



0000012157

RECEIVED

Arizona Corporation Commission

DOCKETED

BEFORE THE ARIZONA CORPORATION COMMISSION

DEC 18 2000

DEC 18 P 4:13
AZ CORP COMMISSION
DOCUMENT CONTROL

DOCKETED BY CR

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

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
POST-HEARING BRIEF

I. INTRODUCTION

This case allows the Arizona Corporation Commission ("Commission") an opportunity to move away from the traditional form of public utility regulation as the means for controlling earnings and making decisions about the allowable costs of individual services. The Settlement Agreement entered into between the Utilities Division of the Arizona Corporation Commission ("Staff") and Qwest Corporation ("Qwest") seeks the adoption of a price cap plan that achieves many of the same objectives, but through the direct regulation of prices. The plan also has the beneficial effect of providing Qwest with the incentives to become more efficient and innovative, and to make new investments more rapidly. Thus, in many respects, price cap regulation, like that proposed in the Settlement Agreement, more closely mirrors the effects of a fully competitive market. The

1 Commission should support such a goal and adopt the Settlement Agreement in its
2 entirety.

3 Competitive local exchange carriers ("CLECs") and the Residential Utility
4 Consumer Office ("RUCO") oppose the Settlement Agreement simply because it
5 does not adopt their particular adjustments, which are, in many instances,
6 incorrect, inappropriate, and narrowly focused to advance only their own
7 economic interests. These opponents seek to divert the Commission's attention
8 from the key issues before it: does the Settlement Agreement, as a whole, benefit
9 consumers, protect competition and promote the public's interest? However,
10 throughout this case, and again at hearing, the CLECs and RUCO have failed to
11 demonstrate that the Settlement Agreement is not a reasonable and well-reasoned
12 means to allow Qwest to enter the competitive marketplace on a more equal
13 footing while providing adequate protection to Arizona consumers and other
14 service providers.

15 **II. THE SETTLEMENT AGREEMENT SERVES THE PUBLIC**
16 **INTEREST AND SHOULD BE ACCEPTED.**

17 The Settlement Agreement represents a reasonable compromise of the
18 contested issues in this case, and ends a rate case that has been pending since
19 January 1999, a period of twice the time contemplated by the Commission time
20 clock rule. The Settlement Agreement is supported by other parties to this case,
21 including the Department of Defense ("DOD"), the Communications Workers of
22 America ("CWA"), and the Arizona Payphone Association ("APA"). More
23 importantly, the Settlement Agreement serves the public interest. Therefore, the
24 Settlement Agreement should be accepted by the Commission.

25 The Settlement Agreement contains several key aspects which protect and
26 benefit the public. Significantly, the Settlement Agreement provides rate stability

1 for its three-year term. [TR¹ II at 239.] Under the terms of the Settlement
2 Agreement basic service rates for residential and business customers may
3 decrease, however, these rates may *not* increase over the levels set in 1995. Id.
4 The rate stability the Settlement Agreement provides is clearly in the public's
5 interest.

6 The Settlement Agreement also provides additional incentives for Qwest to
7 meet existing service quality performance standards in Arizona. These incentives
8 are in addition to the incentives currently contained in Qwest's service quality
9 tariff as modified by the Qwest merger order. The additional penalties will take
10 the form of one-time credits of \$2.00 for each business and residential access line
11 in Arizona in any year in which Qwest becomes subject to penalties under two or
12 more of the five categories defined in section 2.6 of the Service Quality Plan
13 Tariff. [Settlement Agreement at 6-7.] Service quality improvement is an
14 important issue to the public and groups such as the CWA. [TR I at 45.] Qwest's
15 willingness to accept this provision demonstrates its continued commitment to
16 provide quality service to its Arizona customers.

17 Additionally, the Settlement Agreement contains a vigorously negotiated
18 revenue requirement. [TR III at 673.] The revenue deficiency contained in the
19 Settlement Agreement is less than a quarter of that originally requested by Qwest.
20 Further, the fact that all the revenue increases are applied to competitive services,
21 while all revenue decreases relate to noncompetitive or wholesale services, places
22 the burden on Qwest to recover these revenues through rates for competitive
23 services and services the Commission has ordered to be flexibly priced. Id.

24
25
26

¹ "TR" is the transcript of hearing prepared by the court reporter in this docket, with
roman numerals referencing the transcript volume.

1 Most importantly, the Settlement Agreement adopts a price cap plan. As
2 previously discussed the Settlement Agreement ensures rate stability, protecting
3 consumers. The Settlement Agreement benefits all residential and business
4 customers by capping the rates that Qwest may charge for essential, basic services.
5 Residential and business basic service rates cannot increase above rates set in
6 1995 for the three-year term of the Settlement Agreement. [TR II at 239.]
7 Significantly, these rates may actually decrease. [TR III at 602-603.]

8 Under the price cap plan, many customers will see actual reductions in their
9 monthly bill due to the elimination of zone charges in those exchanges with
10 expanded base rate areas. [Qwest Notice of Filing Testimony Summaries,
11 November 28, 2000: Summary of Testimony of Maureen Arnold at 2.] The plan
12 reduces the rates for installation of basic residence service and eliminates the
13 initial charge to connect service in rural areas. [Testimony of Maureen Arnold,
14 October 27, 2000, at 7-8.] Therefore, not only will the monthly rates for basic
15 service be capped, but these reductions in rates, totaling \$14 million, will make it
16 more affordable for customers to obtain service, especially in rural areas of the
17 state. Id. The rate reductions are consistent with the goals of this Commission and
18 the Telecommunications Act of 1996.

19 The price cap plan, through the indexing mechanism, provides the potential
20 for reductions in the prices for services contained in Basket 1. [Testimony of
21 Maureen Arnold, October 27, 2000, at 4, 9-10.] The plan is structured so that
22 customers of Basket 1 services are guaranteed to realize a productivity benefit of
23 4.2%. Id. If inflation is less than 4.2% in any given year, then the weighted
24 average price for services in Basket 1 will be reduced. Id. If inflation is greater
25 than or equal to 4.2%, then the weighted average price will be capped. Id. Harry
26 M. Shooshan III, Staff's price cap plan expert, testified that this provision of the

1 plan (whereby Qwest is restricted from increasing the price index if inflation is
2 high) is a significant, beneficial feature of the plan that, to his knowledge, is not
3 found in any other state's price cap plan. [TR III at 618.]

4 Additionally, under the Settlement Agreement a reduction in intrastate
5 switched access charges will occur over the three-year term of the plan, thereby
6 creating the opportunity for intraLATA long distance rates of all interexchange
7 carriers serving Arizona to decrease. Switched access charges would be reduced
8 \$5 million per year, or \$15 million over the three-year term of the Settlement
9 Agreement. [TR III at 604.] The Settlement Agreement also sets a goal of
10 reducing switched access rates to the interstate level. Id. As a result, long-
11 distance prices for calls within Arizona should be reduced. Id.

12 The plan also allows for pricing flexibility for services in Basket 3. All
13 services that are initially placed in Basket 3 are currently priced on a flexibly
14 priced basis, or have been previously determined by the Commission to be
15 competitive. [TR II at 235.] Therefore, it is entirely appropriate that this
16 flexibility continue under the plan. Id. The plan also provides added protection
17 by specifically prohibiting price discrimination against any class of customer. [TR
18 II at 236.] Additionally, the price cap plan is expressly subject to all of the
19 Commission's existing competition rules that normally protect competitors. In
20 accordance with the rules, the plan provides safeguards against anti-competitive
21 pricing and prevents subsidies from noncompetitive to competitive services. Id.

22 The price cap plan also allows Qwest to start the process of moving from
23 traditional monopoly regulation to regulation that is consistent with a competitive
24 market. The plan promotes the move towards competition while maintaining
25 oversight by the Commission. [TR I at 73.] During the transition to competition,
26 the plan protects consumers by ensuring that the residential and business customer

1 will be able to get basic needed services at prices less than or equal to their current
2 rates. The only difference to consumers is the availability of more options.

3 The Settlement Agreement affords Qwest the flexibility to respond to
4 competition while encouraging Qwest to invest in the state, operate more
5 efficiently and to improve service quality. [Testimony Harry M. Shooshan III,
6 October 27, 2000, at 2, 5-7.] Qwest's investment in Arizona, along with the rate
7 stabilization which will occur under the Settlement Agreement, will benefit the
8 public. Therefore, the Commission should find that the Settlement Agreement is
9 in the public interest and approve the Agreement as filed.

10 **III. THE REVENUE REQUIREMENT IS A REASONABLE**
11 **COMPROMISE.**

12 The revenue requirement established by the Settlement Agreement is
13 reasonable and in the public interest. The total revenue increase that Qwest may
14 implement under the Settlement Agreement is \$42.9 million. [Supplemental
15 Testimony of Michael A. Brosch, October 27, 2000, at 1.] Of this amount, only
16 \$17.6 million constitutes an immediate revenue increase. Id. The remaining
17 \$25.3 million represents authorized increases in overall revenue from only
18 competitive or flexibly priced services that Qwest may (or may not) elect to
19 implement in the future. Id. Because these increases are applied to only Basket 3
20 services (while all revenue decreases relate to non-competitive or wholesale
21 services), the Settlement Agreement places the burden on Qwest to realize any net
22 revenue from the competitive marketplace. Thus, Qwest is not guaranteed the
23 recovery of this portion of the revenue requirement.

24 The \$42.9 million revenue requirement was derived from exhaustive
25 discussions between Staff and Qwest, based on judgments associated with the
26 litigation risk of presenting and arguing many issues set forth in Staff's and the

1 other parties' pre-filed evidence. [Supplemental Testimony of Michael A. Brosch,
2 October 27, 2000, at 1-2.] There was no issue-by-issue negotiation and the total
3 revenue requirement agreed upon was not premised upon specific outcomes for
4 particular issues. Id. In fact, the parties agreed that the Settlement Agreement
5 would not serve as a precedent for future proceedings and that income available
6 from operations was not based on a compilation of specific adjustments. Id.
7 Therefore, the Settlement Agreement does not advance any particular ratemaking
8 theory or position, but rather is a compromise of all issues between the Staff and
9 Qwest. Id.

10 Staff originally supported a rate increase of \$7.2 million, while Qwest
11 sought a total revenue increase of \$201.2 million. [Supplemental Testimony of
12 Michael A. Brosch, October 27, 2000, at 2.] To arrive at the \$42.9 million
13 revenue requirement, the Settlement Agreement employs the Staff's original rate
14 base—the lowest of those presented by all parties.² Additionally, the Settlement
15 Agreement adopts Staff's 11.75% return on equity, again closer to the lowest
16 suggested equity return of 11.5% (RUCO) than to Qwest's advocated 14%.
17 [Rebuttal Testimony of Michael A. Brosch, November 20, 2000, at 4.] As a
18 result, Qwest accepted Staff's rate base and rate of return positions in full for the
19 purpose of settling this case. Id. Likewise, Qwest agreed to a productivity factor
20 (4.2%) that is closer to the upper limits of productivity factors used by states with
21 price cap plans.³

22 Moreover, Staff and Qwest arrived at the income available from Qwest's
23 current operations through vigorous negotiations. For example, several operating

24 _____
25 ² Only three parties (Qwest, Staff and RUCO) submitted fair value rate bases as required by the
Arizona Constitution. [Testimony of George Redding, October 27, 2000, at 3.]

26 ³ The average productivity factor for such states is 2.95%. [Rebuttal Testimony of
Michael A. Brosch, November 20, 2000, at 11.]

1 income adjustments proposed by Staff and other parties involved considerable
2 litigation risk because of the nature of the issues involved and the absence of any
3 Commission precedent (e.g., software capitalization, incentive compensation, out-
4 of-period wage and salary increases, and overheads assigned to the sale of
5 exchanges). [Supplemental Testimony of Michael A. Brosch, October 27, 2000,
6 at 2.] These adjustments were either not at issue in Qwest's last rate case or
7 contrary to earlier Commission decisions. If Staff (or any other party) did not
8 prevail on a few of these adjustments, the resulting approved rate increase could
9 be much larger than the \$42.9 million in the Settlement Agreement. Id.
10 Additionally, if the Commission granted a return on equity only modestly higher
11 than Staff's 11.75%, the resulting rate increase would again be larger. Id. Thus,
12 even when viewed in isolation, a compromise of only these adjustments illustrates
13 the reasonableness of the settlement revenue requirement, particularly in light of
14 the many other adjustments that were accepted.

15 In contrast, RUCO and other interveners offer nothing to show that the
16 compromise reached by Staff and Qwest is unreasonable but instead merely
17 reiterate their original positions. RUCO and AT&T criticize the settlement
18 revenue requirement claiming that neither Staff nor Qwest considered their
19 adjustments. However, both Staff (Brosch) and Qwest (Redding) testified that
20 they reviewed the adjustments proposed by all parties. [Rebuttal Testimony of
21 Michael A. Brosch, November 20, 2000, 2-6; Rebuttal Testimony of George
22 Redding, November 20, 2000, 2-4, 6-11.] In fact, during negotiations the parties
23 presented several different scenarios using the adjustments of various parties
24 before arriving at the negotiated position of \$113.7 million of income available
25 (yielding the \$42.9 million revenue requirement). [Rebuttal Testimony of George
26 Redding, November 20, 2000, at 8.] Consequently, although the initial

1 negotiations were between the Staff and Qwest, the positions of other parties,
2 including RUCO, DOD and AT&T were considered.

3 As explained by Staff (Brosch), many of RUCO's adjustments correspond
4 directly to similar positions taken by Staff. [Rebuttal Testimony of Michael A.
5 Brosch, November 20, 2000, at 2.] However, in other instances, RUCO
6 adjustments were rejected as inappropriate. Id. For example, RUCO incorrectly
7 reversed all of Qwest's proposed toll revenue loss ignoring test year data
8 reflecting an actual and measurable decline in the company's toll revenues. Id.
9 RUCO improperly included an estimated gain on the sale of Qwest exchanges
10 even though the Commission was addressing any such gain in another docket.⁴ Id.
11 In reviewing Qwest wages and salaries, RUCO employed the wrong accounting
12 methodology and did not perform a complete annualization of Qwest's payroll. In
13 contrast, Staff posted required adjustments to reflect known corrections to Qwest's
14 pre-filed case, even if making such adjustments increased the revenue
15 requirement. [Rebuttal Testimony of Michael A. Brosch, November 20, 2000, at
16 3.] RUCO failed to make any of these corrections, which would have resulted in
17 at least a \$12.2 million revenue increase in RUCO's proposal. Id. These
18 omissions by RUCO, along with the toll loss and gain on sale adjustments and
19 RUCO's lower return on equity, account for much of RUCO's variation from
20 Staff.

21 AT&T claims that the Settlement Agreement revenue requirement "can
22 only be described as arbitrary and began from an unreasonably inflated revenue

23 ⁴ Indeed, the Commission approved the sale on December 12, 2000, with a treatment of
24 gain on the sale of the exchanges by Qwest that is inconsistent with RUCO's proposed
25 adjustments here. In the Matter of the Joint Application of U S WEST Communications,
26 Inc. and Citizens Utilities Rural Company, Inc. for Approval of the Transfer of Assets in
Certain Telephone Wire Centers to Citizens Rural and the Deletion of Those Wire
Centers From U S WEST's Service Territory, Docket Nos. T-01051B-99-0737 and T-
01954B-99-0737, Decision No. 63268, December 15, 2000.

1 requirement base.” AT&T then characterizes the \$42.9 million as a “split the
2 baby” treatment that must be “accorded to the proposed adjustments of other
3 interested parties as well.” AT&T’s characterization is inaccurate because the
4 Settlement Agreement did not begin with Qwest’s asserted revenue requirement,
5 but instead used Staff’s rate base and rate of return outright. [Rebuttal Testimony
6 of Michael A. Brosch, November 20, 2000, at 4.] The Settlement Agreement also
7 used Staff’s adjusted operating income rather than Qwest’s, with upward
8 adjustments to recognize that Staff and other parties would likely not prevail on
9 every one of their many adjustments. Id.

10 In reality, AT&T’s arguments are based on the premise that every
11 unsubstantiated adjustment proposed by every non-signatory party must be used to
12 reduce the revenue requirement in a 50/50 factoring process. [Rebuttal Testimony
13 of Michael A. Brosch, November 20, 2000, at 5.] However, in many cases
14 adjustments listed by AT&T are not “corrections” at all, but improper
15 disallowances and imputation adjustments based upon incorrect assumptions,
16 misunderstandings of Staff’s and Qwest’s positions, improper ratemaking policies
17 and inconsistencies with prior Commission decisions. For example, at hearing,
18 AT&T incorrectly insisted that the Settlement Agreement merely adopted the
19 same rate of return used in Qwest’s (then-U S WEST) prior rate case. [TR IV at
20 714.] AT&T continued to insist on a greater directory imputation adjustment
21 based on an imputation of directory profits,⁵ irrespective of a decision by the
22 Arizona Court of Appeals reversing the methodology employed by AT&T and
23 requiring a surcharge on Arizona customers to recover the revenue not collected.

24
25
26 ⁵[TR IV at 755-756, Exhibit ATT-8 (Direct Testimony of Lee L. Selwyn, August 8,
2000, at 118).]

1 [TR IV at 742.] AT&T claims that such "litigation" risks should be afforded little
2 or no weight

3 In contrast to the positions advanced by AT&T and RUCO, other
4 interveners who originally advanced different revenue requirements testified in
5 support of the Settlement Agreement. DOD agreed that the Settlement Agreement
6 represents a reasonable compromise given the many contentious issues raised by
7 the parties and the inherent uncertainty of revenue requirement projections. [TR
8 IV at 673.] In support of the Settlement Agreement, DOD noted that "[T]he fact
9 that all the revenue increases are applied to competitive services, while all revenue
10 decreases relate to noncompetitive or wholesale services, places the burden on
11 Qwest to realize the net revenue increase authorized under the Settlement
12 Agreement." Id. The Communications Workers of America, Arizona State
13 Council, and the Arizona Payphone Association also supported the Settlement
14 Agreement. [TR I at 43-45; TR at 519, Exhibit APA-1.]

15 By their nature, settlements are a compromise of contested positions. Even
16 RUCO's expert witness (Smith) admits that "any particular party will not
17 necessarily prevail on all of the adjustments it is sponsoring." [TR IV at 757-758,
18 763-764; Exhibit RUCO-13 (Supplemental Testimony of Ralph C. Smith,
19 November 13, 2000) at 3.] There is nothing arbitrary about a vigorously
20 negotiated compromise of the revenue requirement that is not burdened with
21 detailed issue-by-issue findings in favor of specific parties on each of the
22 multitude of adjustments proposed in this proceeding. In fact, any attempt to
23 reach a settlement by specific resolution of each proposed adjustment would likely
24 have required detailed concessions that the parties would have been unwilling to
25 make. Such an approach virtually guarantees full litigation of each of the various
26 issues so that non-signatories could contest the various concessions made or not

1 made in such a settlement. In effect, interveners like AT&T, MCI, Cox and
2 RUCO simply seek to defeat the Settlement Agreement by insisting on this
3 approach without presenting any credible evidence that the negotiated revenue
4 requirement is unreasonable.

5 **IV. THE PRICE CAP PLAN IS LAWFUL.**

6 The structure of the price cap plan, as contained in the Settlement
7 Agreement, comports with Arizona law and provides significant benefits to both
8 consumers and competitors. The price cap plan establishes three baskets of
9 services: basic/essential non-competitive services; wholesale services; and
10 flexibly-priced competitive services. Under Basket 1, certain basic/essential non-
11 competitive services are capped at current rate levels for the three-year term of the
12 plan. [Testimony of Harry M. Shooshan III, October 27, 2000, at 6.]
13 Additionally, consumers benefit directly from Qwest's increased efficiencies
14 through a productivity factor of 4.2 % applied to Basket 1 services, which includes
15 a 0.5 consumer dividend. [Testimony of Harry M. Shooshan III, October 27,
16 2000, at 5.]

17 Both RUCO and AT&T criticize the productivity factor of 4.2%. However,
18 the productivity factor must be viewed in the context of the other elements of the
19 formula. [Testimony of Harry M. Shooshan III, October 27, 2000, at 5.] For
20 example, the inflation minus productivity calculation is capped at zero and has no
21 lower bound. Id. This is a significant concession by Qwest in that it has accepted
22 the risk of inflation for the term of the price cap plan. Id. In this aspect, the
23 proposed Settlement Agreement formula is quite different—and more
24 constraining—than that used by the Federal Communications Commission
25 (“FCC”) or other states that allow an increase should inflation outstrip
26 productivity. [TR III at 642.]

1 AT&T argues for implementation of the FCC productivity factor, but states
2 that it does not oppose a jurisdictionally-based factor. RUCO makes no specific
3 recommendation. It simply demands a downward adjustment in the inflation
4 factor without reconciling the effect on the customer dividend included in the
5 productivity factor. Ultimately, RUCO's witness concludes that "4.2% is within a
6 plausible range for this particular variable, when looked at in isolation."
7 [Supplemental Testimony of Ben Johnson, Ph.D., November 13, 2000, at 19.] In
8 reality, AT&T and RUCO arbitrarily advocate for a higher factor with no evidence
9 to support such an increase.

10 Both RUCO and AT&T fail to come to grips with productivity factors used
11 in other jurisdictions. As described in the testimony of Qwest (Redding) and Staff
12 (Shooshan) witnesses, the majority of other jurisdictions have productivity factors
13 much lower than that proposed by the Settlement Agreement or the FCC.
14 [Rebuttal Testimony of Harry M. Shooshan III, November 20, 2000, at 11.] In
15 fact, the 4.2% factor agreed to by Staff and Qwest remains near the top of the
16 range. [Rebuttal Testimony of George Redding, November 20, 2000, at 13.]

17 RUCO urges the Commission to reject the Settlement Agreement because it
18 claims that other jurisdictions have required incumbent local exchange carriers to
19 implement rate reductions in order to gain increased pricing freedom and other
20 benefits of price cap regulation. In effect, RUCO would have Qwest "pay" for
21 price cap regulation with a rate reduction. RUCO fails to offer any cost of service
22 rate-making principle that supports this proposal. Neither does it provide any
23 reason why the public interest requires Qwest to pay for a different form of
24 regulation. RUCO presents no evidence that rate reductions imposed on or agreed
25 to by other companies in other states were, in fact, "payment" for price cap
26 regulation. It makes no effort to show that the circumstances of Qwest in Arizona

1 are the same as the circumstances existing in these other states. In fact, no
2 evidence of any kind was presented that stated the rationale or reasoning for the
3 rate decreases in these other states.

4 Moreover, Staff presented evidence that RUCO's claim that states typically
5 require rate reductions prior to establishing price cap regulation is untrue. As
6 discussed by Staff's witness, Harry M. Shooshan III, a balanced plan as proposed
7 in the Settlement Agreement should not be altered to include such reductions:

8 Q. So if the Commission in evaluating this price cap plan felt that
9 it would be appropriate to add a requirement that either rates
10 decrease or that additional investment be required, you would not
11 find that additional requirement to be unreasonable?

12 A. Yes, I would, in the context of this settlement. This is, after
13 all, settlement where the parties have negotiated an agreement. And
14 it seems to me that any imposition of new requirements in what is a
15 balanced – in my view, balanced and fair plan, you know, could put
16 in jeopardy the entire plan.

17 I think that, again, as I said, the benefits to consumers, and I
18 think they're significant here, Mr. Wakefield, have to be looked at in
19 their entirety. I think, as I say, you're referring to Dr. Johnson's
20 testimony said, isn't true that in other states there have been rate
21 reductions required. It's also true in other states that there have been
22 rate freezes that have been required, a freeze being the rate doesn't
23 move anywhere. These rates, as I said, can move down, including
24 the ones that have been hard capped. In other states, and I can think,
25 for example, of Maine, basic rates have been allowed to go up. So
26 there are a variety of different things that need to be done. I think
this is a balanced plan.

[TR III at 614-615.]

20 The creation of a separate basket for wholesale services allows the
21 Commission to focus on the inputs that competitors rely on to compete with
22 Qwest. [Testimony of Harry M. Shooshan III, October 27, 2000, at 4.]
23 Segregating these services also permits reductions in intrastate carrier charges to
24 occur without offsetting increases in rates for basic service. [Testimony of Harry
25 M. Shooshan III, October 27, 2000, at 5.] Under the Settlement Agreement, the

1 phased reductions in switched access charges will, instead, be offset by providing
2 Qwest with a capped amount of "headroom" to adjust the prices of already
3 flexibly-priced services in Basket 3. Id. Further, the price cap plan lowers
4 charges made by Qwest to long-distance carriers by \$15 million over the three-
5 year period, with the result that long-distance prices for calls in Arizona should be
6 reduced provided that IXC's or CLEC's that use Qwest's wholesale services pass
7 such reductions on to their customers. [Testimony of Harry M. Shooshan III,
8 October 27, 2000, at 7.] The plan sets a future goal to reduce switched access
9 charges to interstate levels. [TR III at 604.] Thus, the reduction in switched
10 access rates demonstrate substantial movement towards that goal and represent
11 one component of an agreement that balances the interests of Qwest, its retail and
12 wholesale customers, and competitors.

13 AT&T argues that the Commission should reject the Settlement Agreement
14 because it does not lower switched access rates to interstate levels set by the FCC
15 or eliminate the Carrier Common Line ("CCL") and the Interconnection ("IC")
16 charges.⁶ [Testimony of Arleen M. Starr, November 13, 2000, at 1 and 9.] AT&T
17 ignores the fact that interstate and intrastate structures are not the same. The
18 interstate rate structure contains an End User Common Line ("EUCL") charge that
19 generates significant revenue. [Rebuttal Testimony of Scott A. McIntyre,
20 November 20, 2000, at 3; TR II at 180-183.] In the interstate environment, this
21 rate element is paid by the end user, not the carrier, and has been increased over
22 time as the FCC has shifted significant revenue requirements from the carriers to
23 end user customers. Id.

24
25 _____
26 ⁶ AT&T also claims that switched access rates should be set at cost, but provides no
authority from any jurisdiction to support such a requirement. [Testimony of Arleen M.
Starr, November 13, 2000, at 1 and 3.]

1 AT&T casually disregards the policy issues created by its demand that the
2 Commission redesign intrastate switched access to place payment responsibility
3 on basic exchange ratepayers. [TR IV at 701.] Currently no other state
4 commission in Qwest's fourteen-state territory has ordered into effect an intrastate
5 EUCL charge. [TR IV at 701.] Staff has rejected the concept of following
6 interstate switched access charges as contrary to the public interest:

7 Following the FCC CALLS Order would result in a large increase in
8 fixed monthly charges to Qwest customers in Arizona. The low
9 interstate "per minute" rates charged to carriers are achieved by
10 charging end user customers a large End User Common Line
11 (EUCL) charge, which is currently \$4.35 per month, and scheduled
to increase further in the future. This EUCL charge to end users has
the effect of "buying down" the per minute access charges that the
IXCs otherwise would have to pay. It is not in the public interest to
impose a similar intrastate EUCL charge on customers.

12 [Rebuttal Testimony of William Dunkel, November 20, 2000, at 11.]

13 Moreover, AT&T did not review decisions issued by this Commission in
14 other rate cases addressing this very issue. [TR IV at 702-703.] For example, In
15 the Matter of the Application of Table Top Telephone Company for a Hearing to
16 Determine the Earnings of the Company, Etc., Docket No. T-02724A-99-0595,
17 Decision No. 62840 (August 24, 2000), the Commission reviewed the
18 appropriateness of an increase to Table Top's switched access rates finding that
19 such increases were within the range approved for other Arizona local exchange
20 providers. The Commission rejected both Qwest's argument that Table Top's
21 switched access rates should be decreased, rather than increased, to conform with
22 the national trend, and the concept of shifting such costs to a flat rate subscriber
23 line charge. Id.

24 Testimony by Staff in this case further supports the Commission's long-
25 held belief that carriers, like AT&T, should contribute to shared or common costs
26

1 through switched access rates. [Rebuttal Testimony of William Dunkel,
2 November 20, 2000, at 3-11.] AT&T admits that it would require Qwest to
3 provide and maintain loop facilities in order to deliver toll service on a stand-alone
4 basis. [TR IV at 695.] AT&T further acknowledges that it can choose to self-
5 provide loop facilities and thereby avoid CCL and IC charges, if it so chooses.
6 [TR IV at 697.] Ultimately, Staff determined that AT&T's proposal to further
7 reduce switched access or eliminate CCL and IC charges would allow AT&T to
8 take a "free ride" on the loop facility of Qwest.⁷

9 AT&T's position regarding switched access is simply an attempt to obtain
10 favorable rate treatment for itself and reduce its cost of doing business. AT&T
11 refuses to recognize that Qwest must recover its revenue requirement from some
12 place. AT&T demands that switched access rates be reduced further, but objects
13 to the revenue loss being made up in other baskets, and particularly those that
14 directly affect AT&T. [TR IV at 703.] Even DOD acknowledged that a further
15 decrease in switched access rates would necessitate corresponding offsets either
16 through the establishment of a EUCL charge or a further increase in the Basket 3
17 price cap. [TR III at 674.]

18 Finally, although AT&T demands that prices be set at FCC rates, it does not
19 apply this requirement to its own rates. As recently as November 28, 2000, the
20 Commission approved AT&T's request to increase its rates for tandem switched
21 transport, at levels above both interstate (FCC) and Qwest rates. See Decision No.
22 63214, November 28, 2000, In the Matter of AT&T Communications of the
23 Mountain States Application to Increase its Rates for Access Service, Docket No.
24 T-03016A-00-0539; TR II at 183-185.

25
26

⁷[Rebuttal Testimony of William Dunkel, November 20, 2000, at 5.]

1 Basket 3 services contain retail services previously classified by the
2 Commission as competitive and/or flexibly priced, and may be priced no lower
3 than the applicable price floor and increased to generate no more than an
4 additional \$25.3 million. [TR III at 432-434.] Under the terms of the plan, Qwest
5 has the ability to create packages of Basket 3 services and design packages
6 combining Basket 1 and Basket 3 services. [TR III at 534.] Concerns that Qwest
7 could price anti-competitively under the terms of the plan are however unfounded.
8 The Settlement Agreement requires Qwest's continued compliance with
9 applicable Arizona imputation and price floor rules. [TR III at 543.] For any
10 "essential" service included in the package, Qwest is required to impute the price
11 of the wholesale elements of those services.⁸ [TR II at 237.] The package price
12 must also fully recover the TSLRIC of any "non-essential" elements included
13 therein. Id. For example, if intraLATA toll services are included in a package,
14 Qwest must demonstrate that the intraLATA toll component exceeds the properly
15 calculated imputation floor. The price cap plan further prohibits cross
16 subsidization of competitive service by non-competitive services and
17 discrimination against any class of customer in violation of A.R.S. § 40-334.

18 The plan encourages Qwest to offer a variety of new services and service
19 packages that will respond more directly to consumer needs and affords the
20 flexibility to price these new offerings to meet the demands of the market.
21 [Testimony of Harry M. Shooshan III, October 27, 2000, at 2.] In reality, the
22 price cap plan simply takes advantage of the existing Commission framework for
23 competitive and non-competitive services. At the inception of the plan, Basket 3

24 _____
25 ⁸ The only exception to this requirement is for packages that include basic residential
26 service. Under the terms of the Settlement Agreement, such packages will include the
Basket 1 retail price for the residence line in the price floor calculation. [Rebuttal
Testimony of David L. Teitzel, November 20, 2000, at 8.]

1 includes only those services that have been afforded pricing flexibility or have
2 been determined by the Commission to be competitive under the criteria set forth
3 in A.A.C. R14-2-1108. [TR II at 235.] A Basket 1 service may move to Basket 3
4 only upon Qwest meeting those same criteria. Additionally, to the extent that
5 Qwest offers an Basket 1 service as part of a Basket 3 "package," Qwest must
6 advise its customers that the "basic essential" service remains available on a stand-
7 alone basis (at the hard-capped price). [Rebuttal Testimony of David L. Teitzel,
8 November 20, 2000, at 14-15.]

9 The Settlement Agreement also provides a 30-day review process for Staff
10 whenever Qwest introduces a new service or new package of services under the
11 price cap plan. Thus, the Commission is able to ensure that the new service or
12 package meets the requirements of the Settlement Agreement and all Commission
13 rules.

14 Additionally, Qwest is subject to new penalties in the form of bill credits for
15 failing to meet service quality standards. Qwest must also provide additional
16 consumer information in bill inserts, including information about the Complaint
17 process.

18 **V. IMPUTATION, CROSS-SUBSIDIZATION AND PRICE FLOOR**
19 **RULES WORK.**

20 Under terms of the Settlement Agreement, Qwest has the ability to create
21 packages of Basket 3 services and also to design packages combining Basket 1
22 and Basket 3 services. AT&T, MCI, RUCO and Cox argue that the Commission
23 should place more restraints on Basket 3 prices because, from their perspective,
24 services in the basket are not competitive. However, the Commission has already
25 designated all services identified in Basket 3 as competitive, or found that
26 sufficient competition exists to justify flexible pricing of these services in prior

1 Qwest dockets. [TR II at 235.] Therefore, it is appropriate for these services to be
2 included in Basket 3 and to continue to be flexibly priced, as they are today. Id.

3 The CLECs and RUCO also claim that Basket 3 pricing enables Qwest to
4 price discriminate. Section 4(g) of the Settlement Agreement specifically
5 prohibits price discrimination against any class of customer. [TR II at 236.]
6 These interveners also contend that Basket 3 services can be subsidized by Basket
7 1 services, which are essentially non-competitive. They ignore that all services in
8 Basket 3 are currently priced above their respective TSLRIC costs. Id. TSLRIC
9 cost is the appropriate measure of cross subsidy such that if the service is priced
10 above its respective TSLRIC cost, it is not being subsidized. Id. Additionally,
11 A.C.C. R14-2-1310 and R14-2-1109 (c) requires that all basic services remain
12 priced above TSLRIC. Id. Neither the CLECs or RUCO presented any evidence
13 that Qwest was not complying with these requirements.

14 Finally, the interveners argue that the Settlement Agreement will enable
15 Qwest to violate pricing floors. However, under A.A.C. R14-2-1310(c), and the
16 express terms of the Settlement Agreement, Qwest is required to continue to
17 comply with applicable Arizona imputation and price floor rules. [TR II at 237.]
18 For any "essential" services included in the package, Qwest is required to impute
19 the price of the wholesale elements of those services. The package price must also
20 fully recover the TSLRIC of any "non-essential" elements included in the
21 package. If intraLATA toll services are included in a package, Qwest must
22 demonstrate that the intraLATA toll component exceeds the properly calculated
23 imputation price floor.

24 It is important to note that the Settlement Agreement represents a
25 compromise between the parties on the critical issues in this Docket. Qwest has
26 agreed to forego local exchange rate increases in Basket 1 services and has also

1 agreed to cap these rates for the term of the plan. Qwest has also agreed to forego
2 the “competitive zone” pricing flexibility sought in its original filing, which would
3 have enabled Qwest to flexibly price virtually all services in the greater Phoenix
4 and Tucson wire centers. Finally, in view of the fact that the final wholesale UNE
5 deaveraging order has not been issued, Qwest has agreed to forego its proposal in
6 this rate case to align retail local exchange rates with deaveraged UNE loop prices.

7 The Settlement Agreement is a reasonable proposal, provides a strong
8 measure of protection for consumers against rate increases for “non-competitive”
9 services and enables Qwest to generate sufficient revenues to recover a portion of
10 its identified revenue requirement.

11 **VI. THE SETTLEMENT AGREEMENT DOES NOT MIRROR THE**
12 **PROPOSITION 108 OR COMPETITIVE ZONE PLANS.**

13 Opponents of the Settlement Agreement characterize the Price Cap Plan as
14 replicating Proposition 108 or Qwest’s proposal for competitive zone treatment in
15 its original rate case application. [TR I at 11-12, 15, 20, and 53.] On its face, the
16 Settlement Agreement rebuts such misinterpretations. Additionally, Qwest
17 (Teitzel) and Staff (Shooshan) testified to the differences between the various
18 proposals. [TR II at 238-240.] Neither the CLECs or RUCO submitted any
19 evidence to the contrary.

20 Under Proposition 108, virtually all telecommunications services, including
21 basic local exchange service, were deregulated and removed from the
22 Commission’s jurisdiction. [TR II at 238.] Moreover, current Commission rules
23 regarding imputation and competitiveness were abrogated. Id. In addition, the
24 legislation imposed no price ceilings or caps on the provision of
25 telecommunications services. Id. Finally, Proposition 108 placed the burden of
26

1 proof on competitors relative to demonstrations of the lack of competition for such
2 services. [TR II at 239.]

3 Under Qwest's original competitive zone proposal, all services in Qwest's
4 Phoenix and Tucson wire centers would have been flexibly priced. The price cap
5 established for these competitive zones permitted a 100% ceiling above Qwest's
6 existing rates and, in effect, would allow Qwest to double its prices. Id.

7 In contrast, the Settlement Agreement provides the least flexibility of all
8 three proposals. It establishes a hard cap on all basic exchange services in Basket
9 1, such that those prices cannot be increased for three years. Id. Under the price
10 cap plan, the ceiling for Basket 3 services is limited to 10% on the aggregate. [TR
11 II at 239-240.] Moreover, Basket 3 services have already been determined
12 competitive or flexibly priced by the Commission. Finally, all Commission rules
13 relative to imputation, establishing retail prices above TSLRIC and non-
14 discrimination apply to the price cap plan. [TR II at 240.]

15 As explained by Staff witness, Harry M. Shooshan III, "[d]espite the fact to
16 try to torture the reading of the Settlement Agreement, it rejects the competitive
17 zone proposal made by Qwest. It is straining credulity to say that the flexibility
18 that Qwest has for services that have already been declared competitive or for
19 which they've been given competitive pricing flexibility somehow is similar to or
20 equivalent to adopting the competitive zone plan that they initially put on the table
21 here." [TR III at 605-606.]

22
23 **VII. ADOPTION OF THE SETTLEMENT AGREEMENT DOES NOT**
24 **RAISE DUE PROCESS CONCERNS.**

25 Finally, opponents of the Settlement Agreement argue that the process used
26 to reach agreement deprived them of due process and that negotiations occurred

1 “behind closed doors” thereby preventing the parties and the public from
2 providing meaningful input. The CLECs and RUCO present no authority to
3 support the notion that Commission-approved settlements violate due process
4 concerns. They ignore the fact that the Commission regularly considers
5 settlements in rate cases. See, e.g., In the Matter of the Application of Southwest
6 Gas Corporation for the Establishment of Just and Reasonable Rates and Charges
7 Designed to Realize a Reasonable Rate of Return on the Fair Value of the
8 Properties of Southwest Gas Corporation Devoted to Its Operations Throughout
9 Arizona and the Simultaneous Implementation of Purchased Gas Cost Adjustment
10 Changes, Docket No. U-1551-96-596, Decision No. 60352, August 29, 1997. In
11 fact, the Commission has previously adopted settlements in other U S WEST rate
12 cases. See e.g., In the Matter of the Application of U S WEST Communications
13 for a Hearing to Determine the Earnings of the Company, the Fair Value of the
14 Company for Rate Making Purposes, to Fix a Just and Reasonable Rate of Return
15 Thereon and to Approve Rate Schedules Designed to Develop Such Return,
16 Docket No. E-1051-91-004, Decision No. 57462 (July 15, 1991).

17 There is nothing remarkable about the settlement process used in this case.
18 Qwest negotiated and reached agreement with Staff. All parties were given the
19 opportunity to participate in the settlement discussions. For example, Qwest
20 communicated with both Staff and RUCO when commencing settlement
21 negotiations. Upon reaching agreement, Qwest and Staff sent all parties a
22 statement of the principles to be memorialized in the Settlement Agreement.
23 Qwest and Staff held meetings with parties that wished to participate. The
24 Arizona Payphone Association was the only party that responded with an
25
26

1 alternative proposal. Qwest reviewed it, had some discussion with the APA, and
2 came to a settlement with it.⁹ [TR I at 74.]

3 The CLECs' and RUCO's unsubstantiated claim that their input on the
4 Settlement Agreement was ignored is simply outrageous. As detailed in the
5 testimony of Staff witness, Shooshan, comments received from all parties directly
6 affected the final agreement reached:

7
8 "And I can tell you that in those conversations that were had and
9 face-to-face meetings with the other parties, a lot of the discussion
10 was: What did you mean by this? What did you mean by that? And
11 I think particularly of AT&T and MCI, who asked some very
12 constructive questions during those conversations, and as a result of
13 that, there's language before this Commission today that's been
14 significantly sharpened as a result of those kinds of questions.

15 So I sit here, and I listen to parties who say somehow they were shut
16 out of the process and they weren't given an opportunity to ask
17 questions. And the language, they're not sure what it means.
18 They've had that opportunity, and those that constructively took part
19 in that opportunity, at least to my knowledge, had some of those
20 concerns dealt with. Where there were ambiguities, the language
21 has been sharpened. For example, the specific reference to carrying
22 forward the imputation requirements came as a result of a question
23 asked by either AT&T or MCI during that meeting. I think that is a
24 significant improvement in terms of clarifying the intent of the
25 parties.

26 There are other provisions in there, including the reference to
section - to A.R.S. 40-343. That's in there again as a result of
questions that were asked during the briefings when other parties
were given an opportunity to sign on to this agreement.

So again, I would just simply say that to say that somehow this has
been done behind closed doors and people haven't had a chance to
get at least legitimate questions answered about this plan I think
misstates what at least I think I know the process to be up to this
point."

[TR III at 607-609.]

Finally, the Commission has conducted a hearing, which included the
receipt of public comment, on the Settlement Agreement. Prior to the hearing,
additional time was allowed for discovery. Parties were permitted to file

⁹ Additionally, the CWA and DOD support adoption of the Settlement Agreement.

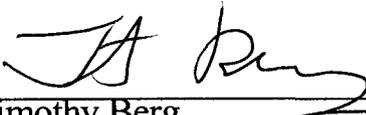
1 supplemental testimony on the Settlement Agreement. At hearing, all persons
2 were afforded an opportunity to make their views known and to present evidence
3 concerning whether the Settlement Agreement was reasonable and in the public
4 interest.

5 **VIII. CONCLUSION**

6 Based on the evidence presented at hearing, and the foregoing, Qwest
7 requests that the Hearing Officer issue a proposed order recommending that the
8 Commission adopt the Settlement Agreement in its entirety.

9 RESPECTFULLY SUBMITTED this 18th day of December, 2000.

10 FENNEMORE CRAIG, P.C.

11
12
13 By 
14 Timothy Berg
15 Theresa Dwyer
16 3003 North Central, Suite 2600
17 Phoenix, Arizona 85012
18 Attorneys for Qwest Corporation

19 ORIGINAL AND TEN of the foregoing
20 filed this 18 day of
21 December, 2000, with:

22 Docket Control
23 ARIZONA CORPORATION COMMISSION
24 1200 West Washington
25 Phoenix, Arizona 85007

26 COPY of the foregoing hand-delivered
this 18 day of December, 2000, to:

Deborah Scott
Director, Utilities Division
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, Arizona 85007

1 Maureen Scott
2 Chris Kempley
3 Legal Division
4 ARIZONA CORPORATION COMMISSION
5 1200 West Washington
6 Phoenix, Arizona 85007

7 COPY of the foregoing e-mailed and
8 sent regular mail this 18 day
9 of December, 2000, to:

10 Jane L. Rodda
11 Acting Chief Administrative Law Judge
12 Hearing Division
13 ARIZONA CORPORATION COMMISSION
14 400 West Congress St.
15 Tucson, Arizona 85701

16 Hearing Division
17 ARIZONA CORPORATION COMMISSION
18 1200 West Washington
19 Phoenix, AZ 85007

20 Scott S. Wakefield, Chief Counsel
21 Residential Utility Consumer Office
22 2828 N. Central Ave., Suite 1200
23 Phoenix, AZ 85004-1022

24 Darren S. Weingard
25 Natalie D. Wales
26 Sprint Communications Company, L.P.
1850 Gateway Drive, 7th floor
San Mateo, CA 94404-2467

18 Steven J. Duffy
19 Ridge & Isaacson, P.C.
20 3101 N. Central Ave., Suite 432
21 Phoenix, AZ 85012

22 Raymond S. Heyman
23 Randall H. Warner
24 Roshka Heyman & DeWulf
25 Two Arizona Center
26 400 N. Fifth St., Suite 1000
Phoenix, AZ 85004

- 1 Peter Q. Nyce, Jr.
2 General Attorney, Regulatory Law Office
3 U.S. Army Legal Services Agency
4 Department of the Army
5 901 N. Stuart St., Suite 700
6 Arlington, VA 22203-1837
- 7 Richard Lee
8 Snavelly, King, Majoros, O'Connor & Lee, Inc.
9 1220 L St., N.W., Suite 410
10 Washington, D.C. 20005
- 11 Thomas F. Dixon
12 MCI WorldCom
13 707 17th St., Suite 3900
14 Denver, CO 80202
- 15 Thomas H. Campbell
16 Lewis & Roca
17 40 N. Central Ave.
18 Phoenix, AZ 85004
- 19 Richard S. Wolters
20 AT&T
21 1875 Lawrence St., Suite 1575
22 Denver, CO 80202
- 23 Mary E. Steele
24 Davis Wright Tremaine LLP
25 2600 Century Square
26 1501 Fourth Avenue
Seattle, WA 98101
- 18 Mark J. Trierweiler
19 AT&T
20 111 West Monroe, Ste. 1201
21 Phoenix, AZ 85003
- 22 Diane Bacon, Legislative Director
23 Communications Workers of America
24 Arizona State Council
25 5818 N. 7th St., Suite 206
26 Phoenix, AZ 85014-5811
- 24 Michael W. Patten
25 Brown & Bain, P.A.
26 2901 North Central Avenue, Suite 2000
Phoenix, Arizona 85001-0400

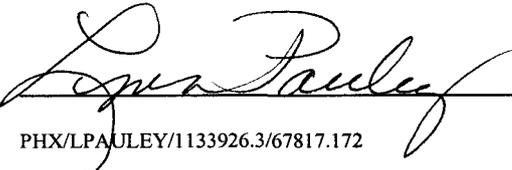
- 1 Michael M. Grant
- 2 Todd C. Wiley
- 3 Gallagher & Kennedy, P.A.
- 4 2575 East Camelback Road
- 5 Phoenix, AZ 85016-9225
- 6 Jeffrey Crockett
- 7 Snell & Wilmer
- 8 One Arizona Center
- 9 Phoenix, AZ 85004-0001
- 10 J.E. McGillivray
- 11 300 S. McCormick
- 12 Prescott, AZ 86303
- 13 Jon Poston
- 14 Arizonians for Competition in Telephone Service
- 15 6733 East Dale Lane
- 16 Cave Creek, AZ 85331
- 17 Albert Sterman
- 18 Vice President
- 19 Arizona Consumers Council
- 20 2849 E. 8th Street
- 21 Tucson, AZ 85716
- 22 Douglas Hsiao
- 23 Frank Paganelli
- 24 Rhythms Links, Inc.
- 25 6933 Revere Parkway
- 26 Englewood, CO 80112
- 27 Jim Scheltema
- 28 Blumenfeld & Cohen
- 29 1625 Massachusetts Ave., NW, Suite 300
- 30 Washington, SC 20036
- 31 Martin A. Aronson
- 32 William D. Cleaveland
- 33 Morrill & Aronson, PLC
- 34 One East Camelback, Suite 340
- 35 Phoenix, AZ 85012-1658
- 36 Joan S. Burke
- 37 Osborn Maledon, P.A.
- 38 2929 N. Central Ave., Suite 2100
- 39 Phoenix, AZ 85012
- 40
- 41
- 42

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25
26

Mark N. Rogers
Excell Agent Service, L.L.C.
2175 W. 14th Street
Tempe, AZ 85281

Chuck Turner, Mayor
Town of Gila Bend
P.O. Box A
644 W. Pima Street
Gila Bend, AZ 85337-0019

William F. Cottrell
7064 W. Angela Drive
Glendale, AZ 85308


PHX/LPAULEY/1133926.3/67817.172