routers, transmission electronics and electronics providing service to customers.

(3) Support assets consist of buildings, computers and other administrative and support equipment.

(4) Construction in progress includes inventory held for construction and property of the aforementioned categories that has not been placed in service as it is still under construction.

We recorded depreciation expense of \$924 million , \$986 million and \$1.048 billion for the years ended December 31, 2016 , 2015 and 2014 , respectively.

In 2014 , we recorded an impairment charge of \$17 million in connection with a sale-leaseback transaction involving an office building that we closed in the fourth quarter of 2014 . This impairment charge is included in selling, general and administrative expense in our consolidated statement of operations for the year ended December 31, 2014 .

(6) Severance

Periodically, we reduce our workforce and accrue liabilities for the related severance costs. These workforce reductions resulted primarily from the progression or completion of our post-acquisition integration plans related to CenturyLink's indirect acquisition of us, increased competitive pressures, cost reduction initiatives, process improvements through automation and reduced workload demands due to the loss of customers purchasing certain services.

We report severance liabilities within accrued expenses and other liabilities-salaries and benefits in our consolidated balance sheets and report severance expenses in cost of services and products and selling, general and administrative expenses in our consolidated statements of operations.

Changes in our accrued liability for severance expenses were as follows:

	Severance	
	(Dollars in millions)	
Balance at December 31, 2014	\$	10
Accrued to expense		51
Payments, net		(55)
Balance at December 31, 2015		6
Accrued to expense		89
Payments, net		(43)
Balance at December 31, 2016	\$	52

(7) Employee Benefits

Pension and Post-Retirement Benefits

QCII's post-retirement benefit plans were merged into CenturyLink's post-retirement benefit plans on January 1, 2012 and on December 31, 2014, QCII's qualified pension plan and a pension plan of an affiliate were merged into the CenturyLink Retirement Plan, which was renamed the CenturyLink Combined Pension Plan. Prior to the plan mergers, a substantial portion of our active and retired employees participated in QCII's pension and post-retirement plans. Based on current laws and circumstances, (i) CenturyLink was not required to make a cash contribution to the CenturyLink Combined Pension Plan in 2016 and (ii) CenturyLink does not expect it will be required to make a contribution in 2017. The amount of required contributions to the CenturyLink Combined Pension Plan in 2018 and beyond will depend on earnings on plan investments, prevailing discount rates, demographic experience, changes in plan benefits and changes in funding laws and regulations. CenturyLink occasionally makes voluntary contributions in addition to required contributions, and CenturyLink made such voluntary cash contributions of \$100 million to the CenturyLink Combined Pension Plan during each of the third quarters of 2016 and 2015. CenturyLink currently expects to make a voluntary contribution of \$100 million to the trust for its qualified pension plan in 2017. No contributions were made to the post-retirement occupational health care trust in 2016 or 2015 and CenturyLink does not expect to make a contribution in 2017.

The unfunded status of CenturyLink's qualified pension plan for accounting purposes was \$2.352 billion and \$2.215 billion as of December 31, 2016 and 2015, respectively, which includes the merged QCII qualified pension plan. The unfunded status of CenturyLink's post-retirement benefit plans for accounting purposes was \$3.360 billion and \$3.374 billion as of December 31, 2016 and 2015, respectively.

In 2015, our ultimate parent company, CenturyLink, changed their allocation methodology with respect to their now centrally managed pension and post-retirement plans. Specifically, under this new methodology, CenturyLink will allocate current service costs to subsidiaries relative to employees who are currently earning benefits under the pension and post-retirement benefit plans. The net periodic benefit cost allocated to us is now paid on a monthly basis through CenturyLink's intercompany cash management process.

The affiliate obligations, net in current and noncurrent liabilities on the consolidated balance sheets primarily represents the cumulative allocation of expense, net of payments, associated with QCII's pension plans and post-retirement benefits plans prior to the plan mergers. In 2015, we agreed to a plan to settle the outstanding pension and post-retirement affiliate obligations, net balance with QCII over a 30 year term. Payments will be made on a monthly basis. For the years ended December 31, 2016 and 2015, we made settlement payments in the aggregate of \$97 million and \$105 million, respectively, to QCII on our affiliate obligations, net balance. Changes in the affiliate obligations, net are reflected in operating activities on our consolidated statements of cash flows.

We were allocated \$45 million of pension service costs and \$14 million of post-retirement service costs during the year ended December 31, 2016, which represented 70% of CenturyLink's total pension and post-retirement service costs for the year. The combined net pension and post-retirement service costs is included in cost of services and products and selling, general and administrative expenses on our consolidated statement of operations for the year ended December 31, 2016.

We were allocated \$57 million of pension service costs and \$17 million of post-retirement service costs during the year ended December 31, 2015, which represented 69% of CenturyLink's total pension and post-retirement service costs for the year. The combined net pension and post-retirement service costs is included in cost of services and products and selling, general and administrative expenses on our consolidated statement of operations for the year ended December 31, 2015.

We were allocated \$98 million in pension income during the year ended December 31, 2014. Our allocated post-retirement benefit expense for the year ended December 31, 2014 was \$128 million. These allocated amounts represent our share of the pension and post-retirement benefit expenses based on the actuarially determined amounts. Prior to the plan mergers, our allocated portion of QCII's pension and post-retirement benefit income and expense was 92% for the year ended December 31, 2014. The combined net pension and post-retirement benefits (income) expenses is included in cost of services and products and selling, general and administrative expenses on our consolidated statements of operations for the year ended December 31, 2014.

CenturyLink sponsors a noncontributory qualified defined benefit pension plan that covers substantially all of our employees. As noted above, on December 31, 2014, QCII's pension plan was merged into the CenturyLink Retirement Plan, which was renamed the CenturyLink Combined Pension Plan. The plan also provides survivor and disability benefits to certain employees. In November 2009, and prior to the plan merger, the pension plan was amended to no longer provide pension benefit accruals for active non-represented employees after December 31, 2009. In addition, non-represented employees hired after January 1, 2009 are not eligible to participate in the plans. Active non-represented employees who participate in these plans retain their accrued pension benefit earned as of December 31, 2009 and certain participants will continue to earn interest credits on their benefit after December 31, 2009. Employees are eligible to receive their vested accrued benefit when they separate from CenturyLink. The plans also provided a death benefit for eligible beneficiaries of certain retirees; however, the plan was amended to eliminate this benefit effective March 1, 2010 for retirees who retired prior to January 1, 2004 and whose deaths occur after February 28, 2010 and eliminate the death benefit for eligible beneficiaries of certain retirees who retired after December 31, 2003.

CenturyLink maintains post-retirement benefit plans that provide health care and life insurance benefits for certain eligible retirees. The QCII post-retirement benefit plans were merged into CenturyLink's post-retirement benefit plans on January 1, 2012. The benefit obligation for the occupational health care and life insurance post-retirement plans is estimated based on the terms of benefit plans. In calculating this obligation, CenturyLink considers numerous assumptions, estimates and judgments, including but not limited to, discount rates, health care cost trend rates and plan amendments. In October 2013, we renewed a four-year collective bargaining agreement which covers approximately 11,000 of our unionized employees. Effective January 1, 2014, the approximately 11,000 active employees and eligible post-1990 retirees who are former represented employees, had changes to their health and welfare benefits including: (i) changes to align the coverage and benefits for these active employees and non-Medicare eligible post-1990 retirees with the health and welfare coverage and benefits offered to all other CenturyLink employees and other CenturyLink retirees (with some exceptions) (ii) increased out-of-pocket health care costs through plan design changes effective January 1, 2014 and the elimination of Class II dependent coverage and (iii) elimination of the group medical plan coverage and benefits for Medicare-eligible post-1990 retirees and the establishment of a health reimbursement account and assistance to this population with their transition effective May 1, 2014 to their own purchase of individual policies through the Medicare Exchange market place using the health reimbursement account. In order to maintain their eligibility, post-1990 retirees continue to be obligated to contribute to the cost of health care benefits in excess of specified limits on the company-funded portion of retiree health care costs (also referred to as the "caps"), as they have since January 1, 2009.

The terms of the post-retirement health care and life insurance plans between CenturyLink and its eligible non-represented employees and its eligible post-1990 non-represented retirees are established by CenturyLink and are subject to change at its discretion. CenturyLink has a practice of sharing some of the cost of providing health care benefits with its non-represented employees and post-1990 non-represented retirees. The benefit obligation for the non-represented post-retirement health care benefits is based on the terms of the current written plan documents and is adjusted for anticipated continued cost sharing with non-represented employees and post-1990 non-represented retirees. However, CenturyLink's contribution under its post-1990 non-represented retirees' health care plan is capped at a specific dollar amount.

Medicare Prescription Drug, Improvement and Modernization Act of 2003

CenturyLink sponsors post-retirement health care plans with several benefit options that provide prescription drug benefits that CenturyLink deems actuarially equivalent to or exceeding Medicare Part D. CenturyLink recognizes the impact of the federal subsidy received under the Medicare Prescription Drug, Improvement and Modernization Act of 2003 in the calculation of its post-retirement benefit obligation and net periodic post-retirement benefit expense.

Other Benefit Plans

Health Care and Life Insurance

We provide health care and life insurance benefits to essentially all of our active employees. We are largely self-funded for the cost of the health care plan. Our health care benefit expense for current employees was \$241 million, \$217 million and \$204 million for the years ended December 31, 2016, 2015 and 2014, respectively. Union-represented employee benefits are based on negotiated collective bargaining agreements. Employees' group basic life insurance plans are fully insured and the premiums are paid by CenturyLink.

401(k) Plans

CenturyLink sponsors qualified defined contribution plans covering substantially all of our employees. Under these plans, employees may contribute a percentage of their annual compensation up to certain maximums, as defined by the plans and by the Internal Revenue Service ("IRS"). Currently, we match a percentage of our employees' contributions in cash. We recognized \$42 million, \$43 million and \$47 million in expense related to these plans for the years ended December 31, 2016, 2015 and 2014, respectively.

Deferred Compensation Plans

CenturyLink sponsors non-qualified deferred compensation plans for various groups that includes certain of our current and former highly compensated employees. The plans are frozen and participants can no longer defer compensation to these plans. The value of the assets and liabilities related to these plans was not significant.

(8) Share-based Compensation

Share-based compensation expenses are included in cost of services and products, and selling, general, and administrative expenses in our consolidated statements of operations.

For the years ended December 31, 2016, 2015 and 2014, we recorded a share-based compensation expense of approximately \$22 million, \$21 million and \$21 million, respectively. We recognized an income tax benefit from our compensation expense of approximately \$8 million, \$8 million and \$8 million, respectively, during the years ended December 31, 2016, 2015 and 2014, respectively.

(9) Products and Services Revenues

We are an integrated communications company engaged primarily in providing an array of communications services, including local voice, broadband, private line (including special access), network access, Ethernet, information technology, video and other ancillary services. We strive to maintain our customer relationships by, among other things, bundling our service offerings to provide our customers with a complete offering of integrated communications services.

From time to time, we change the categorization of our products and services, and we may make similar changes in the future. During the second quarter of 2016, we determined that because of declines due to customer migration to other strategic products and services, certain of our services, specifically our private line (including special access) services, are more closely aligned with our legacy services than with our strategic services. As a result, we reflect these operating revenues as legacy services, and we have reclassified certain prior period amounts to conform to this change. The revision resulted in a reduction of revenue from strategic services and a corresponding increase in revenue from legacy services of \$823 million and \$980 million for the years ended December 31, 2015 and 2014, respectively.

We currently categorize our products, services and revenues among the following three categories:

- *Strategic services*, which include primarily broadband, Ethernet, video and other ancillary services;
- *Legacy services*, which include primarily local voice, private line (including special access), Integrated Services Digital Network ("ISDN") services (which use regular telephone lines to support voice, video and data applications), switched access and traditional wide area network ("WAN") (which allow a local communications network to link to networks in remote locations); and
- *Affiliates and other services*, which consist primarily of CAF support payments, USF support payments, USF surcharges and services we provide to our affiliates. We receive federal support payments from both Phase 1 and Phase 2 of the CAF program, and support payments from both federal and state USF programs. These support payments are government subsidies designed to reimburse us for various costs related to certain telecommunications services, including the costs of deploying, maintaining and operating voice and broadband infrastructure in high-cost rural areas where we are not able to fully recover our costs from our customers. We also collect USF surcharges based on specific items we list on our customers' invoices to fund the FCC's universal service programs. We provide to our affiliates, telecommunication services that we also provide to external customers. In addition, we provide to our affiliates, computer system development and support services, network support and technical services.

Our operating revenues for our products and services consisted of the following categories for the years ended December 31, 2016 , 2015 and 2014 :

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Strategic services	\$ 2,690	2,610	2,449
Legacy services	3,222	3,600	3,967
Affiliates and other services	2,998	2,754	2,422
Total operating revenues	\$ 8,910	8,964	8,838

We do not have any single external customer that provides more than 10% of our total consolidated operating revenues. Substantially all of our consolidated revenues come from customers located in the United States.

We recognize revenues in our consolidated statements of operations for certain USF surcharges and transaction taxes that we bill to our customers. Our consolidated statements of operations also reflect the offsetting expense for the amounts we remit to the government agencies. The total amount of such surcharges and transaction taxes that we included in revenues aggregated to \$149 million , \$147 million and \$151 million for the years ended December 31, 2016 , 2015 and 2014 , respectively. These USF surcharges, where we record revenue, are included in "other" operating revenues and transaction taxes are included in "legacy services" revenues. We also act as a collection agent for certain other USF and transaction taxes that we are required by government agencies to bill our customers, for which we do not record any revenue or expense because we only act as a pass-through agent.

Our operations are integrated into and reported as part of the consolidated segment data of CenturyLink. CenturyLink's chief operating decision maker ("CODM") is our CODM, but reviews our financial information on an aggregate basis only in connection with our quarterly and annual reports that we file with the Securities and Exchange Commission. Consequently, we do not provide our discrete financial information to the CODM on a regular basis. As such, we believe we have one reportable segment.

(10) Affiliate Transactions

We provide to our affiliates, telecommunications services that we also provide to external customers. In addition, we provide to our affiliates, computer system development and support services and network support and technical services.

Below are details of the services we provide to our affiliates:

- *Telecommunications services.* Data, broadband and voice services in support of our affiliates' service offerings;
- *Computer system development and support services.* Information technology services primarily include the labor cost of developing, testing and implementing the system changes necessary to support order entry, provisioning, billing, network and financial systems, as well as the cost of improving, maintaining and operating our operations support systems and shared internal communications networks; and
- *Network support and technical services.* Network support and technical services relate to forecasting demand volumes and developing plans around network utilization and optimization, developing and implementing plans for overall product development, provisioning and customer care.

We charge our affiliates for services based on market price or fully distributed cost ("FDC"). We charge our affiliates market price for services that we also provide to external customers, while other services that we provide only to our affiliates are priced by applying an FDC methodology. FDC rates include salaries and wages, payroll taxes, employee related benefits, miscellaneous expenses, and charges for the use of our buildings, computing and software assets. Whenever possible, costs are directly assigned to our affiliates for the services they use. If costs cannot be directly assigned, they are allocated among all affiliates based upon cost causative measures; or if no cost causative measure is available, these costs are allocated based on a general allocator. These cost allocation methodologies are reasonable. From time to time, we adjust the basis for allocating the costs of a shared service among affiliates. Such changes in allocation methodologies are generally billed prospectively.

We also purchase services from our affiliates including telecommunication services, insurance, flight services and other support services such as legal, regulatory, finance and accounting, tax, human resources and executive support. Our affiliates charge us for these services based on market price or FDC.

(11) Income Taxes

We are included in the consolidated federal income tax returns and the combined state income tax returns of CenturyLink. CenturyLink treats our consolidated results as if we were a separate taxpayer. The policy requires us to settle our tax liabilities through a change in our general intercompany obligation based upon our separate return taxable income, which is reflected in advances to affiliates on our consolidated balance sheets and the changes in advances to affiliates are reflected as investing activities on our consolidated statements of cash flows. Because we are included in the consolidated federal income tax returns and the combined state income tax returns of CenturyLink, any tax audits involving CenturyLink will also involve us.

Beginning with the 2013 tax year, CenturyLink's federal consolidated returns are subject to annual examination by the IRS.

Our open income tax years by major jurisdiction are as follows at December 31, 2016:

Jurisdiction	Open Tax Years
Federal	2013—current
State	
Arizona	2010—current
Other states	2012—current

Since the period for assessing additional liability typically begins upon the filing of a return, it is possible that certain jurisdictions could assess tax for years prior to the open tax years disclosed above. Additionally, it is possible that certain jurisdictions in which we do not believe we have an income tax filing responsibility, and accordingly did not file a return, may attempt to assess a liability, or other jurisdictions to which we pay taxes may attempt to assert that we owe additional taxes.

As of December 31, 2016, 2015 and 2014, we had no liability for interest related to uncertain tax positions. We did not record a liability for interest related to uncertain tax positions for the year ended December 31, 2016. We made no accrual for penalties related to income tax positions.

Income Tax Expense

The components of the income tax expense from continuing operations are as follows:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Income tax expense:			
Current:			
Federal and foreign	\$ 686	734	738
State and local	115	114	129
Total current	801	848	867
Deferred:			
Federal and foreign	(103)	(170)	(209)
State and local	(20)	(19)	(19)
Total deferred	(123)	(189)	(228)
Income tax expense	\$ 678	659	639

The effective income tax rate for continuing operations differs from the statutory tax rate as follows:

	Years Ended December 31,		
	2016	2015	2014
	(in percent)		
Effective income tax rate:			
Federal statutory income tax rate	35.0 %	35.0 %	35.0%
State income taxes-net of federal effect	3.5 %	3.6 %	4.0%
Other	— %	(0.6)%	0.7%
Effective income tax rate	38.5 %	38.0 %	39.7%

Deferred Tax Assets and Liabilities

The components of the deferred tax assets and liabilities are as follows:

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Deferred tax assets and liabilities:		
Deferred tax liabilities:		
Property, plant and equipment	\$ (1,384)	(1,431)
Intangibles assets	(1,088)	(1,153)
Receivable from an affiliate due to pension plan participation	(452)	(460)
Other	—	(59)
Total deferred tax liabilities	(2,924)	(3,103)
Deferred tax assets:		
Payable to affiliate due to post-retirement benefit plan participation	954	921
Debt premiums	—	21
Other	209	277
Total deferred tax assets	1,163	1,219
Valuation allowance on deferred tax assets	(12)	(12)
Net deferred tax assets	1,151	1,207
Net deferred tax liabilities	\$ (1,773)	(1,896)

At December 31, 2016 , we have established a valuation allowance of \$12 million as it is not more likely than not that this amount of deferred tax assets will be realized. There was no change to the valuation allowance in 2016.

Other Income Tax Information

We paid \$801 million , \$848 million and \$861 million to QSC related to income taxes in the years ended December 31, 2016 , 2015 and 2014 , respectively.

(12) Fair Value Disclosure

Our financial instruments consist of cash and cash equivalents, accounts receivable, advances to affiliates, accounts payable, note payable-affiliate and long-term debt, excluding capital lease obligations. Due to their short-term nature, the carrying amounts of our cash and cash equivalents, accounts receivable, advances to affiliates, accounts payable and note payable-affiliate approximate their fair values.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between independent and knowledgeable parties who are willing and able to transact for an asset or liability at the measurement date. We use valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs when determining fair value and then we rank the estimated values based on the reliability of the inputs used following the fair value hierarchy set forth by the FASB. We determined the fair values of our long-term debt, including the current portion, based on quoted market prices where available or, if not available, based on discounted future cash flows using current market interest rates.

The three input levels in the hierarchy of fair value measurements are defined by the FASB generally as follows:

Input Level	Description of Input
Level 1	Observable inputs such as quoted market prices in active markets.
Level 2	Inputs other than quoted prices in active markets that are either directly or indirectly observable.
Level 3	Unobservable inputs in which little or no market data exists.

The following table presents the carrying amounts and estimated fair values of our long-term debt, excluding capital lease and other obligations and unamortized debt issuance costs, as well as the input levels used to determine the fair values:

		As of December 31, 2016		As of December 31, 2015	
	Input Level	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(Dollars in millions)					
Liabilities-Long-term debt (excluding capital lease and other obligations)	2	\$ 7,229	7,203	7,222	7,456

(13) Stockholder's Equity

Common Stock

We have one share of common stock (no par value) issued and outstanding, which is owned by QSC.

In addition, in the normal course of business, we transfer assets and liabilities to and from QSC and its affiliates, which are recorded through our equity. It is our policy to record these asset transfers based on carrying values.

Dividends

We declared the following cash dividend to QSC:

	Years Ended December 31,		
	2016	2015	2014
(Dollars in millions)			
Cash dividend declared to QSC	\$ 1,300	1,350	1,400
Cash dividend paid to QSC	1,300	1,350	1,400

The timing of cash payments for declared dividends to QSC is at our discretion in consultation with QSC. We may declare and pay dividends to QSC in excess of our earnings to the extent permitted by applicable law. Our debt covenants do not limit the amount of dividends we can pay to QSC.

(14) Quarterly Financial Data (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
(Dollars in millions)					
2016					
Operating revenues	\$ 2,253	2,223	2,226	2,208	8,910
Operating income	625	602	576	519	2,322
Income tax expense	188	179	159	152	678
Net income	304	288	255	238	1,085

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
(Dollars in millions)					
2015					
Operating revenues	\$ 2,217	2,222	2,287	2,238	8,964
Operating income	545	521	572	622	2,260
Income tax expense	167	152	171	169	659
Net income	247	238	268	321	1,074

During the fourth quarter of 2016, we recognized \$78 million of severance expenses and other one-time termination benefits associated with workforce reductions.

During the third quarter of 2015, we recognized an incremental \$64 million of revenue associated with the FCC's CAF Phase 2 high-cost support program (primarily impacted by the one-time transitional payment) and an additional incremental \$31 million in the fourth quarter of 2015.

(15) Commitments and Contingencies***Pending Matters***

Subsidiaries of CenturyLink, Inc., including us, are among hundreds of companies in an industry-wide dispute, raised in nearly 100 federal lawsuits (filed between 2014 and 2016) that have been consolidated in the United States District Court for the District of Northern Texas for pretrial procedures. The disputes relate to switched access charges that local exchange carriers ("LECs") collect from interexchange carriers ("IXCs") for IXCs' use of LEC's access services. In the lawsuits, three IXCs, Sprint Communications Company L.P. ("Sprint"), affiliates of Verizon Communications Inc. ("Verizon") and affiliates of Level 3 Communications LLC ("Level 3"), assert that federal and state laws bar LECs from collecting access charges when IXCs exchange certain types of calls between mobile and wireline devices that are routed through an IXC. Some of these IXCs have asserted claims seeking refunds of payments for access charges previously paid and relief from future access charges. In addition, Level 3 has ceased paying switched access charges on these calls.

In November 2015, the federal court agreed with the LECs and rejected the IXCs' contention that federal law prohibits these particular access charges, and also allowed the IXCs to refile state-law claims. Since then, many of the LECs and IXCs have filed revised pleadings and additional motions, which remain pending. Separately, some of the defendants, including us, have petitioned the FCC to address these issues on an industry-wide basis.

The outcome of these disputes and lawsuits, as well as any related regulatory proceedings that could ensue, are currently not predictable. If we are required to stop assessing these charges or to pay refunds of any such charges, our financial results could be negatively affected.

Other Proceedings and Disputes

From time to time, we are involved in other proceedings incidental to our business, including patent infringement allegations, administrative hearings of state public utility commissions relating primarily to our rates or services, actions relating to employee claims, various tax issues, environmental law issues, grievance hearings before labor regulatory agencies and miscellaneous third party tort actions.

We are currently defending several patent infringement lawsuits asserted against us by non-practicing entities, many of which are seeking substantial recoveries. These cases have progressed to various stages and one or more may go to trial in the coming 24 months if they are not otherwise resolved. Where applicable, we are seeking full or partial indemnification from our vendors and suppliers. As with all litigation, we are vigorously defending these actions and, as a matter of course, are prepared to litigate these matters to judgment, as well as to evaluate and consider all reasonable settlement opportunities.

We are subject to various federal, state and local environmental protection and health and safety laws. From time to time, we are subject to judicial and administrative proceedings brought by various governmental authorities under these laws. Several such proceedings are currently pending, but none is reasonably expected to exceed \$100,000 in fines and penalties.

The outcome of these other proceedings is not predictable. However, based on current circumstances, we do not believe that the ultimate resolution of these other proceedings, after considering available defenses and any insurance coverage or indemnification rights, will have a material adverse effect on our financial position, results of operations or cash flows.

CenturyLink, Inc. and its affiliates are involved in several legal proceedings to which we are not a party that, if resolved against them, could have a material adverse effect on their business and financial condition. As an indirect wholly-owned subsidiary of CenturyLink, Inc., our business and financial condition could be similarly affected. You can find descriptions of these legal proceedings in CenturyLink, Inc.'s quarterly and annual reports filed with the Securities and Exchange Commission. Because we are not a party to any of the matters, we have not accrued any liabilities for the matters.

Capital Leases

We lease certain facilities and equipment under various capital lease arrangements. Depreciation of assets under capital leases is included in depreciation and amortization expense in our consolidated statements of operations. Payments on capital leases are included in repayments of long-term debt, including current maturities in our consolidated statements of cash flows.

The tables below summarize our capital lease activity:

	Years Ended December 31,		
	2016	2015	2014
	(Dollars in millions)		
Assets acquired through capital leases	\$ 10	10	3
Depreciation expense	5	19	32
Cash payments towards capital leases	6	20	32

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Assets included in property, plant and equipment	\$ 40	66
Accumulated depreciation	22	55

The future annual minimum payments under capital lease arrangements as of December 31, 2016 were as follows:

	Future Minimum Payments
	(Dollars in millions)
Capital lease obligations:	
2017	\$ 7
2018	7
2019	4
2020	1
2021	2
2022 and thereafter	5
Total minimum payments	26
Less: amount representing interest and executory costs	(7)
Present value of minimum payments	19
Less: current portion	(6)
Long-term portion	\$ 13

Operating Leases

We lease various equipment, office facilities, retail outlets, switching facilities and other network sites. These leases, with few exceptions, provide for renewal options and escalations that are either fixed or based on the consumer price index. Any rent abatements, along with rent escalations, are included in the computation of rent expense calculated on a straight-line basis over the lease term. The lease term for most leases includes the initial non-cancelable term plus any term under renewal options that are reasonably assured. For the years ended December 31, 2016, 2015 and 2014, our gross rental expense was \$72 million, \$75 million and \$79 million, respectively. We also received sublease rental income for the years ended December 31, 2016, 2015 and 2014 of \$4 million, \$4 million and \$4 million, respectively.

At December 31, 2016, our future rental commitments for operating leases were as follows:

	Future Minimum Payments
	(Dollars in millions)
Operating leases:	
2017	\$ 51
2018	47
2019	40
2020	33
2021	17
2022 and thereafter	38
Total future minimum payments ⁽¹⁾	\$ 226

⁽¹⁾ Minimum payments have not been reduced by minimum sublease rentals of \$28 million due in the future under non-cancelable subleases.

Purchase Commitments

We have several commitments primarily for marketing activities and support services from a variety of vendors to be used in the ordinary course of business totaling \$103 million at December 31, 2016. Of this amount, we expect to purchase \$55 million in 2017, \$40 million in 2018 through 2019, \$5 million in 2020 through 2021 and \$3 million in 2022 and thereafter. These amounts do not represent our entire anticipated purchases in the future, but represent only those items for which we were contractually committed as of December 31, 2016.

(16) Other Financial Information

Other Current Assets

The following table presents details of other current assets in our consolidated balance sheets:

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Prepaid expenses	\$ 48	46
Assets held for sale	8	—
Other	73	77
Total other current assets	<u>\$ 129</u>	<u>123</u>

We recorded a loss of \$11 million in connection with the impairment of an office building being reclassified as held for sale in the fourth quarter of 2016 . This impairment charge is included in selling, general and administrative expense in our consolidated statement of operations for the year ended December 31, 2016 . We anticipate the sale of the office building to close during the first half of 2017.

Selected Current Liabilities

Current liabilities reflected in our consolidated balance sheets include accounts payable:

	As of December 31,	
	2016	2015
	(Dollars in millions)	
Accounts payable	<u>\$ 398</u>	<u>369</u>

Included in accounts payable at December 31, 2016 and 2015 , were \$53 million and \$29 million , respectively, associated with capital expenditures.

(17) Labor Union Contracts

Approximately 50% of our employees are members of various bargaining units represented by the Communication Workers of America and the International Brotherhood of Electrical Workers. We believe that relations with our employees continue to be generally good. Approximately 11,000 , or 50% , of our employees that are subject to collective bargaining agreements that are scheduled to expire October 7, 2017.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as defined in Rule 13a-15(e) of the Securities Exchange Act (the “Exchange Act”)) designed to provide reasonable assurance that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. These include controls and procedures designed to ensure that this information is accumulated and communicated to the Company’s management, including its Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Management, with the participation of our Chief Executive Officer, Glen F. Post, III, and our Chief Financial Officer, R. Stewart Ewing, Jr., evaluated the effectiveness of the Company’s disclosure controls and procedures as of December 31, 2016. Based on this evaluation, the Company’s Chief Executive Officer and Chief Financial Officer have concluded that the Company’s disclosure controls and procedures were effective as of December 31, 2016, at the reasonable assurance level.

The effectiveness of our or any system of disclosure controls and procedures is subject to certain limitations, including the exercise of judgment in designing, implementing and evaluating the controls and procedures, the assumptions used in identifying the likelihood of future events and the inability to eliminate misconduct completely. As a result, there can be no assurance that our disclosure controls and procedures will detect all errors or fraud. By their nature, our or any system of disclosure controls and procedures can provide only reasonable assurance regarding management’s control objectives.

Internal Control Over Financial Reporting

Management’s Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act), a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles in the United States. Under the supervision and with the participation of management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control-Integrated Framework (2013) issued by the COSO. Based on our evaluation under the framework of COSO, management concluded that our internal control over financial reporting was effective at December 31, 2016.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

We have omitted this information pursuant to General Instruction I.

ITEM 11. EXECUTIVE COMPENSATION

We have omitted this information pursuant to General Instruction I.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

We have omitted this information pursuant to General Instruction I.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

We have omitted this information pursuant to General Instruction I.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Pre-Approval Policies and Procedures

The Audit Committee of CenturyLink's Board of Directors is responsible for the appointment, compensation and oversight of the work of our independent registered public accounting firm. Under the Audit Committee's charter, the Audit Committee pre-approves all audit and permissible non-audit services provided by our independent registered public accounting firm. The approval may be given as part of the Audit Committee's approval of the scope of the engagement of our independent registered public accounting firm or on an individual basis. The pre-approval of non-audit services may be delegated to one or more of the Audit Committee's members, but the decision must be reported to the full Audit Committee. Our independent registered public accounting firm may not be retained to perform the non-audit services specified in Section 10A(g) of the Exchange Act.

Fees Paid to the Independent Registered Public Accounting Firm

QCII first engaged KPMG LLP to be our independent registered public accounting firm in May 2002. The aggregate fees billed or allocated to us for the years ended December 31, 2016 and 2015 for professional accounting services, including KPMG's audit of our annual consolidated financial statements, are set forth in the table below.

	Years Ended December 31,	
	2016	2015
	(Dollars in thousands)	
Audit fees	\$ 2,700	2,910
Audit-related fees	—	—
Total fees	\$ 2,700	2,910

KPMG did not provide to us any professional services for tax compliance, tax advice or tax planning in 2016 or 2015 .

For purposes of the preceding table, the professional fees are classified as follows:

Audit fees: These are fees billed for the year shown for professional services performed for the audit of the consolidated financial statements included in our Form 10-K filing for that year, the review of condensed consolidated financial statements included in our Form 10-Q filings made during that year, comfort letters, consents and assistance with and review of documents filed with the SEC. Audit fees for each year shown include amounts that have been billed through the date of this filing and any additional amounts that are expected to be billed thereafter.

Audit-related fees: These are fees billed for assurance and related services that were performed in the year shown and that are traditionally performed by our independent registered public accounting firm. More specifically, these services include regulatory filings. Audit-related fees for each year shown include amounts that have been billed through the date of this filing.

The Audit Committee of CenturyLink, Inc. approved in advance all of the services performed by KPMG described above.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Exhibits identified in parentheses below are on file with the SEC and are incorporated herein by reference. All other exhibits are provided as part of this electronic submission. ⁽¹⁾

Exhibit Number	Description
3.1	Amended and restated Articles of Incorporation of Qwest Corporation (incorporated by reference to Exhibit 3.1 of Qwest Corporation's Quarterly Report on Form 10-Q for the period ended March 31, 2013 (File No. 001-03040) filed with the Securities and Exchange Commission on May 13, 2013).
3.2	Amended and Restated Bylaws of Qwest Corporation (incorporated by reference to Exhibit 3.3 of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-03040) filed with the Securities and Exchange Commission on January 13, 2004).
4.1	Indenture, dated as of April 15, 1990, by and between The Mountain States Telephone and Telegraph Company (currently named Qwest Corporation) and The First National Bank of Chicago (incorporated by reference to Exhibit 4.2 of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-03040) filed with the Securities and Exchange Commission on January 13, 2004).
	a. First Supplemental Indenture, dated as of April 16, 1991, by and between U S WEST Communications, Inc. (currently named Qwest Corporation) and The First National Bank of Chicago (incorporated by reference to Exhibit 4.3 of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-03040) filed with the Securities and Exchange Commission on January 13, 2004).
4.2	Indenture, dated as of April 15, 1990, by and between Northwestern Bell Telephone Company (predecessor to Qwest Corporation) and The First National Bank of Chicago (incorporated by reference to Exhibit 4.5(b) of CenturyLink, Inc.'s Quarterly Report on Form 10-Q for the period ended March 31, 2012 (File No. 001-07784) filed with the Securities and Exchange Commission on May 10, 2012).
	a. First Supplemental Indenture, dated as of April 16, 1991, by and between U S WEST Communications, Inc. (currently named Qwest Corporation) and The First National Bank of Chicago (incorporated by reference to Exhibit 4.3 of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2002 (File No. 001-03040) filed with the Securities and Exchange Commission on January 13, 2004).
4.3	Indenture, dated as of October 15, 1999, by and between U S West Communications, Inc. (currently named Qwest Corporation) and Bank One Trust Company, N.A., as trustee (incorporated by reference to Exhibit 4(b) of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 1999 (File No. 001-03040) filed with the Securities and Exchange Commission on March 3, 2000).
	a. Fifth Supplemental Indenture, dated as of May 16, 2007, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 of Qwest Corporation's Current Report on Form 8-K (File No. 001-03040) filed with the Securities and Exchange Commission on May 18, 2007).
	b. Eighth Supplemental Indenture, dated as of September 21, 2011, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.9 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on September 20, 2011).
	c. Ninth Supplemental Indenture, dated as of October 4, 2011, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.1 of Qwest Corporation's Current Report on Form 8-K (File No. 001-03040) filed with the Securities and Exchange Commission on October 4, 2011).

⁽¹⁾ Certain of the items in Sections 4.1 through 4.3 (j) omit supplemental indentures or other instruments governing debt that has been retired, or (ii) refer to trustees who may have been replaced, acquired or affected by similar changes. In accordance with Item 601(b) (4) (iii) (A) of Regulation S-K, copies of certain instruments defining the rights of holders of certain of our long-term debt are not filed herewith. Pursuant to this regulation, we hereby agree to furnish a copy of any such instrument to the SEC upon request.

Exhibit Number	Description
	d. Tenth Supplemental Indenture, dated as of April 2, 2012, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on March 30, 2012).
	e. Eleventh Supplemental Indenture, dated as of June 25, 2012, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on June 22, 2012).
	f. Twelfth Supplemental Indenture, dated as of May 23, 2013, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.13 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on May 22, 2013).
	g. Thirteenth Supplemental Indenture, dated as of September 29, 2014, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.14 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on September 26, 2014).
	h. Fourteenth Supplemental Indenture, dated as of September 21, 2015, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.15 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on September 21, 2015).
	i. Fifteenth Supplemental Indenture, dated as of January 29, 2016, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.16 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on January 29, 2016).
	j. Sixteenth Supplemental Indenture, dated as of August 22, 2016, by and between Qwest Corporation and U.S. Bank National Association (incorporated by reference to Exhibit 4.17 of Qwest Corporation's Form 8-A (File No. 001-03040) filed with the Securities and Exchange Commission on August 22, 2016).
4.4	Revolving Promissory Note, dated as of April 18, 2012, pursuant to which Qwest Corporation may borrow from an affiliate of CenturyLink, Inc. up to \$1.0 billion on a revolving basis (incorporated by reference to Exhibit 4.7(b) of CenturyLink, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2012 (File No 001-07784) filed with the Securities and Exchange Commission on August 9, 2012).
4.5	Credit Agreement, dated as of February 20, 2015, by and among Qwest Corporation, the several lenders from time to time parties thereto, and CoBank, ACB, as administrative agent (incorporated by reference to Exhibit 4.5 of Qwest Corporation's Annual Report on Form 10-K for the year ended December 31, 2014 (File No. 001-03040) filed with the Securities and Exchange Commission on February 27, 2015).
12*	Calculation of Ratio of Earnings to Fixed Charges.
23*	Independent Registered Public Accounting Firm Consent.
31.1*	Certification of the Chief Executive Officer of CenturyLink, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of the Chief Financial Officer of CenturyLink, Inc. pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32*	Certification of the Chief Executive Officer and Chief Financial Officer of CenturyLink, Inc. pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101*	Financial statements from the Annual Report on Form 10-K of Qwest Corporation for the period ended December 31, 2016, formatted in XBRL: (i) the Consolidated Statements of Operations, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Cash Flows, (iv) the Consolidated Statements of Stockholder's Equity and (v) the Notes to the Consolidated Financial Statements.

* Exhibit filed herewith.

ITEM 16. SUMMARY OF BUSINESS AND FINANCIAL INFORMATION

Not applicable.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this annual report to be signed on its behalf by the undersigned, thereunto duly authorized on March 2, 2017.

QWEST CORPORATION

By: /s/ David D. Cole

David D. Cole

Executive Vice President, Controller and Operations Support
(Chief Accounting Officer and Duly Authorized Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this annual report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Signature

/s/ Glen F. Post, III

Glen F. Post, III

/s/ R. Stewart Ewing, Jr.

R. Stewart Ewing, Jr.

/s/ Stacey W. Goff

Stacey W. Goff

Title

Chief Executive Officer and President (Principal Executive Officer)

Director, Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Director

QWEST CORPORATION

CALCULATION OF RATIO OF EARNINGS TO FIXED CHARGES

(UNAUDITED)

	Years Ended December 31,				
	2016	2015	2014	2013	2012
	(Dollars in millions)				
Income before income tax expense	\$ 1,763	1,733	1,609	1,566	1,391
Add: estimated fixed charges	579	568	546	557	513
Add: estimated amortization of capitalized interest	8	8	8	8	9
Less: interest capitalized	(19)	(18)	(17)	(17)	(18)
Total earnings available for fixed charges	\$ 2,331	2,291	2,146	2,114	1,896
Estimate of interest factor on rentals	\$ 23	24	25	26	28
Interest expense, including amortization of premiums, discounts and debt issuance costs	537	526	504	514	467
Interest capitalized	19	18	17	17	18
Total fixed charges	\$ 579	568	546	557	513
Ratio of earnings to fixed charges	4.0	4.0	3.9	3.8	3.7

Consent of Independent Registered Public Accounting Firm

The Board of Directors
Qwest Corporation:

We consent to the incorporation by reference in the registration statement (No. 333-202411-01) on Form S-3 of Qwest Corporation of our report dated March 2, 2017 with respect to the consolidated balance sheets of Qwest Corporation and subsidiaries as of December 31, 2016 and 2015, and the related consolidated statements of operations, cash flows, and stockholder's equity for each of the years in the three-year period ended December 31, 2016, which report appears in the December 31, 2016 annual report on Form 10-K of Qwest Corporation.

/s/ KPMG LLP

Shreveport, Louisiana
March 2, 2017

CERTIFICATION

I, Glen F. Post, III, certify that:

1. I have reviewed this annual report on Form 10-K of Qwest Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2017

/s/ Glen F. Post, III

Glen F. Post, III
Chief Executive Officer and President

CERTIFICATION

I, R. Stewart Ewing, Jr., certify that:

1. I have reviewed this annual report on Form 10-K of Qwest Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15 (e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's Board of Directors:
 - a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 2, 2017

/s/ R. Stewart Ewing, Jr.

R. Stewart Ewing, Jr.
Executive Vice President, Chief
Financial Officer and Assistant
Secretary

CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER CERTIFICATION

Each of the undersigned, acting in his capacity as the Chief Executive Officer or Chief Financial Officer of Qwest Corporation ("Qwest"), certifies that, to his knowledge, the annual report on Form 10-K for the year ended December 31, 2016 of Qwest fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and that the information contained in the Form 10-K fairly presents, in all material respects, the financial condition and results of operations of Qwest as of the dates and for the periods covered by such report.

A signed original of this statement has been provided to Qwest and will be retained by Qwest and furnished to the Securities and Exchange Commission or its staff upon request.

Date: March 2, 2017

By: /s/ Glen F. Post, III

Glen F. Post, III
Chief Executive Officer and President

Date: March 2, 2017

By: /s/ R. Stewart Ewing, Jr.

R. Stewart Ewing, Jr.
Executive Vice President and Chief Financial Officer