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901 NORTH STUART STREET
ARLINGTON, VA 22203-1837

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BEFORE THE ARIZONA CORPORATION COMMISSION

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DOCKET NO. T-01051B-99-0105

IN THE MATTER OF THE APPLICATION)
OF US WEST COMMUNICATION, INC. A)
COLORADO CORPORATION, FOR A)
HEARING TO DETERMINE THE EARNINGS)
OF THE COMPANY FOR A HEARING TO)
DETERMINE THE EARNINGS OF THE)
COMPANY FOR RATEMAKING PURPOSES,)
TO FIX A JUST AND REASONABLE RATE)
OF RETURN THEREON AND TO APPROVE)
RATE SCHEDULES)

NOTICE OF FILING

Enclosed for filing are an original and ten(10) copies of the Testimony on the Agreement Between The Commission Staff and Qwest of Richard B. Lee, on behalf of the United States Department of Defense and All Other Federal Executive Agencies, in the above referenced proceeding.

Copies have been served on all known parties in accordance with the enclosed Service List.

Respectfully submitted this 7th day of November, 2000.

Sincerely,

[Handwritten Signature]

PETER Q. NYCE, JR.
General Attorney
Regulatory Law Office
Phone: (703) 696-1644
Fax: (703) 696-2960

Enclosure

BEFORE THE ARIZONA CORPORATION COMMISSION

CARL J. KUNASEK
Chairman

JIM IRVIN
Commissioner

WILLIAM A. MUNDELL
Commissioner

IN THE MATTER OF THE APPLICATION)
OF U S WEST COMMUNICATIONS, INC.,)
A COLORADO CORPORATION, FOR A)
HEARING TO DETERMINE THE EARNINGS)
OF THE COMPANY, THE FAIR VALUE)
OF THE COMPANY FOR RATEMAKING)
PURPOSES, TO FIX A JUST AND)
REASONABLE RATE OF RETURN THEREON)
AND TO APPROVE RATE SCHEDULES)
DESIGNED TO DEVELOP SUCH RETURN)
_____)

DOCKET NO. T-01051B-99-0105

TESTIMONY ON THE AGREEMENT BETWEEN
THE COMMISSION STAFF AND QWEST

of

RICHARD B. LEE

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE
And
ALL OTHER FEDERAL EXECUTIVE AGENCIES

ROBERT N. KITTEL, CHIEF
Regulatory Law Office
Office of The Judge Advocate General
U.S. Army Litigation Center
901 N. Stuart Street, Suite 713
Arlington, Virginia 22203-1837

By

Peter Q. Nyce, Jr.
General Attorney

November 13, 2000

Testimony of Richard B. Lee

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1 **INTRODUCTION**

2 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

3 A. My name is Richard B. Lee. I am Vice President of the economic consulting firm
4 of Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly King"). My business
5 address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

6 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS DOCKET?**

7 A. I am appearing on behalf of the Department of Defense and all other Federal
8 Executive Agencies ("DOD/FEA").

9 **Q. ARE YOU THE SAME RICHARD B. LEE WHO SUBMITTED DIRECT**
10 **TESTIMONY IN THIS PROCEEDING ON JULY 25, 2000, AND SURREBUTTAL**
11 **TESTIMONY ON SEPTEMBER 8, 2000?**

12 A. Yes, I am.

13 **Q. DID YOUR DIRECT TESTIMONY CONTAIN A DESCRIPTION OF YOUR**
14 **BACKGROUND AND EXPERIENCE?**

15 A. Yes, it did.

16 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT**
17 **SUPERVISION?**

18 A. Yes, it was.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

20 A. The purpose of my testimony is to present DOD/FEA's position on the
21 Settlement Agreement between the Commission Staff and Qwest dated October

1 20, 2000.

2 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

3 A. DOD/FEA finds the Settlement Agreement to be in the public interest. DOD/FEA
4 remains open, however, to the possibility that the Settlement Agreement may be
5 enhanced by modifications proposed by other parties.

6

7 **THE SETTLEMENT AGREEMENT IS IN THE PUBLIC INTEREST**

8

9 **Q. PLEASE SUMMARIZE THE SETTLEMENT AGREEMENT**

10 A. The Settlement Agreement has two principal components. First, the Settlement
11 Agreement resolves the many contested issues in this rate case by authorizing a
12 \$42.9 million increase in Qwest's net intrastate revenues, of which approximately
13 \$17.6 million would be implemented immediately. Second, the Settlement
14 Agreement establishes a three-year Price Cap Plan during which neither Qwest
15 nor Staff will initiate a general rate case.

16 **Q. PLEASE SUMMARIZE THE PROPOSED PRICE CAP PLAN.**

17 A. The Price Cap Plan establishes three baskets of service. Each basket is subject
18 to specific pricing rules.

19 Basket One consists of Basic/Essential Noncompetitive Services. The
20 price cap for this basket will decrease each year to the extent that inflation is less
21 than an assumed productivity increase of 4.2 percent.

1 Basket Two consists of Essential Wholesale Services. Intrastate
2 Switched Access service rates will be decreased by \$5 million each year, with
3 the eventual objective of parity with interstate switched access rates. All other
4 services in this basket are either frozen or subject to other specific pricing rules.

5 Basket Three consists of Flexibly-Priced Competitive Services that have
6 already been accorded pricing flexibility. The price cap for this basket will begin
7 at 110 percent of current rates, reflecting the \$25.3 million of higher authorized
8 net intrastate revenues not implemented immediately. This cap will be increased
9 by \$5 million each year to offset the reductions in intrastate access rates.

10 The Price Cap Plan also increases the Service Quality Plan penalties
11 applicable if Qwest fails to meet existing performance standards in Arizona.

12 **Q. IS THE RESOLUTION OF THE ISSUES IN THE RATE CASE IN THE PUBLIC**
13 **INTEREST?**

14 **A.** Yes, it is. In its January 8, 1999, filing, Qwest proposed an increase of \$225.9
15 million in authorized net revenues, with \$70.9 million to be implemented
16 immediately. DOD/FEA, Staff, the Residential Utility Consumer Office ("RUCO")
17 and AT&T all found Qwest's revenue requirement proposal to be vastly
18 excessive. The Settlement Agreement represents a reasonable compromise
19 given the many contentious issues raised by the parties and the inherent
20 uncertainty of revenue requirement projections.

21 The Settlement Agreement strikes an appropriate balance between the

1 interests of Qwest and its ratepayers. Indeed, under the Settlement Agreement,
2 all of the revenue increases allowed are applied to competitive services, while all
3 of the revenue decreases required are related to noncompetitive or wholesale
4 services. This rate design feature appropriately places the burden on Qwest to
5 realize the net revenue increase authorized under the Settlement Agreement.

6 **Q. IS THE PROPOSED PRICE CAP PLAN IN THE PUBLIC INTEREST?**

7 A. Yes, it is. This aspect of the Settlement Agreement also appropriately balances
8 the interests of Qwest and its ratepayers.

9 The productivity factor of 4.2 percent represents a realistic, but
10 challenging, target for Qwest over the next three years. If it exceeds this target,
11 Qwest will be rewarded with higher earnings. If it falls short, Qwest, and not its
12 ratepayers, will suffer the consequences.

13 The proposed reductions in intrastate access charges are most
14 appropriate. The offsetting increase to the competitive service cap provides
15 Qwest with an opportunity to recoup these lost access revenues in the
16 marketplace.

17 The strengthening of the penalties associated with service quality failures
18 is an important part of the Price Cap Plan. It should serve to discourage the
19 achievement of higher earnings at the expense of service quality.

20 Finally, the three-year period of the Price Cap Plan seems appropriate for
21 all concerned. Three years represent a long enough period to provide Qwest

1 with a real incentive to reap the earnings rewards which would come with
2 outstanding productivity improvements. At the same time, three years is a short
3 enough period to prevent Qwest from reaping a windfall at the expense of
4 ratepayers if the productivity factor is found to be too low.

5 **Q. IS THE PROPOSED PRICE CAP PLAN PERFECT?**

6 A. I doubt it. Although I have no specific recommendations to make concerning the
7 details of the plan, it is possible that other parties may propose worthwhile
8 modifications. I recommend that Qwest, the Staff and the Commission remain
9 open to such enhancements to the Price Cap Plan as may be proposed during
10 this proceeding.

11

12 **CONCLUSION**

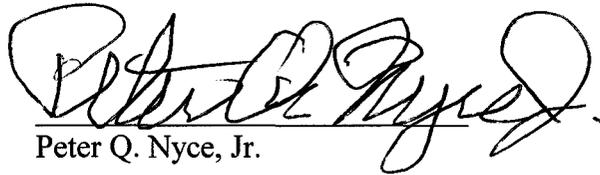
13 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

14 A. Yes, it does.

CERTIFICATE OF SERVICE

I, Peter Q. Nyce, Jr., certify that I have this day caused the Testimony on the Agreement Between The Commission Staff and Qwest of Richard B. Lee, on behalf of the Department of Defense and All Other Federal Executive Agencies, to be served on all known parties by sending a copy by either Federal Express or by regular U.S. Mail delivery to those on the "Service List" attached hereto.

Executed November 7, 2000, at Arlington Virginia.


Peter Q. Nyce, Jr.

MARY B TRIBBY
AT&T
1857 LAWRENCE ST SUITE 1575
DENVER COLORADO 80202

THOMAS H CAMPBELL
LEWIS & ROCA
40 N CENTRAL AVENUE
PHOENIX ARIZONA 85004

PAUL BULLIS CHIEF COUNSEL
LEGAL DIVISION
ARIZONA CORP COMMISSION
1200 WEST WASHINGTON STREET
PHOENIX ARIZONA 85007

RICHARD LEE
SNAVELY KING & MAJOROS
O'CONNOR & LEE INC
1220 L STREET N W SUITE 410
WASHINGTON DC 20005

MAUREEN SCOTT
LEGAL DIVISION
ARIZONA CORP COMMISSION
1200 WEST WASHINGTON AVENUE
PHOENIX ARIZONA 85007

CHUCK TURNER MAYOR
TOWN OF GILA BEND
PO BOX A
644 W PIMA STREET
GILA BEND ARIZONA 85331

JON POSTON
ARIZONANS FOR COMPETITION IN
TELEPHONE SERVICE
6733 E DALE LANE
CAVE CREEK ARIZONA 85331

JEFFREY W CROCKETT
SNELL & WILMER
ONE ARIZONA CENTER
PHOENIX ARIZONA 85004-001

MARIA ARIAS-CHAPLEAU
RICHARD S WOLTERS
AT&T
1875 LAWRENCE STREET SUITE 1575
DENVER COLORADO 80202

J E & B V MCGILLIVRAY
300 S McCORMICK
PRESCOTT ARIZONA 86303

LYN FARMER CHIEF COUNSEL
LEGAL DIVISION
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON STREET
PHOENIX ARIZONA 85007

JERRY RUDIBAUGH
CHIEF HEARING OFFICER
ARIZONA CORP COMMISSION
1200 WEST WASHINGTON AVE
PHOENIX ARIZONA 85007

RAY WILLIAMSON
ACTING DIRECTOR
UTILITIES DIVISION
ARIZONA CORP COMMISSION
1200 WEST WASHINGTON STREET
PHOENIX ARIZONA 85007

LEX SMITH
MICHAEL PATTEN
BROWN AND BAIN
2901 N CENTRAL AVE
PHOENIX AZ 85001-0400

DOCKET CONTROL
ARIZONA CORP COMMISSION
1200 WEST WASHINGTON AVENUE
PHOENIX ARIZONA 85007

STEVEN J DUFFY
RIDGE & ISAACSON P C
3101 NORTH CENTRAL AVENUE SUITE 432
PHOENIX ARIZONA 85012

DEBORAH R SCOTT
ASSOCIATE GENERAL COUNSEL
CITIZENS UTILITIES COMPANY
2901 N CENTRAL AVE SUITE 1660
PHOENIX AZ 85012

SCOTT S WAKEFIELD CHIEF COUNSEL
RUCO
2828 NORTH CENTRAL AVENUE SUITE 1200
PHOENIX ARIZONA 85004-1022

PATRICIA VANMIDDE
AT&T
111 W MONROE SUITE 1201
PHOENIX ARIZONA 85003

MICHAEL PATTERN
BROWN & BAIN P A
2901 N CENTRAL AVE SUITE 2000
P O BOX 400
PHOENIX ARIZONA 85001-0400

TIMOTHY BERG
FENNEMORE CRAIG
3003 N CENTRAL AVE STE 2600
PHOENIX ARIZONA 85012

GREG PATTERSON
RUCO
2828 N CENTRAL AVE STE 1200
PHOENIX ARIZONA 85004

ARIZONA REPORTING SRV INC
2627 N 3RD STREET STE 3
PHOENIX ARIZONA 85004-1104

RAYMOND S HEYMAN
ROSHKA HEYMAN & DEWULF
400 N FIFTH STREET
PHOENIX AZ 85004

THOMAS F DIXON
MCI TELECOMMUNICATIONS CORP
707 17TH STREET SUITE 3900
DENVER COLORADO 80202

DIANE BACON
LEGISLATIVE DIRECTOR
COMMUNICATIONS WORKERS OF AMERICA
5818 NORTH 7TH ST SUITE 206
PHOENIX ARIZONA 85014

MARK N ROGERS
EXCELL AGENT SERVICES L L C
2175 W 14TH STREET
TEMPE ARIZONA 85281

DARREN S WEINGARD
SPRINT COMMUNICATIONS COMPANY L P
1850 GATEWAY DRIVE 7TH FLOOR
SAN MATEO CA 94404-2467

CRIG MARKS
CITIZENS UTILITIES COMPANY
2901 N CENTRAL AVENUE SUITE 1660
PHOENIX ARIZONA 85012

DOUGLAS HSIAO
PHYTHMS LINKS INC
6933 REVERE PARKWAY
ENGLEWOOD COLORADO 80112

JIM SCHELTEMA
BLUMENFELD & COHEN
1625 MASSACHUSETTS AVE N W
SUITE 300
WASHINGTON DC 20036

ALBERT STERMAN
ARIZONA CONSUMERS COUNCIL
2849 E 8TH STREET
TUCSON ARIZONA 85716

MARTIN A ARONSON
WILLIAM D CLEAVELAND
MORRILL & ARONSON P L C
ONE EAST CAMELBACK SUITE 340
PHOENIX ARIZONA 85012-1648

JOAN S BURKE
OSBORN MALEDON P A
2929 N CENTRAL AVENUE SUITE 2100
PHOENIX ARIZONA 85012