EMBARQ CORPORATION

CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 2016 AND 2015
(WITH REPORT OF INDEPENDENT AUDITORS THEREIN)

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KPMG LLP
333 Texas Street, Suite 1900
Shreveport, LA 71101-3692

Independent Auditors' Report

The Board of Directors and Stockholder
Embarq Corporation:

We have audited the accompanying consolidated financial statements of Embarq Corporation and subsidiaries (the Company), which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, comprehensive income, cash flows, and stockholder's (deficit) equity for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Shreveport, Louisiana
September 15, 2017

EMBARQ CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(Dollars in millions)

	Years Ended December 31,	
	2016	**2015**
Operating Revenues		
Operating revenues	$ 3,331	3,435
Operating revenues - affiliates	524	469
Total operating revenues	3,855	3,904
Operating Expenses		
Operating expenses	1,172	1,215
Operating expenses - affiliates	917	844
Depreciation	801	877
Total operating expenses	2,890	2,936
Operating Income	965	968
Other (Expense) Income		
Interest expense	(177)	(223)
Interest expense - affiliates	(122)	(106)
Other income (expense), net	4	(1)
Total other expense, net	(295)	(330)
Income Before Income Tax Expense	670	638
Income tax expense	256	250
Net Income	$ 414	388

See accompanying notes to consolidated financial statements.

EMBARQ CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Dollars in millions)

	Years Ended December 31,	
	2016	**2015**
Net Income	$ 414	388
Other Comprehensive Income		
Other, net of $— and $2 tax	—	(3)
Comprehensive Income, net of tax	$ 414	385

See accompanying notes to consolidated financial statements.

EMBARQ CORPORATION

CONSOLIDATED BALANCE SHEETS

(Dollars in millions and shares in thousands)

	As of December 31,	
	2016	**2015**
Assets		
Current assets		
Cash and cash equivalents	$ 2	1
Accounts receivable, less allowance of $41 and $44	344	335
Advances to affiliates	1,971	1,880
Prepaid expenses and other current assets	86	86
Total current assets	2,403	2,302
Gross property, plant and equipment	24,362	23,963
Accumulated depreciation	(20,167)	(19,505)
Net property, plant and equipment	4,195	4,458
Goodwill	25	25
Other assets	124	125
Total Assets	$ 6,747	6,910
Liabilities and Stockholder's Equity (Deficit)		
Current liabilities		
Current maturities of long-term debt	$ 72	1,184
Accounts payable	100	78
Advances from affiliates	1,862	1,234
Note payable - affiliate	989	926
Accrued salaries and benefits	83	69
Accrued other taxes	37	37
Deferred revenue	114	128
Accrued interest	21	29
Other current liabilities	84	86
Current affiliate obligations, net	46	50
Total current liabilities	3,408	3,821
Noncurrent liabilities		
Long-term debt	1,786	1,865
Deferred income taxes, net	636	728
Affiliate obligations, net	663	706
Other noncurrent liabilities	242	192
Total noncurrent liabilities	3,327	3,491
Commitments and contingencies (Note 10)		
Stockholder's equity (deficit)		
Common stock, $0.01 par value; 1 shares authorized, issued and owned by CenturyLink, Inc.	—	—
Additional paid-in capital	(676)	(676)
Retained earnings	688	274
Total stockholder's equity (deficit)	12	(402)
Total Liabilities and Stockholder's Equity (Deficit)	$ 6,747	6,910

See accompanying notes to consolidated financial statements.

EMBARQ CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Dollars in millions)

	Years Ended December 31,	
	2016	2015
Operating Activities		
Net income	$ 414	388
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	801	877
Deferred income taxes, net	(90)	(86)
Provision for uncollectible accounts	35	44
Accrued interest on note payable - affiliate	64	59
Gain on sale of properties	(7)	(2)
Changes in current assets and liabilities:		
Accounts receivable	(44)	(45)
Prepaid expenses and other current assets	—	(1)
Accounts payable and other current liabilities	5	(12)
Changes in affiliate obligations, net	(47)	(33)
Changes in other noncurrent assets and liabilities, net	41	(48)
Net cash provided by operating activities	1,172	1,141
Investing Activities		
Payments for property, plant and equipment	(526)	(466)
Proceeds from sale of property	11	26
Changes in advances to affiliates	(91)	16
Net cash used in investing activities	(606)	(424)
Financing Activities		
Payments on long-term debt	(1,193)	—
Changes in advances from affiliates	628	(721)
Net cash used in financing activities	(565)	(721)
Net increase (decrease) in cash and cash equivalents	1	(4)
Cash and cash equivalents at beginning of period	1	5
Cash and cash equivalents at end of period	$ 2	1
Supplemental Cash Flow Information:		
Income taxes paid, net	$ (346)	(335)
Interest paid (net of capitalized interest of $7 and $6)	$ (244)	(270)

See accompanying notes to consolidated financial statements.

EMBARQ CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDER'S (DEFICIT) EQUITY

(Dollars in millions)

	Common Stock	Additional Paid-in Capital	(Accumulated Deficit)Retained Earnings	Accumulated Other Comprehensive Income	Total Stockholder's (Deficit)Equity
December 31, 2014	$ —	(676)	(114)	3	(787)
Net income	—	—	388	—	388
Amortization of other, net of $2 tax	—	—	—	(3)	(3)
December 31, 2015	—	(676)	274	—	(402)
Net income	—	—	414	—	414
December 31, 2016	$ —	(676)	688	—	12

See accompanying notes to consolidated financial statements.

EMBARQ CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unless the context requires otherwise, references in this report to "Embarq" refer to Embarq Corporation, references to "we," "us" and "our" refer to Embarq Corporation and its consolidated subsidiaries and references to "CenturyLink" refer to our direct parent company, CenturyLink, Inc. and its consolidated subsidiaries.

Note 1. Background, Basis of Presentation and Significant Accounting Policies

Background

We provide a suite of integrated communications services including local and long-distance voice, data services, broadband, satellite video, professional services and sales of telecommunications equipment to residential and business customers in the 18-state region of Florida, Indiana, Kansas, Minnesota, Missouri, Nebraska, Nevada, New Jersey, North Carolina, Ohio, Oregon, Pennsylvania, South Carolina, Tennessee, Texas, Virginia, Washington and Wyoming. We refer to this region as our local service area. Additionally, we provide customers access to our local network and other wholesale communications services to other carriers.

We were incorporated in 2005 under the laws of Delaware and were formerly a wholly-owned subsidiary of Sprint Nextel Corporation ("Sprint Nextel"). On May 17, 2006, Embarq was established as a separate, stand-alone company upon its operations being spun off from Sprint Nextel. On July 1, 2009, Embarq and CenturyLink, a Louisiana corporation, completed a merger transaction whereby a wholly-owned subsidiary of CenturyLink merged with and into Embarq, with us surviving as a wholly-owned subsidiary of CenturyLink.

Basis of Presentation

Our 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 between us and CenturyLink and our non-consolidated affiliates have not been eliminated and are denoted as affiliate transactions in our consolidated financial statements and notes thereto. See Note 9—Affiliate Transactions for additional information. The impact of acquisition accounting for CenturyLink's acquisition of us has not been pushed down to our consolidated financial statements. We continue to operate as a wholly-owned subsidiary of CenturyLink.

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, customer retention patterns, allowance for doubtful accounts, depreciation, 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. These estimates, judgments and assumptions can materially affect the reported amounts of assets, liabilities and components of stockholder's equity (deficit) as of the dates of our consolidated balance sheets, as well as the reported amounts of revenues, expenses and components of cash flows during the periods presented in our consolidated statements of operations, our consolidated statements of comprehensive income and our consolidated statements of cash flows. We also make estimates in our assessments of potential losses in relation to threatened or pending tax and legal matters. See Note 6—Income Taxes and Note 10—Commitments and Contingencies for additional information.

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 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 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 three to seven 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. Cash incentives given to customers are recognized as reductions to revenue.

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 continuing service is based upon its relative selling price and 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.

We do not have any single customer that provides more than 10% of our total operating revenue. All of our revenue comes from customers located in the United States.

Affiliate Transactions

Due to 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 in our consolidated financial statements 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. Services provided by us to our affiliates are recognized as operating revenues - affiliates in our consolidated statements of operations. Services provided by us to our affiliates totaled $1.015 billion and $950 million in 2016 and 2015, respectively, of which $524 million and $469 million was recognized as operating revenues - affiliates and $491 million and $481 million was recognized as a reduction in operating expenses, respectively. We recognize amounts billed to our affiliates as a reduction to operating expenses for services we provide to our affiliates that we would otherwise not provide to external customers in the normal course of business. We recognize operating expenses - affiliates at the amounts billed to us by our affiliates. Services purchased by us from our affiliates totaled $916 million and $844 million in 2016 and 2015, respectively.

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 of CenturyLink provides lines of credit to certain other affiliates, including us. The 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 CenturyLink disburses cash to settle our obligations to third parties. Under CenturyLink's centralized cash management process, 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/from affiliates on the accompanying consolidated balance sheets. Our consolidated statements of cash flows reflect changes in advances to affiliates as investing activities and changes in advances from affiliates as financing activities. From time to time, we declare and pay dividends to CenturyLink, using cash repaid to us under these advances, which has the net effect of reducing the amount of these advances. For the years ended December 31, 2016 and 2015, no cash dividends were declared nor paid.

Interest is assessed on the advances to affiliates based on the three-month U.S. T-bill rate and interest is assessed on the advances from affiliates based on CenturyLink's weighted average borrowing rate. For the years ended December 31, 2016 and 2015, we recognized $58 million and $47 million, respectively, of interest expense related to our advances from affiliates in interest expense - affiliates in our consolidated statements of operations.

In the normal course of business, we may transfer assets and liabilities to and from CenturyLink and its affiliates based on carrying values.

Universal Service Fund, Connect America Fund, Gross Receipts Taxes and Other Surcharges

In determining whether to include in our revenues and expenses for the taxes and surcharges collected from customers and remitted to government authorities, including Universal Service Fund ("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 and surcharges assessed in each jurisdiction where we do business. In jurisdictions where we determine that we are the principal taxpayer, we record the taxes and surcharges on a gross basis and include them in our operating revenues and operating expenses. In jurisdictions where we determine that we are merely a pass-through collection agent for certain other taxes and surcharges, we record the taxes and surcharges on a net basis and do not include them in our operating revenues and operating expenses.

During 2016 and 2105, we recognized revenues in our consolidated statements of operations for certain USF surcharges that we billed to our customers. Our consolidated statements of operations also reflect the offsetting expense for the amounts we remitted to governmental agencies. For the year ended December 31, 2016, we recorded $50 million of USF surcharges in operating revenues and $47 million of USF contributions in operating expenses. For the year ended December 31, 2015, we recorded $50 million of USF surcharges in operating revenues and $42 million of USF contributions in operating expenses.

We also generate operating revenues from CAF support payments and USF support payments. 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 capable infrastructure in high-cost rural areas where we are not able to fully recover our costs from our customers. We recorded $194 million and $202 million of revenue from federal and state universal service support programs for each of the years ended December 31, 2016 and 2015, respectively. Such amounts represents approximately 5.0% of our total operating revenues for both years ended December 31, 2016 and 2015.

Advertising Costs

Costs related to advertising are expensed as incurred and included in operating expenses in our consolidated statements of operations. For the years ended December 31, 2016 and 2015, our advertising expense was $39 million and $40 million, 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 6—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 state tax net operating loss carryforwards (“NOLs”), 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. Our policy is to reflect interest expense associated with unrecognized tax benefits in income tax expense.

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. At December 31, 2016 and 2015, we evaluated the need to retain all or a portion of the valuation allowance on our deferred tax assets. As of December 31, 2016 and 2015, we concluded that it was more likely than not that we would realize substantially all of our deferred tax assets. See Note 6—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 CenturyLink funds our cash disbursement needs. The net cash transferred to CenturyLink has been reflected as advances to/from affiliates on 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 type of customer, 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.

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

	Beginning Balance	Additions	Deductions	Ending Balance
	(Dollars in millions)			
2016	$ 44	35	(38)	41
2015	$ 49	44	(49)	44

We are exposed to concentrations of credit risk from residential and business customers within our local service area, business customers outside of our local service area and from other telecommunications service providers. 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 these 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.

Property, Plant and Equipment

Property, plant and equipment is stated at original cost plus the estimated value of any associated legally or contractually required retirement obligations. 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 abnormal or 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. Capital expenditures of $15 million and $9 million were included in accounts payable on our consolidated balance sheets at December 31, 2016 and 2015, respectively. See Note 4—Property, Plant and Equipment for additional information.

We perform annual 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 have asset retirement obligations associated with the legally or contractually required removal of a limited group of property, plant and equipment assets from leased properties and the disposal of certain hazardous materials present in our owned properties. When an asset retirement obligation is identified, usually in association with the acquisition of the asset, we record the fair value of the obligation as a liability. The fair value of the obligation is also capitalized as property, plant and equipment and then amortized over the estimated remaining useful life of the associated asset. Where the removal obligation is not legally binding, the net cost to remove assets is expensed in the period in which the costs are actually incurred.

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. No such impairment was recognized in 2016 or 2015.

Goodwill

We are required to assess goodwill for impairment at least annually, or more frequently, if an event occurs or circumstances change that would indicate that 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 at the reporting unit level, and in reviewing the criteria for reporting units, we have determined that our operations consist of one reporting unit, consistent with our determination that our business consists of one reporting segment. See Note 2—Goodwill for additional information. Our annual goodwill impairment assessment date is December 31.

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, our 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. We maintain a non-qualified pension plan for certain of our eligible highly compensated employees. In addition, certain employees may become eligible to 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 their other affiliates. The allocation of the service costs to us is based upon our employees who are currently earning benefits under the plans. The amounts contributed on our behalf 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 and its affiliates.

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.

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.

Note 2. Goodwill

Our goodwill was derived from businesses we acquired where the purchase price exceeded the fair value of the net assets acquired. As noted in Note 1—Background, Basis of Presentation and Significant Accounting Policies, CenturyLink has not pushed any of its $6.245 billion of goodwill associated with its acquisition of us to our consolidated financial statements. The book value of goodwill was $25 million for both years ended December 31, 2016 and 2015.

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 December 31, 2016, we utilized a level 3 valuation technique to estimate the fair value of our equity by considering a market approach method. The market approach method includes the use of comparable multiples of similar companies whose services are comparable to ours. We utilized an earnings before interest, taxes, depreciation and amortization (EBITDA) multiple of 6.2 for the market approach calculation. 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.

Note 3. Long-Term Debt and Revolving Promissory Note

The following table summarizes our long-term debt and note payable - affiliate as of the following periods:

	Interest Rates	Maturities	As of December 31, 2016	As of December 31, 2015
			(Dollars in millions)	
Senior notes				
Notes due 2016	7.082%	2016	$ —	1,184
Notes due 2036	7.995%	2036	1,485	1,485
Other	9.000%	2019	150	150
First mortgage bonds	7.125% - 8.770%	2017 to 2025	223	231
Capital lease obligations			1	—
Unamortized debt discount and unamortized debt issuance costs			(1)	(1)
Total long-term debt			1,858	3,049
Less current maturities			(72)	(1,184)
Long-term debt, excluding current maturities			$ 1,786	1,865
Note payable - affiliate	6.678%	2022	$ 989	926

Various subsidiaries of ours have outstanding first mortgage bonds or unsecured debentures. Each issue of first mortgage bonds is secured by substantially all of the property, plant and equipment of the issuing subsidiary. In the aggregate, approximately 40% of our net property, plant and equipment is pledged to secure the first mortgage bonds at December 31, 2016. At December 31, 2016 and 2015, $223 million and $231 million of first mortgage bonds were outstanding, respectively.

Aggregate Maturities of Long-Term Debt

The following table represents the aggregate maturities of our long-term debt, excluding unamortized debt issuance costs and our note payable - affiliate, as of December 31, 2016:

	(Dollars in millions)
2017	$ 72
2018	1
2019	163
2020	—
2021	—
2022 and thereafter	1,623
Total long-term debt	$ 1,859

Repayments

2016

On December 23, 2016, a subsidiary of Embarq Corporation redeemed $5 million of its 8.375% Notes due 2025, which resulted in an immaterial loss.

On September 19, 2016, a subsidiary of Embarq Corporation redeemed all of its 8.77% Notes due 2017, which was less than $4 million and resulted in an immaterial loss.

On June 1, 2016, Embarq Corporation paid at maturity the $1.184 billion principal amount and accrued and unpaid interest due under its 7.082% Notes.

Interest Expense

For the years ended December 31, 2016 and 2015, we recorded $186 million and $235 million of gross interest expense on long-term debt, respectively. Additionally, for the years ended December 31, 2016 and 2015, we capitalized interest of $7 million and $6 million, respectively.

Revolving Promissory Note

We are currently indebted to an affiliate of our ultimate parent company, CenturyLink, under a revolving promissory note that provides us with a funding commitment of up to $2.5 billion aggregate principal amount through June 30, 2022. The outstanding principal balance of this revolving promissory note and the accrued interest thereon shall be due and payable on demand, but if no demand, then on June 30, 2022. Interest is assessed for all principal and unpaid interest amounts outstanding for the periods ended June 1 and December 1 ("Interest Period") in an amount equal to the outstanding balance on the last day of such Interest Period times the Applicable Interest Rate. The Applicable Interest Rate is the weighted average of CenturyLink's borrowing rate during the Interest Period, which was 6.678% as of December 31, 2016. Any accrued and unpaid interest on June 1 and December 1 is capitalized to note payable - affiliate on the accompanying consolidated balance sheets and begins bearing interest. Such borrowings had an outstanding balance of $989 million and $926 million at December 31, 2016 and 2015, respectively, which is reflected under current liabilities, in note payable - affiliate, on our consolidated balance sheets. For the years ended December 31, 2016 and 2015, we recognized interest expense of $64 million and $59 million, respectively, related to our note payable - affiliate. Our consolidated statements of cash flows reflect accrued interest activity on the note payable - affiliate as operating activities and principal payments on the note payable - affiliate as a financing activity. As of December 31, 2016, $6 million of accrued interest is reflected in accrued interest on our consolidated balance sheet.

CenturyLink Credit Facility

CenturyLink has access to up to $2.0 billion aggregate principal amount of revolving credit under an amended revolving credit facility that matures in December 2019. The amended credit facility (the "Credit Facility") has 16 lenders, with commitments ranging from $3.5 million to $198.5 million and allows CenturyLink to obtain revolving loans and to issue up to $400 million of letters of credit, which upon issuance reduce the amount available for other extensions of credit. Interest is assessed on borrowings using either the LIBOR or the base rate (as defined in the Credit Facility) plus an applicable margin between 1.00% and 2.25% per annum for LIBOR loans and 0.00% and 1.25% per annum for base rate loans depending on its then current senior unsecured long-term debt rating. At December 31, 2016, CenturyLink had $370 million in borrowings and no amounts of letters of credit outstanding under the Credit Facility. The Credit Facility is guaranteed on an unsecured basis by Embarq.

Covenants

We believe we were in material compliance with the provisions and covenants in our debt agreements at December 31, 2016.

Note 4. Property, Plant and Equipment

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

	Depreciable Lives	As of December 31,	
		2016	2015
		(Dollars in millions)	
Property, plant and equipment:			
Land	N/A	$ 86	88
Fiber, conduit and other outside plant[(1)]	15 - 45 years	11,748	11,554
Central office and other network electronics[(2)]	4 - 10 years	10,747	10,889
Support assets[(3)]	5 - 30 years	1,591	1,332
Construction in progress[(4)]	N/A	190	100
Gross property, plant and equipment		24,362	23,963
Accumulated depreciation		(20,167)	(19,505)
Net property, plant and equipment		$ 4,195	4,458

(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.

In the fourth quarter of 2014, we sold an office building in a sale-leaseback transaction for $12 million resulting in an $8 million gain. On January 21, 2015, we received net cash proceeds of $12 million from the sale of the office building.

Asset Retirement Obligations

At December 31, 2016, our asset retirement obligations balance was primarily related to estimated future costs of removing equipment from leased properties and estimated future costs of properly disposing of asbestos and other hazardous materials upon remodeling or demolishing buildings. Asset retirement obligations are included in other non-current liabilities on our consolidated balance sheet.

The following table provides asset retirement obligations activity:

	Years Ended December 31,	
	2016	2015
	(Dollars in millions)	
Balance at beginning of year	$ 15	15
Accretion expense	—	1
Liabilities settled	—	—
Other adjustments	(1)	(1)
Balance at end of year	$ 14	15

Note 5. Severance

Periodically, we reduce our workforce and accrue liabilities for the related severance costs. These workforce reductions resulted primarily from 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 salaries and benefits on our consolidated balance sheets and report severance expenses in operating 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, 2015	$ —
Accrued to expense	54
Payments, net	(31)
Balance at December 31, 2016	$ 23

Note 6. Income Taxes

Income Tax Expense

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

	Years Ended December 31,	
	2016	2015
	(Dollars in millions)	
Income tax expense:		
Current:		
Federal	$ 307	300
State	39	36
Total current	346	336
Deferred:		
Federal	(83)	(91)
State	(7)	5
Total deferred	(90)	(86)
Total income tax expense	$ 256	250

	Years Ended December 31,	
	2016	2015
	(Dollars in millions)	
Income tax expense was allocated as follows:		
Income tax expense in our consolidated statements of operations:		
Attributable to income before income tax expense	$ 256	250
Stockholder's deficit:		
Tax effect of the change in accumulated other comprehensive income	$ —	(2)

The following is a reconciliation from the statutory federal income tax rate to our effective income tax rate:

	Years Ended December 31,	
	2016	2015
	(Percentage of pre-tax income)	
Effective income tax rate:		
Federal statutory income tax rate	35.0%	35.0 %
State income taxes, net of federal effect	3.2%	4.3 %
Adjustment of liability for unrecognized tax position	—%	(0.1)%
Effective income tax rate	38.2%	39.2 %

Our 2016 effective tax rate was 38.2% compared to 39.2% for 2015. Our 2016 and 2015 rates reflect adjustments for permanent items, uncertain tax positions and other items, as well as the state income taxes.

Deferred Tax Assets and Liabilities

The tax effects of temporary differences that gave rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2016 and 2015 were as follows:

	As of December 31,	
	2016	**2015**
	(Dollars in millions)	
Deferred tax assets and liabilities:		
Deferred tax assets:		
Affiliate obligations, net	$ 281	268
Net operating loss carryforward	27	28
Other	120	77
Total deferred tax assets	428	373
Less valuation allowance	(16)	(15)
Net deferred tax assets	412	358
Deferred tax liabilities		
Property, plant and equipment, primarily due to depreciation differences	(1,030)	(1,069)
Other	(18)	(17)
Total deferred tax liabilities	(1,048)	(1,086)
Net deferred tax liabilities	$ (636)	(728)

Other Income Tax Information

At December 31, 2016, we had state NOLs of $677 million. If unused, the NOLs will expire between 2017 and 2032; however, no significant amounts expire until 2020. We expect to use some of these NOLs as an offset against our future taxable income, although the timing of that use will depend upon our future earnings and future tax circumstances.

We establish valuation allowances when necessary to reduce the deferred tax assets to amounts we expect to realize. At December 31, 2016 and 2015, we had a valuation allowance of $16 million and $15 million, respectively, as it is more likely than not that this amount of NOLs will not be utilized prior to expiration.

Tax Audits and Uncertain Tax Positions

A reconciliation of the change in our gross unrecognized tax benefits (excluding both interest and any related federal benefit) from January 1 to December 31 for 2015 is as follows:

	Unrecognized Tax Benefits
	(Dollars in millions)
Unrecognized tax benefits at December 31, 2014	$ 1
Decreases from the lapse of statute of limitation	(1)
Unrecognized tax benefits at December 31, 2015	$ —

As of December 31, 2016 and 2015, we had an insignificant amount of unrecognized tax benefits recorded on our consolidated balance sheets.

We recognized an insignificant amount of interest on our unrecognized tax benefits as a liability on our consolidated balance sheets as of December 31, 2016 and 2015. For the year ended December 31, 2016, we recognized an immaterial expense in our consolidated statement of operations. For the year ended December 31, 2015, we recognized an immaterial benefit in our consolidated statement of operations and consolidated statement of comprehensive income.

Our tax payments and receipts for combined or consolidated returns are paid to or received from CenturyLink. We continue to make some tax payments directly to certain tax jurisdictions where we file separate income tax returns. During 2016 and 2015, we made $340 million and $330 million, respectively, in tax payments to CenturyLink.

Beginning with the 2013 tax year, CenturyLink is subject to annual examination by the Internal Revenue Service ("IRS"). Our results are included in the CenturyLink consolidated federal income tax return.

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

Jurisdiction	Open Tax Years
Federal	2013—current
Various 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 that other jurisdictions to which we pay taxes may attempt to assert that we owe additional taxes.

Note 7. Employee Benefits

Certain of our active and retired employees participate in CenturyLink’s noncontributory qualified defined benefit pension plan and CenturyLink's qualified post-retirement health care plan. The Embarq qualified defined benefit pension plan and a pension plan of an affiliate were merged into the CenturyLink Retirement Plan as of December 31, 2014, which was renamed the CenturyLink Combined Pension Plan. Embarq's post-retirement benefit plan was merged into CenturyLink's post-retirement benefit plans on January 1, 2010. Prior to the plan mergers, a substantial portion of our active and retired employees participated in Embarq's pension and post-retirement plans.

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 CenturyLink'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 CenturyLink over a 30 year term. Payments are made on a monthly basis. For the years ended December 31, 2016 and 2015, we made settlement payments of $47 million and $55 million, respectively, to CenturyLink on our affiliate obligations, net balance. Changes in the affiliate obligations, net are reflected in operating activities in our consolidated statements of cash flows.

We were allocated $15 million of pension service costs and $5 million of post-retirement service costs during the year ended December 31, 2016, which represented 23.9% of CenturyLink's total pension and post-retirement service costs for the year. We were allocated $20 million of pension service costs and $6 million of post-retirement service costs during the year ended December 31, 2015, which represented 24.6% 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 operating expenses in our consolidated statement of operations.

Other Benefit Plans

401(k) Plan

CenturyLink sponsors qualified defined contribution benefit plans covering substantially all of our employees. Under the plans, employees may contribute a percentage of their annual compensation to the plans up to certain maximums, as defined by the plans and by the IRS. Currently, we match a percentage of employee contributions in cash. We recognized expenses related to the plans of $12 million and $13 million for the years ended December 31, 2016 and 2015, respectively, which are included within operating expenses in our consolidated statements of operations.

Note 8. Fair Value Disclosure

Our financial instruments consist of cash and cash equivalents, accounts receivable, advances to affiliates, advances from affiliates, accounts payable, note payable - affiliate and long-term debt. Due to their short-term nature, the carrying amounts of our cash and cash equivalents, accounts receivable, advances to affiliates, advances from affiliates, note payable - affiliate and accounts payable 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 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	2	$ 1,858	1,801	3,049	3,154

Note 9. 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 either 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. We believe 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 certain services from our affiliates, which are charged to us based on either market price or FDC.

Note 10. Commitments and Contingencies

CenturyLink is involved in several legal proceedings to which we are not a party that, if resolved against CenturyLink, could have a material adverse effect on its 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 Securities and Exchange Commission. Because we are not a party to any of these matters, we have not accrued any liabilities for these matters.

In this section, when we refer to a class action as "putative" it is because a class has been alleged, but not certified in that matter. Until and unless a class has been certified by the court, it has not been established that the named plaintiffs represent the class of plaintiffs they purport to represent.

We have established accrued liabilities for the matters described below where losses are deemed probable and reasonably estimable.

Pending Matters

In William Douglas Fulghum, et al. v. Embarq Corporation, et al., filed on December 28, 2007 in the United States District Court for the District of Kansas, a group of retirees filed a class action lawsuit challenging the decision to make certain modifications in retiree benefits programs relating to life insurance, medical insurance and prescription drug benefits, generally effective January 1, 2006 and January 1, 2008 (which, at the time of the modifications, was expected to reduce estimated future expenses for the subject benefits by more than $300 million). Defendants include Embarq, certain of its benefit plans, its Employee Benefits Committee and the individual plan administrator of certain of its benefits plans. Additional defendants include Sprint Nextel and certain of its benefit plans. The court certified classes on the claims for vested benefits and age discrimination, but rejected class certification on the claims for breach of fiduciary duty. On October 14, 2011, the Fulghum lawyers filed a new, related lawsuit, Abbott et al. v. Sprint Nextel et al. In Abbott, approximately 1,500 plaintiffs alleged breach of fiduciary duty in connection with the changes in retiree benefits that were at issue in Fulghum. After extensive district court proceedings in Fulghum, and an interlocutory appeal to the United States Court of Appeals for the Tenth Circuit, defendants prevailed in 2015 on all age discrimination claims and on the majority of claims for vested benefits. The district court in Fulghum subsequently granted judgment in favor of defendants on all remaining vested benefits claims, and in July 2016 ordered that any affected class members could appeal this ruling. No appeal was taken, and all claims for vested benefits thus have lapsed. On August 31, 2016, the parties reached a settlement in principle on all remaining claims in Fulghum and Abbott. Since then, a settlement agreement has been finalized and, per its terms, the vast majority of the settlement funds were paid out to the claims administrator in March 2017, with the remainder to be paid out in the next few months. As of December 31, 2016, the plan sponsor had accrued a liability for these matters sufficient to cover its settlement obligations.

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. The Verizon entities did not file any new state claims, while Sprint filed state claims substantially similar to those previously dismissed. Based on the November 2015 ruling, we filed suit against Level 3 seeking payment of charges which Level 3 has disputed and withheld. 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.

CenturyLink and several of its subsidiaries are defendants in lawsuits filed over the past few years in the Circuit Court of St. Louis County, Missouri by numerous Missouri municipalities alleging underpayment of taxes. These municipalities are seeking, among other things, (i) a declaratory judgment regarding the extent of our obligations to pay certain business license and gross receipts taxes and (ii) a monetary award of back taxes covering 2007 to the present, plus penalties and interest. In a February 2017 ruling in connection with one of these pending cases, the court entered a final order awarding plaintiffs $3.95 million and broadening the tax base on a going forward basis. We filed a notice of appeal on March 3, 2017. For a variety of reasons, we expect the outcome of our appeal to reduce our ultimate exposure, although we can provide no assurances to this effect.

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.

CenturyLink and 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.

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.

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 and 2015, our gross rental expense was $49 million and $51 million, respectively, which is included within operating expenses in our consolidated statements of operations.

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

	Future Minimum Payments
	(Dollars in millions)
Operating leases:	
2017	$ 10
2018	9
2019	8
2020	6
2021	4
2022 and thereafter	6
Total future minimum payments	$ 43

Purchase Obligations

We have several commitments primarily for support services and products from several vendors to be used in the ordinary course of business totaling $15 million at December 31, 2016. Of this amount, we expect to purchase $7 million in 2017 and $8 million in 2018 through 2019. These amounts do not represent our entire anticipated purchases in the future, but represents only those items for which we were contractually committed as of December 31, 2016.

Note 11. Labor Union Contracts

Approximately 3,500, or 42%, of our employees are members of various bargaining units represented by the Communications Workers of America or the International Brotherhood of Electrical Workers. Approximately 1,600, or 19%, of our employees are subject to collective bargaining agreements that expire in 2017.

Note 12. Other Financial Information

In 2016, we received net cash proceeds of $6 million from the sale of a building and net cash proceeds of $4 million from the sale of land. We recognized a total gain of $6 million on the sales of the building and land in 2016. At December 31, 2015, there were assets held for sale in the amount of $4 million included in other current assets. In 2015, we sold an office building for net cash proceeds of $10 million. We recognized a gain of $2 million on the sale of the office building.

Note 13. Accumulated Other Comprehensive Income

The table below summarizes changes in our accumulated other comprehensive income recorded on our consolidated balance sheet by component for the year ended December 31, 2015:

	Other	Total
	(Dollars in millions)	
Balance at December 31, 2014	3	3
Amounts reclassified from accumulated other comprehensive income	(3)	(3)
Net current-period other comprehensive income	(3)	(3)
Balance at December 31, 2015	—	—

The table below presents information about our reclassifications out of accumulated other comprehensive income by component for the year ended December 31, 2015:

Year Ended December 31, 2015	(Decrease) Increase in Net Income	Affected Line Item in Consolidated Statements of Operations or Footnote Where Additional Information is Presented If The Amount is not Recognized in Net Income in Total
	(Dollars in millions)	
Other	5	Interest expense
Total before tax	5	
Income tax expense	(2)	Income tax expense
Net of tax	$ 3	

Note 14. Subsequent Events

We evaluated subsequent events from December 31, 2016 until September 15, 2017, the date our consolidated financial statements were available to be issued. Based on the events noted through that period, material events occurring after the date of our consolidated financial statements are included in the related footnotes. See Note 10—Commitments and Contingencies for additional information.