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2005 JAN 27 P 4: 36

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JAN 27 2005

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IN THE MATTER OF QWEST
CORPORATION'S FILING AMENDED
RENEWED PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE
INVESTIGATION OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

NOTICE OF FILING REJOINDER
TESTIMONY

Qwest Corporation files herewith the public/redacted version of Rejoinder
Testimony of Peter C. Cummings, Philip E. Grate, Nancy Heller Hughes, Scott A.
McIntyre, Teresa K. Million, Dennis Pappas, Harry M. Shooshan III, David L. Teitzel
and Kerry Dennis Wu.

RESPECTFULLY SUBMITTED this 27th day of January, 2005.

FENNEMORE CRAIG

By:

Timothy Berg
Theresa Dwyer
3003 North Central Ave., Suite 2600
Phoenix, Arizona 85012-2913
(602) 916-5421

-and-

Norman Curtright
QWEST CORPORATION
4041 N. Central, 11th Floor
Phoenix, AZ 85012
Attorneys for Qwest Corporation

1 ORIGINAL and 15 copies hand-delivered for
filing this 27th day of January, 2005 to:

2 Docket Control
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1200 W. Washington St.
4 Phoenix, AZ 85007

5 COPY of the foregoing delivered
this 27th day of January, 2005 to:

6 Jane Rodda
7 Administrative Law Judge
ARIZONA CORPORATION COMMISSION
8 1200 W. Washington St.
Phoenix, AZ 85007

9 Maureen A. Scott
10 Legal Division
ARIZONA CORPORATION COMMISSION
11 1200 W. Washington St.
Phoenix, AZ 85007

12 Ernest G. Johnson, Director
13 Utilities Division
ARIZONA CORPORATION COMMISSION
14 1200 W. Washington St.
Phoenix, AZ 85007

15 COPY of the foregoing mailed
16 this 27th day of January, 2005 to:

17 Scott S. Wakefield, Chief Counsel
Daniel W. Pozefsky, Esq.
18 RUCO
1110 West Washington, Suite 220
19 Phoenix, AZ 85007

20 Michael W. Patten
Roshka Heyman & DeWulf, PLC
21 One Arizona Center
400 East Van Buren Street, Suite 800
22 Phoenix, Arizona 85004

23 Mark A. DiNunzio
Cox Arizona Telcom, LLC
24 20401 North 29th Avenue
Phoenix, Arizona 85027

25

26

- 1 Thomas H. Campbell
Michael T. Hallam
- 2 Lewis and Roca
40 N. Central Avenue
- 3 Phoenix, Arizona 85004

- 4 Thomas F. Dixon
WorldCom, Inc.
- 5 707 17th Street, 39th Floor
Denver, Colorado 80202

- 6 Peter Q. Nyce, Jr.
- 7 Regulatory Law Office
U.S. Army Litigation Center
- 8 901 N. Stuart Street, Suite 713
Arlington, VA 22203-1837

- 9 Daniel D. Haws
- 10 OSIA, Attn: ATZS-JAD
USA Intelligence Center and Ft. Huachuca
- 11 Ft. Huachuca, AZ 85613-0600

- 12 Richard Lee
Snavey King Majoros O'Connor & Lee
- 13 1220 L. Street N.W., Suite 410
Washington, DC 20005

- 14 Patrick A. Clisham
- 15 AT&T Arizona State Director
320 E. Broadmoor Court
- 16 Phoenix, AZ 85022

- 17 Walter W. Meek President
Arizona Utility Investors Association
- 18 2100 N. Central Avenue, Suite 210
Phoenix, AZ 85004

- 19 Albert Sterman, Vice President
Arizona Consumers Council
- 20 2849 E. 8th Street
Tucson, AZ 85716

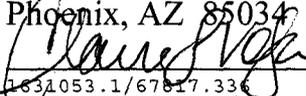
- 22 Accipiter Communications, Inc.
2238 W. Lone Cactus Dr., Ste.100
- 23 Phoenix, AZ 85027

- 24 Alliance Group Services, Inc.
1221 Post Road East
- 25 Westport, CT 06880

- 26

- 1 Archtel, Inc.
1800 West Park Drive, Ste. 250
- 2 Westborough, MA 01581
- 3 Brooks Fiber Communications of Tucson, Inc.
201 Spear Street, 9th Floor
- 4 San Francisco, CA 94105
- 5 Centruytel
PO Box 4065
- 6 Monroe, LA 71211-4065
- 7 Citizens Utilities Rural Co. Inc.
Citizens Communications Co. of Arizona
- 8 4 Triad Center, Suite 200
Salt Lake City, UT 84180
- 9 Citizens Telecommunications Co. of the White Mountains, Inc.
4 Triad Center, Ste. 200
- 10 Salt Lake City, UT 84180
- 11 Comm South Companies, Inc.
2909 N. Buckner Blvd., Ste. 200
- 12 Dallas, TX 75228
- 13 Copper Valley Telephone, Inc.
PO Box 970
- 14 Willcox, AZ 85644
- 15 Electric Lightwave, Inc.
4 Triad Center, Ste. 200
- 16 Salt Lake City, UT 84180
- 17 Eschelon Telecom of Arizona, Inc.
730 Second Avenue South, Ste.1200
- 18 Minneapolis, MN 55402
- 19 Ernest Communications, Inc.
5275 Triangle Pkwy, Ste. 150
- 20 Norcross, GA 30092-6511
- 21 Intermedia Communications, Inc.
3608 Queen Palm Drive
- 22 Tampa, FL 33619-1311
- 23 Level 3 Communications, LLC
1025 Eldorado Blvd.
- 24 Broomfield, CO 80021
- 25
- 26

- 1 Max-Tel Communications, Inc.
105 N. Wickham
- 2 PO Box 280
Alvord, TX 76225
- 3
- 4 MCI WorldCom Communications
201 Spear Street, 9th Floor
San Francisco, CA 94105
- 5
- 6 MCIMetro
201 Spear Street, 9th Floor
San Francisco, CA 94105
- 7
- 8 Metropolitan Fiber Systems of Arizona, Inc.
201 Spear Street, 9th Floor
San Francisco, CA 94105
- 9
- 10 Midvale Telephone Exchange
PO Box 7
Midvale, ID 83645
- 11
- 12 Navajo Communications Co., Inc.
4 Triad Center, Suite 200
Salt Lake City, UT 84180
- 13
- 14 Nextlink Long Distance Svcs.
3930 E. Watkins, Ste. 200
Phoenix, AZ 85034
- 15
- 16 North County Communications Corporation
3802 Rosencrans, Ste. 485
San Diego, CA 92110
- 17
- 18 One Point Communications
Two Conway Park
150 Field Drive, Ste. 300
Lake Forest, IL 60045
- 19
- 20 Opex Communications, Inc.
500 E. Higgins Rd., Ste. 200
Elk Grove Village, IL 60007
- 21
- 22 Pac-West Telecomm, Inc.
1776 W. March Lane, #250
Stockton, CA 95207
- 23
- 24 The Phone Company/Network Services of New Hope
6805 Route 202
New Hope, PA 18938
- 25
- 26

- 1 Rio Virgin Telephone Co.
Rio Virgin Telephone and Cablevision
- 2 PO Box 189
Estacada, OR 97023-000
- 3
- 4 South Central Utah Telephone Association, Inc.
PO Box 226
Escalante, UT 84726-000
- 5
- 6 Southwestern Telephone Co., Inc.
PO Box 5158
Madison, WI 53705-0158
- 7
- 8 Special Accounts Billing Group
1523 Withorn Lane
Inverness, IL 60067
- 9
- 10 Touch America
130 N. Main Street
Butte, MT 59701
- 11
- 12 Table Top Telephone Co, Inc.
600 N. Second Avenue
Ajo, AZ 85321-0000
- 13
- 14 Valley Telephone Cooperative, Inc.
752 E. Malley Street
PO Box 970
Willcox, AZ 85644
- 15
- 16 Verizon Select Services Inc.
6665 MacArthur Blvd, HQK02D84
Irving, TX 75039
- 17
- 18 VYVX, LLC
One Williams Center, MD 29-1
Tulsa, OK 74172
- 19
- 20 Western CLEC Corporation
3650 131st Avenue SE, Ste. 400
Bellevue, WA 98006
- 21
- 22 Williams Local Network, Inc.
One Williams Center, MD 29-1
Tulsa, OK 74172
- 23
- 24 XO Arizona Inc.
3930 Watkins, Ste. 200
Phoenix, AZ 85034
- 25
- 26 
631053.1/67817.336

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

**JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES**

**IN THE MATTER OF QWEST CORPORATION'S)
FILING OF RENEWED PRICE REGULATION PLAN)**

**DOCKET NO.
T-01051B-03-0454**

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**IN THE MATTER OF THE INVESTIGATION OF THE)
COST OF TELECOMMUNICATIONS ACCESS)**
-----)

**DOCKET NO.
T-00000D-00-0672**

REJOINDER TESTIMONY

OF

PETER C. CUMMINGS

QWEST CORPORATION

JANUARY 27, 2005

**TESTIMONY OF PETER C. CUMMINGS
INDEX OF TESTIMONY**

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II. EXHIBITS

Exhibit

Rework of Staff Schedule JR-S1

PCC-1RJ

EXECUTIVE SUMMARY

Rejoinder to the Testimony of Joel M. Reiker

A fundamental error in Mr. Reiker's testimony is the substitution of book values of debt and equity for the market values of debt and equity required to measure capital costs for publicly traded companies. The authorities cited by Mr. Reiker in his testimony clearly specify that market values are to be used in estimating the cost of capital.

Mr. Reiker's adjustment of the relevered beta for Qwest Corp is an unnecessary and unwarranted procedure which has the impact of lowering the equity cost estimate for Qwest Corp.

The Modigliani and Miller methodology employed in Mr. Reiker's Schedule JR-S1 requires the use of market value capital weights. When corrected for this deficiency, Mr. Reiker's reasonableness check result increases from 14.97% to 18.88%.

Rejoinder to the Testimony of William A. Rigsby

Most of the data found in Mr. Rigsby's 'sanity check" (Schedule WAR-10) is not relevant to estimating the cost of equity capital and the data that is relevant supports the 21.4% estimate found in my direct testimony.

Combining the relevant data from Mr. Rigsby's Schedule WAR-10 with his previously filed Schedule WAR-7 provides a range of cost of equity estimates of 20.38% to 24.68%.

1
2
3 **IDENTIFICATION OF WITNESS**

4 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT POSITION.

5 A. My name is Peter C. Cummings and my business address is 1600 Bell Plaza, Room
6 3005, Seattle, Washington 98191. I am employed by Qwest Corporation (QC) as
7 Director - Finance.

8 Q. ARE YOU THE SAME PETER C. CUMMINGS THAT PROVIDED DIRECT AND
9 REBUTTAL TESTIMONY IN THIS PROCEEDING?

10 A. Yes, I am.
11

12 **PURPOSE OF TESTIMONY**
13

14 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

15 A. The purpose of my rejoinder testimony is to evaluate and respond to the surrebuttal
16 testimonies of Staff witness Joel M. Reiker and RUCO witness William A. Rigsby.
17

18 **REJOINDER TO THE TESTIMONY OF JOEL M. REIKER**
19

20 **Market Value and Book Value**

21 Q. WHAT IS THE FUNDAMENTAL DIFFERENCE BETWEEN YOUR TESTIMONY AND
22 MR. REIKER'S TESTIMONY ON CAPITAL STRUCTURE AND FINANCIAL RISK
23 ADJUSTMENT?

- 1 A. The fundamental difference is whether market values or book values of debt and
2 equity should be utilized in estimating the opportunity cost of capital.
3
4 Mr. Reiker's position is that, since the opportunity cost of equity capital is applied to a
5 book value rate base¹, the opportunity cost of capital must be estimated utilizing
6 book values for proxy companies. Further, Mr. Reiker argues that unlevering betas
7 with a market value capital structure and relevering at the book value capital structure
8 for Qwest Corp introduces known inconsistencies.
9
10 My position is that financial theory and practice require the use of market or economic
11 values where they are available. Greater inconsistency is introduced into the
12 estimate of the opportunity cost of capital by utilizing book values for the proxy group
13 capital structure than by straightforward application of financial theory to the
14 accounting book value environment of the regulated entity.
15
16 Q. IN SUPPORT OF BOTH MEASURING AND APPLYING THE COST OF CAPITAL
17 USING BOOK VALUES, MR. REIKER QUOTES A CLASSIC WORK BY
18 PROFESSOR STEWART C. MYERS.² HOW DO YOU RESPOND?

¹ Notwithstanding the issue in this case of whether Arizona law requires application of opportunity cost to fair value rate base.

² Myers, Stewart C. "The application of Finance Theory to Public Utility Rate Cases" Bell Journal of Economics and Management Science, Spring 1972.

1 A. Myers says that market weights should be used in measuring the opportunity cost of
2 capital. After noting that the expected overall cost of capital uses market weights and
3 that book value weights are used in regulatory practice, Myers states:

4 Clearly, the fact that the cost of capital can be applied to a book
5 value rate base does not mean that book weights should be used in
6 measuring it. The definition of cost of capital in terms of investor's
7 opportunity costs definitely implies that market value weights
8 should be used.³
9

10 This was true when Myers wrote this article more than 30 years ago, and it remains
11 true today. My rebuttal testimony showed that finance academics and practitioners
12 have consistently used market values in the estimation of capital costs. The proper
13 approach is to use market values in estimating the cost of capital, even when that
14 cost is ultimately going to be applied in the context of rate of return regulation.
15

16 Q. WHY WOULD THERE BE A GREATER INCONSISTENCY IN RELYING ON BOOK
17 VALUES FOR PROXY COMPANIES THAN BY USING MARKET VALUES FOR THE
18 PROXY COMPANIES AND APPLYING THE COST OF CAPITAL ESTIMATE TO
19 THE REGULATED COMPANY?

20 A. Book values for publicly traded companies are typically quite different from market
21 values. Part of this difference can be explained by valuable assets that do not appear
22 on the company balance sheet, such as human capital and company reputation.
23 Aside from intangibles, book values of equity accounts contain the residual effects of

³ ibid. Interestingly, Myers ends his article by stating "it is hard to believe that the usual book value rate base could not be improved upon. As a matter of fact, the whole existing framework of rate of return regulation, which was taken as a given for purposes of this paper, may not be best." P.94

1 accounting changes, write-offs, and non-cash charges which affect the accounting
2 books, but not the firm's market value. For telephone companies, accounting
3 changes associated with FASB-71 (accounting for regulation) and FASB-106
4 (accounting for post-employment benefits) and accounting writedowns for goodwill
5 and long lived assets have produced large changes in book value equity accounts
6 with little or no impact on the market values of their securities.

7
8 The greater inconsistency would be to [mistakenly] assume that the diverse book
9 value capital structures of proxy companies, which have been subjected to the
10 distortions of accounting rule changes and write-offs, have probative value in
11 estimating the expected opportunity cost of capital. The lesser inconsistency is to
12 apply the proper market value cost of capital estimate from the proxy companies to
13 the accounting value of the regulated entity. The regulated entity accounting is less
14 affected by accounting rule changes, write-offs, and non-cash charges. Ultimately the
15 regulated entity has a market or economic value equal to the present value of its
16 expected cash flows, and under perfect regulation, the application of a market
17 required cost of capital to the accounting value would result in a market value equal to
18 that accounting value.

19
20 The regulated entity accounting or book value is closer to the financially correct
21 market value than the book values of the proxy companies are to market value.
22

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Adjusted Betas

Q. PLEASE COMMENT ON MR. REIKER'S STATEMENT THAT "THE RELATIVE EFFECT OF UNADJUSTING AND READJUSTING BETAS IS THE RESULT OF SIMPLE MATHEMATICS AND NOT AN AD HOC ATTEMPT TO TRIM STAFF'S ESTIMATE OF QWEST'S REQUIRED RETURN."

A. The mathematics are simple, but the effect is large, and the methodology is, in my opinion, unwarranted. The purpose of unlevering the beta of proxy group companies and then relevering the beta to reflect the leverage (financial risk) of the target company is to ascertain the relative cost of capital differences. As company and staff testimonies have demonstrated, the cost of equity capital rises dramatically as leverage increases in the capital structure.

If beta adjustment is to be done, it should be done at the proxy group company level – that is, where beta measurement is done. The parties in this case have all used betas published by reputable sources, Value Line and Merrill Lynch. Both sources routinely adjust measured betas. In the capital structure / financial risk adjustment methodology of unlevering and then relevering proxy group average beta, the analyst should (1) start with either a raw (unadjusted) beta or an adjusted beta, (2) unlever the beta to remove the effects of financial risk, (3) relever the beta to reflect the financial risk of the target company, and (4) make no further adjustments.

1 Consider the situation where the proxy group measured (or "raw") average beta is
2 exactly 1.0. In this situation, the measured beta and adjusted beta would be exactly
3 the same – 1.0. As we would expect, unlevering and relevering either the measured
4 beta or the adjusted beta would yield exactly the same calculated beta for the target
5 company.

6
7 Now let us keep the beta the same – 1.0, but change the definitions. We will call the
8 proxy group beta a "raw beta that needs to be adjusted", and the relevered beta a
9 "raw calculated beta that needs to be adjusted." As we know from the previous
10 paragraph, the measured "raw" beta and the adjusted beta are the same – 1.0. What
11 we have done by our definitional change is to introduce the requirement to adjust the
12 calculated relevered beta. Since the relevered beta will be significantly different from
13 1.0, the adjustment will be significant and will distort the relative risk differential that
14 we are seeking to measure. This is, in essence, what Staff has done with "simple
15 mathematics".

16
17 This example of proxy group beta equal to 1.0 isn't just a hypothetical situation -- the
18 proxy group of six telephone companies has an average beta of 1.01, and the S&P
19 500 companies, as a market measure, by definition have an average beta of 1.0. If
20 we wished to unlever the beta of the S&P 500 and relever to evaluate a company with
21 more or less financial risk than the S&P 500 companies, the relevered beta would
22 provide our answer – no further adjustment required.

23

1

2

3 **Reasonableness Check and Modigliani/Miller Theory**

4 Q. IN SCHEDULE JR-S1, MR. REIKER PRESENTS "A SIMPLIFIED CALCULATION
5 THAT CAN ACT AS A REASONABLENESS CHECK ON STAFF'S CAPITAL
6 STRUCTURE/FINANCIAL RISK ADJUSTMENT." DOES THIS CALCULATION
7 PROVIDE A REASONABLE ESTIMATE OF THE REQUIRED RISK ADJUSTMENT?

8 A. No, it does not. Mr. Reiker cites the seminal work done by Franco Modigliani and
9 Merton Miller on the irrelevance of capital structure (under stringent assumed
10 conditions), but fails to implement the model as specified by the authors. Mr. Reiker
11 has used book values in his analysis, while Modigliani/Miller clearly specify market
12 values of debt and equity.⁴

13

14 Q. WHAT IS THE IMPACT OF USING BOOK VALUES INSTEAD OF MARKET
15 VALUES?

16 A. There is a large impact on the reasonableness check. Mr. Reiker used book values
17 of capital of approximately 50% debt/50% equity in his analysis. The market values

⁴ "Denote by D_j the market value of the debts of the company; by S_j the market value of its common shares; and by $V_j = S_j + D_j$ the market value of all its securities or, as we shall say, the market value of the firm. Then, our Proposition I asserts that we must have in equilibrium:

$$V_j = (S_j + D_j) = X_j / \rho_k \text{ for any firm } j \text{ in class } k$$

That is, the market value of any firm is independent of its capital structure and is given by capitalizing its expected return at the rate ρ_k appropriate to its class.

This proposition can be stated in an equivalent way in terms of the firm's "average cost of capital," X_j/V_j , which is the ratio of its expected return to the market value of all its securities.

1 for debt and equity capital for the sample group are approximately 26% debt/74%
2 equity.⁵ Using the properly specified market values for debt and equity increases the
3 weighted cost of capital to 9.84%, which when adjusted per Mr. Reiker's Schedule
4 JR-S1, results in an adjusted equity cost of 18.88%.

5
6 If we substitute my estimated equity cost for the sample group of 11.2% to 11.7%,
7 then the resulting reasonableness check (using Mr. Reiker's methodology with market
8 value weights) is an adjusted equity cost range of 19.77% to 21.25%. These
9 calculations are shown in Exhibit PCC-1RJ.

10
11 **Conclusions Relative to Mr. Reiker's Surrebuttal Testimony**

12 Q. WHAT ARE YOUR CONCLUSIONS RELATIVE TO MR. REIKER'S TESTIMONY?

13 A. A fundamental error in Mr. Reiker's work is the substitution of book values of debt and
14 equity for the market values of debt and equity required to measure capital costs for
15 publicly traded companies. The authorities cited by Mr. Reiker in his testimony clearly
16 specify that market values are to be used in estimating the cost of capital.

17
18 Mr. Reiker's adjustment of the relevered beta for Qwest Corp is an unnecessary and
19 unwarranted procedure which has the impact of lowering the cost of equity estimate
20 for Qwest Corp.

21

⁵ See Cummings Direct Testimony Exhibit PCC-3.

1 The reasonableness check provided in Schedule JR-S1 is not specified correctly.
2 The Modigliani and Miller methodology employed by Mr. Reiker requires the use of
3 market value capital weights. When corrected for this deficiency, the reasonableness
4 check increases from 14.97% to 18.88%. With the proxy group company equity cost
5 range from my testimony, the reasonableness check result is the range of 19.77% to
6 21.25%.

1 Return on Equity (ROE), i.e. the accounting return expected to be earned in relation
2 to the book value of equity, has no relation to the cost of capital, i.e. the returns
3 expected by investors on the market value of their investment in the company's
4 securities.

5

6 Q. WHAT DATA IN SCHEDULE WAR-10 IS USEFUL IN ESTIMATING THE COST OF
7 CAPITAL?

8 A. Only the beta information in Column B is useful in estimating the cost of capital. The
9 cost of capital is determined in the capital markets and only the beta information
10 provides data relevant to the capital markets.

11

12 Q. WHAT COST OF EQUITY DOES THE BETA INFORMATION SUPPORT?

13 A. The average beta shown in Schedule WAR-10 is 2.15. Combining this beta with Mr.
14 Rigsby's CAPM methodology as shown in Schedule WAR-7 gives the following cost
15 of equity estimates:

16
$$1.72\% + [2.15 \times (10.40\% - 1.72\%)] = 20.38\%$$

17
$$1.72\% + [2.15 \times (12.40\% - 1.72\%)] = 24.68\%$$

18

19 The average beta of 2.15 is also the same as the relevered beta for Qwest Corp as
20 shown in my direct testimony on page 36. When combined with the 3.80% risk free
21 rate and 8.2% equity risk premium from my direct testimony, the cost of equity
22 estimate for the 33 companies from Mr. Rigsby's Schedule WAR-10 is 21.4%.

23

1 **Conclusions Relative to Mr. Rigsby's Surrebuttal Testimony**

2 Q. WHAT IS YOUR CONCLUSION RELATIVE TO MR. RIGSBY'S TESTIMONY?

3 A. Most of the data presented in Mr. Rigsby's "sanity check" is not relevant to estimating
4 the cost of equity capital and the data that is relevant supports the 21.4% estimate
5 found in my direct testimony.

6
7 Combining the relevant data from Mr. Rigsby's "sanity check" (Schedule WAR-10)
8 with his previously filed Schedule WAR-7 provides a range of cost of equity estimates
9 of 20.38% to 24.68%.

10

11 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

12 A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF QWEST CORPORATION'S)
FILING OF RENEWED PRICE REGULATION PLAN)

DOCKET NO.
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IN THE MATTER OF THE INVESTIGATION OF THE)
COST OF TELECOMMUNICATIONS ACCESS)
-----)

DOCKET NO.
T-00000D-00-0672

REJOINDER EXHIBITS

OF

PETER C. CUMMINGS

QWEST CORPORATION

JANUARY 27, 2005

**(Rework of Staff Schedule JR-S1)
 Reasonableness Check on Capital Structure/Financial Risk Adjustment
 Incorporating Modigliani & Miller Capital Structure Theory**

Estimated Weighted Average Cost of Capital (WACC) for Sample Group
 Market value capitalization ratio and staff costs

	Capitalization		Weighted Cost	
	Ratio ¹	Cost ²	Cost	
Debt	0.26	6.83%	1.78%	
Equity	0.74	10.90%	8.07%	9.84%

Adjusted WACC

	Capitalization		Weighted Cost	
	Ratio	Cost	Cost	
Debt	0.75	6.83%	5.12%	
Equity	0.25	18.88%	4.72%	9.84%

Estimated Weighted Average Cost of Capital (WACC) for Sample Group
 Market value capitalization ratio and company costs (low end)

	Capitalization		Weighted Cost	
	Ratio ¹	Cost ³	Cost	
Debt	0.26	6.83%	1.78%	
Equity	0.74	11.20%	8.29%	10.06%

Adjusted WACC

	Capitalization		Weighted Cost	
	Ratio	Cost	Cost	
Debt	0.75	6.83%	5.12%	
Equity	0.25	19.77%	4.94%	10.06%

Estimated Weighted Average Cost of Capital (WACC) for Sample Group
 Market value capitalization ratio and company costs (high end)

	Capitalization		Weighted Cost	
	Ratio ¹	Cost ⁴	Cost	
Debt	0.26	6.83%	1.78%	
Equity	0.74	11.70%	8.66%	10.43%

Adjusted WACC

	Capitalization		Weighted Cost	
	Ratio	Cost	Cost	
Debt	0.75	6.83%	5.12%	
Equity	0.25	21.25%	5.31%	10.43%

Notes:
¹ Market Capitalization Ratio from Cummings Exhibit PCC-3
² Staff Costs from Schedule JR-S1
³ Low end of equity cost range from Cummings Direct p. 34
⁴ High end of equity cost range from Cummings Direct p. 34

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON)

) ss

AFFIDAVIT OF PETER C. CUMMINGS

COUNTY OF KING)

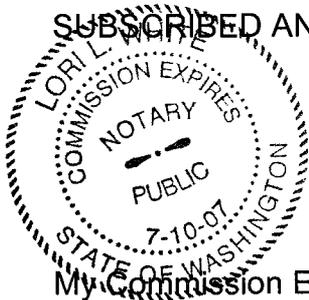
Peter C. Cummings, of lawful age being first duly sworn, deposes and states:

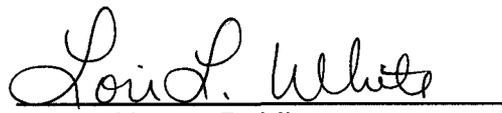
1. My name is Peter C. Cummings. I am Director – Finance for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.


Peter C. Cummings

SUBSCRIBED AND SWORN to before me this 18th day of January, 2005.




Notary Public

My Commission Expires: 7/10/07

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman

WILLIAM A. MUNDELL
Commissioner

MARC SPITZER
Commissioner

MIKE GLEASON
Commissioner

KRISTIN K. MAYES
Commissioner

**IN THE MATTER OF QWEST
CORPORATION'S FILING AMENDED
RENEWED PRICE REGULATION PLAN**

)
) DOCKET NO.
) T-01051B-03-0454
)

**IN THE MATTER OF THE INVESTIGATION
OF THE COST OF TELECOMMUNICATIONS
ACCESS**

)
) DOCKET NO.
) T-00000D-00-0672
)

REJOINDER TESTIMONY OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

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SUMMARY OF REJOINDER TESTIMONY

My rejoinder testimony responds to testimony prepared by Staff witnesses Dunkel, Brosch and Carver and by RUCO witness Diaz Cortez concerning revenue requirement issues. Besides the question of depreciation lives about which Mr. Wu testifies, the most important revenue requirement issues in this case are:

1. When is a change in accounting method or estimate effective for purposes of regulatory accounting and ratemaking in Arizona?
2. What cost-of-service ratemaking methods are to be used in the calculation of revenue requirement in Arizona?
3. In Arizona, what standards of ratemaking properly control cost disallowance?

Accounting Method Changes. With regard to accounting method changes, the issues are whether Qwest adopted accrual accounting for other post employment benefits (OPEBs) and accrual accounting for internal-use-software in 1999 or will adopt these accounting method changes in this case. Staff's surrebuttal presents no new evidence to show that Qwest did not adopt accrual accounting for SOP 98-1 in 1999. Nor does Staff present any new evidence to show that Qwest did adopt accrual accounting for OPEBs in 1999 as both Qwest and RUCO conclude.

Ratemaking Methods. Staff claims its piecemeal approach to annualization of test year revenues and expenses is more reliable than Qwest's consistent application of statistical regression analysis of all significant revenues and expenses. My rejoinder testimony presents the results of a test of the reliability of the results achieved by Staff's and Qwest's approaches with regard to revenues. The test shows that Staff's approach is less reliable than Qwest's.

My rejoinder testimony observes that Staff has articulated no logical reason why, when pro forma adjustments to accrued expenses are made, the corresponding effect on rate base should not also be adjusted. Instead of addressing the reasoning set forth by Staff and the Commission in favor of adjusting rate base, Mr. Carver merely repeats his position without explaining why it is correct.

Disallowance Standards. In surrebuttal Staff's consultants admit that they do not rely on any disallowance standards when proposing disallowance of utility costs. Instead, they analyze utility costs for disallowance in many different ways. My rejoinder testimony explains why I believe Staff should rely on a balanced disallowance standard that protects the interests of ratepayers and investors and why Staff's many ways of analyzing costs are arbitrary. I also explain why I believe it is inappropriate to disallow costs based on standing Commission disallowance policies that are, by their very nature, prejudicial.

Other revenue requirement issues: I offer rejoinder on seven individual revenue requirement issues: 1) I explain why Staff's proposal to remove assets used to support DSL from rate base on the grounds that Qwest violated the FCC's jurisdictional separations rules remains incorrect and impermissible. 2) I explain why Staff's proposal to remove from rate base assets used by one of Qwest's affiliates, Broadband Services, Inc., is incorrect and offer a correct adjustment in its stead. 3) I explain why Staff's proposal to impute revenues to FCC Deregulated products is inappropriate and provide a corrected computation of this proposed adjustment. 4) I offer rejoinder to Staff's and RUCO's arguments opposing my proposal to adopt the same method of accounting for the financing cost of telephone plant under construction that is preferred by the Commission's own accounting rule. 5) I explain why RUCO's recalculation of Qwest's property tax expense remains incorrect. 6) I explain why RUCO's reasons for opposing inclusion of pension asset in rate base are incorrect. 7) I explain why RUCO's proposed adjustment to rate base for allegedly missing accumulated depreciation balances on station apparatus remains incorrect.

Future Reporting Requirements. My testimony explains that Qwest would be willing to provide Staff annual Arizona separated results of operations and why Qwest should not bear the additional burden of preparing rate case adjustments, some of which would be redundant to Qwest's own accounting.

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IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Philip E. Grate. My business address is Qwest Corporation, 1600
7th Avenue, Seattle, Washington.

**Q. ARE YOU THE SAME PHILIP E. GRATE WHO FILED DIRECT AND
REBUTTAL TESTIMONY IN THIS PROCEEDING?**

A. Yes.

PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY?

A. My rejoinder testimony pertains to the calculation of Qwest's revenue
requirement and responds to the surrebuttal testimony of Staff witnesses
Michael L. Brosch, Steven C. Carver and William Dunkel, and to RUCO
witness Marylee Diaz Cortez. Qwest's other revenue requirement rejoinder
witnesses in this case are Nancy Heller Hughes, Peter C. Cummings and
Kerry Dennis Wu.

Ms. Heller Hughes' rejoinder testimony addresses the surrebuttal testimony of
William Dunkel filed on behalf of Staff regarding the Reproduction Cost New
Less Depreciation (RCNLD) value of Qwest's plant in service in Arizona. Mr.
Cummings' rejoinder testimony pertains to Qwest's cost of capital and

1 responds to the surrebuttal testimony of Staff witnesses Joel M. Reiker and
2 RUCO witness William A. Rigsby. Mr. Wu testifies on depreciation in
3 rejoinder of Staff witness Dunkel.

4 **QWEST'S FINANCIAL PERFORMANCE**

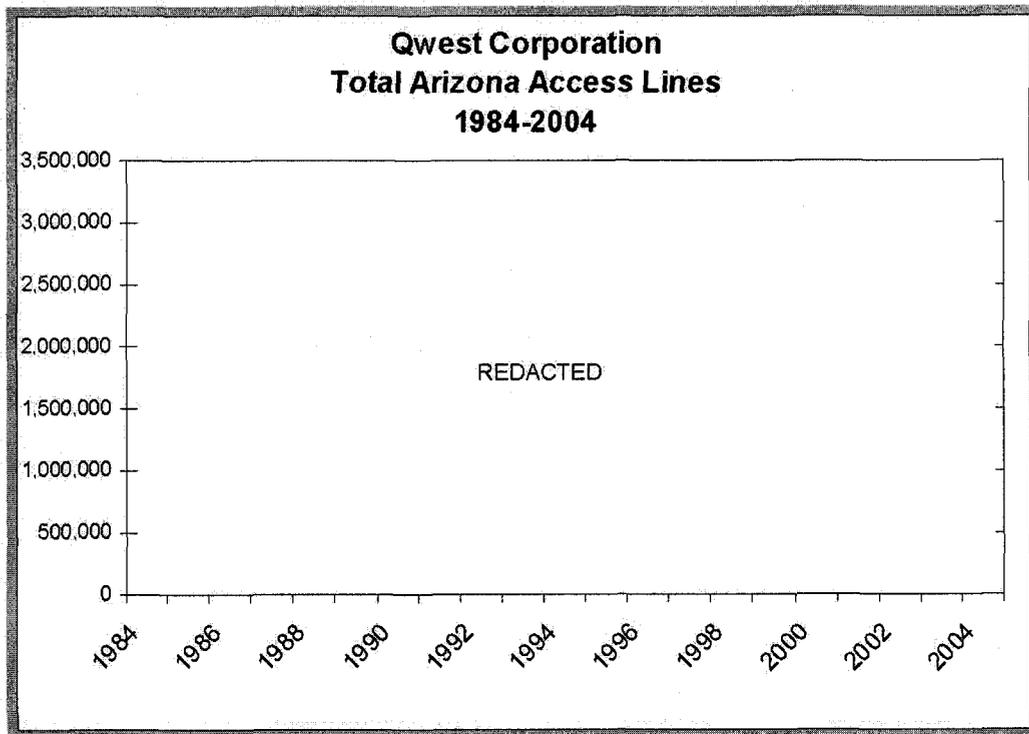
5 **Q. STAFF'S CONSULTANTS TAKE ISSUE WITH YOUR PORTRAYAL OF**
6 **QWEST'S ARIZONA ACCESS LINES.¹ PLEASE RESPOND.**

7 A. Mr. Brosch complains that the scale of the graph I presented on page 3 of my
8 rebuttal testimony visually amplifies the apparent trend in access line counts
9 and asserts that Qwest's REDACTED
10 REDACTED An understanding of the Company's access line history will help
11 the Commission put Qwest's access line loss in perspective.

12 It is my understanding that for over a century, interrupted only by the Great
13 Depression of the 1930's, the Company's access line count enjoyed REDACTED
14 REDACTED Since Qwest's retail access line count REDACTED
15 REDACTED the Company's access line count has REDACTED

16 REDACTED The following chart shows Qwest's
17 Arizona total (wholesale and retail) access line count over the past 20 years.

¹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p 4, ll.1-8.



1

2 The chart shows that

REDACTED

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REDACTED

However, REDACTED

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REDACTED understates the effect of competition on Qwest's business

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because wholesale access lines are sold to Qwest's competitors. Hence,

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every wholesale access line represents direct retail competition for Qwest.

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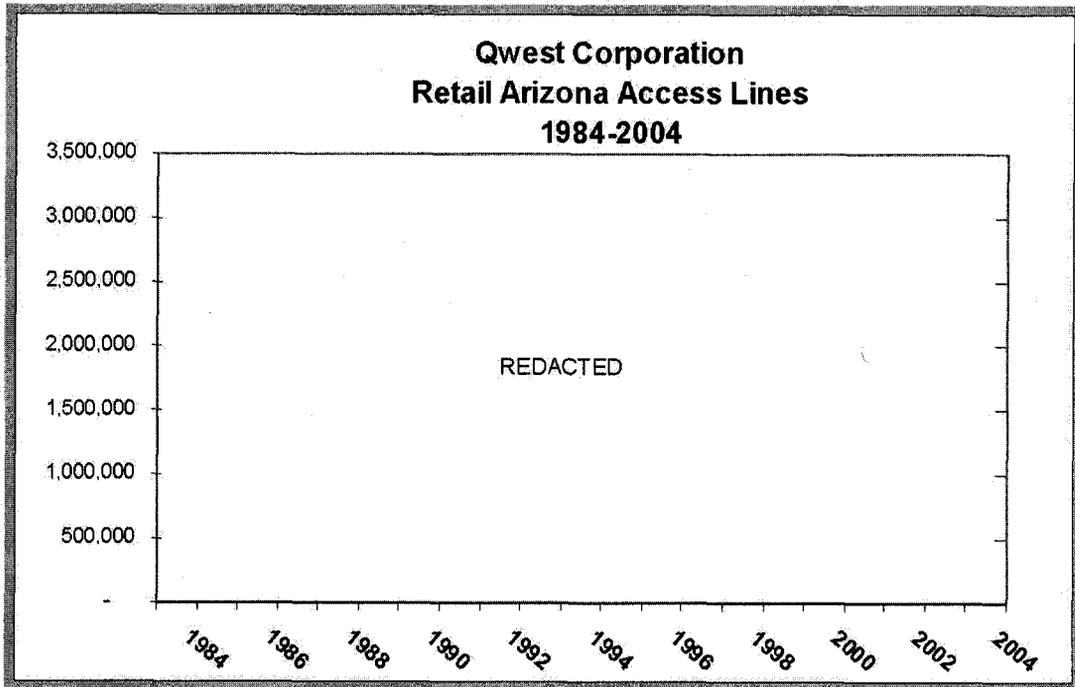
The following graph of retail access lines more accurately reflects the effect of

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competition on Qwest's business because it excludes wholesale access lines

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sold to Qwest's competitors.



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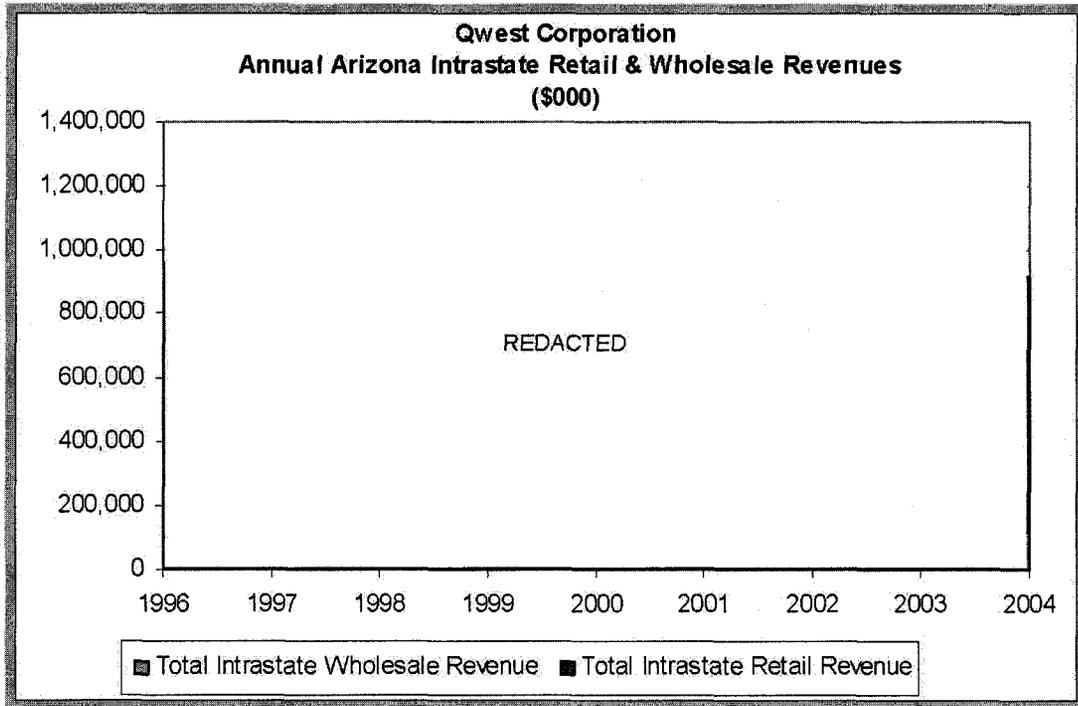
Given the Company's long history of relatively steady access line growth, REDACTED
REDACTED
REDACTED
REDACTED

**Q. PLEASE RESPOND TO MR. BROSCH'S OBSERVATION ABOUT YOUR
OMMISSION OF QWEST'S WHOLESALE ACCESS LINE GROWTH.**

A. Mr. Brosch complains that the omission of wholesale access lines from the graph on page 3 of my rebuttal testimony obscures the considerable growth in wholesale revenues from sale of wholesale access lines.² Following is a

² Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 10-13

1 graph that charts the growth in Qwest's retail and wholesale intrastate
2 revenues, as recorded on its books of account, over the past eight years.



3

4 The graph shows

REDACTED

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REDACTED

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REDACTED

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REDACTED

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Q.

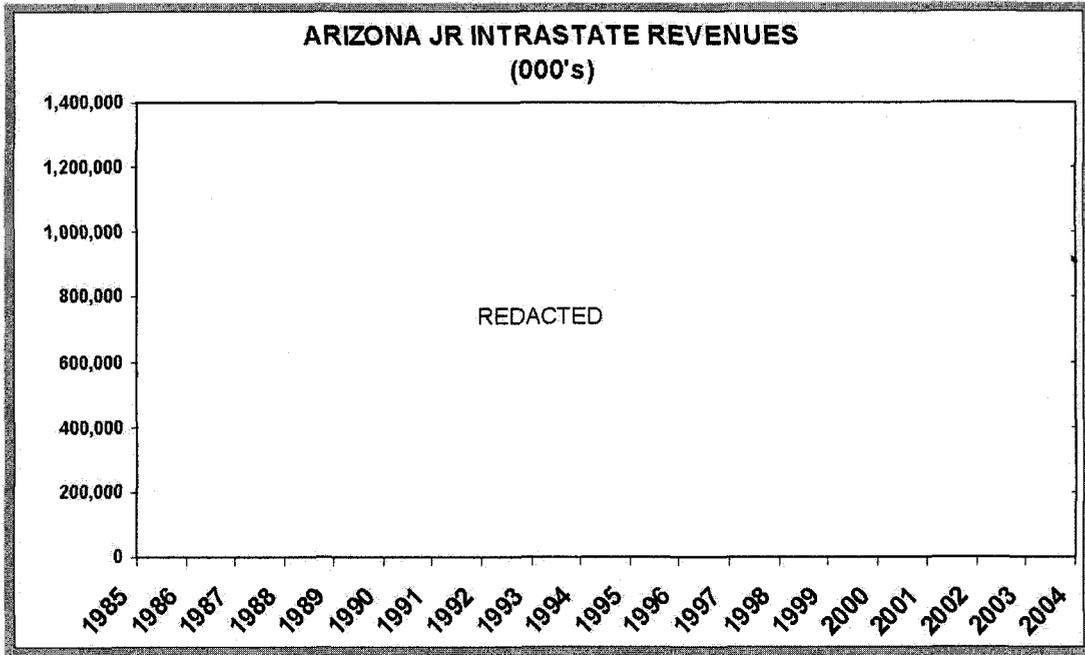
REDACTED

9

A. Yes. The following graph shows Qwest's Arizona intrastate revenues over

10

the past 20 years.



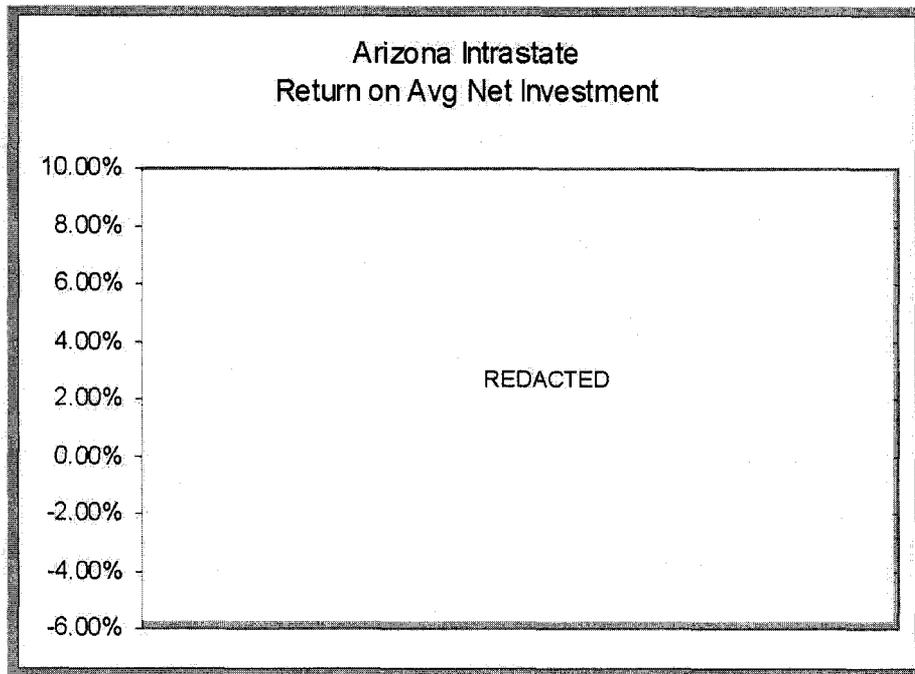
1

2 The graph shows that Qwest's total revenues (including retail and wholesale
3 revenues) REDACTED

4 REDACTED

1 **Q. STAFF'S CONSULTANT COMPLAINS THAT YOUR REBUTTAL GRAPHS**
2 **OF ACCESS LINES, REVENUES AND EXPENSES IGNORE DECLINES IN**
3 **NET INVESTMENT BROUGHT ABOUT BY LARGE DEPRECIATION**
4 **ACCRUALS.³ IS QWEST'S FINANCIAL CONDITION IN ARIZONA**
5 **IMPROVING BECAUSE OF DECLINING INVESTMENT LEVELS AS**
6 **STAFF'S CONSULTANT SUGGESTS?⁴**

7 A. No. The following graph shows Qwest's Arizona intrastate return on average
8 net investment since 1998.



9

³ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p 3. II. 10-29.

⁴ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p 3. II. 11-12.

1 Carver's testimony that are not at issue in this case. It can be found at Qwest
2 Corporation—Exhibit PEG-RJ01.

3 ***History of Accounting Method Changes in Arizona***

4 **Q. DID STAFF QUARREL WITH YOUR REBUTTAL TESTIMONY'S**
5 **CONCLUSION THAT, HISTORICALLY, USOA ACCOUNTING METHOD**
6 **CHANGES WERE INCORPORATED INTO ARIZONA REGULATORY**
7 **ACCOUNTING AND RATEMAKING WITHOUT THE COMPANY, STAFF,**
8 **RUCO OR THE COMMISSION TAKING ANY ACTION?**

9 A. Yes. Staff had two complaints. The first was that my conclusion was
10 misleading because I did not discuss the testimony Mr. Carver filed in Docket
11 No. E-1051-88-146.⁵

12 **Q. HOW DO YOU RESPOND TO THIS FIRST COMPLAINT?**

13 A. The testimony is irrelevant. Even if the Docket No. E-1051-88-146 "complaint
14 proceeding was hotly contested and involved numerous issues,"⁶ the
15 conclusions reached in the interim decision would be non-precedent setting
16 because it was rescinded.

⁵ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 28.

⁶ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 12, l. 26.

1 **Q. WHAT IS STAFF'S SECOND COMPLAINT?**

2 A. Staff's second complaint is that my rebuttal testimony took out of context Mr.

3 Carver's testimony in Docket No. T-10510-99-105 that claimed Qwest had:

4 "previously sought regulatory approval and ratemaking treatment" for several

5 accounting method changes.⁷ That Mr. Carver devotes six pages of

6 surrebuttal testimony to retrofit a meaning to those words⁸ speaks for itself.

7 However, two observations about Mr. Carver's explanation are necessary.

8 The first observation is that Mr. Carver describes the accounting method

9 changes—adopted by USOA and automatically incorporated into Arizona

10 regulatory accounting by operation of Rule R14-2-105 G—as "ratemaking

11 adjustments the Company has included in its various R14-2-103 Filings over

12 the years."⁹ (emphasis added) He considers these "ratemaking adjustments"

13 to be "requests for regulatory approval and ratemaking treatment"¹⁰ despite

14 the absence of any mention of them in the Commission's decisions. He still

15 has not undertaken any "unnecessary research" that would substantiate his

16 claim.¹¹ Instead, he relies on his recollection, knowledge and belief that he

17 compiled a list of pro forma adjustments for accounting method changes that

18 he found in various R14-2-103 (Rule 103) Filings the Company made over the

⁷ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 28.

⁸ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 13, l. 6 to p. 19, l. 5.

⁹ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, l. 5.

¹⁰ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 17, ll. 1-5.

¹¹ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 16, l. 23.

1 years.¹² I have not yet had an opportunity to investigate whether the
2 Company's Rule 103 filings included pro forma adjustments for accounting
3 method changes already adopted into Arizona regulatory accounting under
4 R14-2-510 G. I believe that scenario is unlikely.

5 **Q. WHAT IS THE SECOND OBSERVATION?**

6 A. In direct testimony Mr. Carver complains about RUCO's and Qwest's
7 conclusion that adoption of the accrual accounting method to account for
8 internal-use-software under SOP 98-1 "even though the Company has never
9 previously proposed nor sought Commission approval to recognize this
10 accounting change for intrastate regulatory purposes." However, preferring to
11 have it both ways, Mr. Carver's surrebuttal claims he has never "represented
12 to any Arizona utility or this Commission that 14-2-510(G) or any other
13 Commission Rule requires a regulated utility to formally seek Commission
14 approval before an accounting method change can be recognized for
15 regulatory accounting or ratemaking purposes in Arizona."¹³

¹² Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 16, l. 31 to p. 16, l. 31 to p. 17, l. 1.

¹³ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 17, ll. 14-19.

1 **Q. DOES MR. CARVER ASSERT THAT YOUR ANALYSIS OF THE HISTORY**
2 **OF ACCOUNTING METHOD CHANGES IN ARIZONA IS INCORRECT?**

3 A. In response to the historical analysis of the adoption of ratemaking changes in
4 Arizona and Exhibit PEG-R7¹⁴ Mr. Carver's surrebuttal testimony argues that
5 my rebuttal testimony is: 1) "misleading in its brevity" because it did not
6 discuss the testimony Mr. Carver filed in Docket No. E-1051-88-146 (which
7 complaint I addressed above); 2) takes Mr. Carver's testimony in Docket No.
8 T-1051-99-105 out of context (also discussed above); and 3) is a red herring
9 designed to distract attention from the revenue requirement effect of the
10 adjustment (to be discussed below). However, none of Mr. Carver's
11 testimony claims that my rebuttal testimony's analysis of the historical facts,
12 or its conclusions concerning accounting method changes, are incorrect.

13 ***Accounting for Internal-Use-Software (Staff B-6, C-11; RUCO***
14 ***RB#2, OA#4)***

15 **Q. WHAT IS THE ACCOUNTING ISSUE REGARDING ACCOUNTING FOR**
16 **INTERNAL-USE- SOFTWARE?**

17 A. The issue is whether the USOA's adoption of accrual accounting for internal-
18 use-software, in accordance with SOP 98-1 was incorporated into Arizona
19 regulatory accounting and Qwest ratemaking in 1999. In my rebuttal
20 testimony I explained that the answer is "yes." RUCO concurred and

¹⁴ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 13, l. 6 to p. 19, l. 5.

1 concluded (as did Qwest) that SOP 98-1 was adopted in 1999. In surrebuttal,
2 Mr. Carver offers no facts or evidence showing that Qwest's and RUCO's
3 conclusion was incorrect. Consequently, there is nothing in his testimony to
4 which I can offer substantive rejoinder.

5 **Q. MR. CARVER'S TESTIMONY ASSERTS "MR. GRATE HAS TAKEN THE**
6 **POSITION THAT SOP 98-1 SHOULD HAVE BEEN ADOPTED FOR**
7 **ARIZONA REGULATORY ACCOUNTING PURPOSES" IN 1999.¹⁵ IS HIS**
8 **UNDERSTANDING OF YOUR TESTIMONY CORRECT?**

9 A. No. My rebuttal testimony is not that SOP 98-1 should have been adopted in
10 1999 but rather that SOP 98-1 was adopted in 1999.¹⁶ I also testified that
11 Qwest had notified the parties that Qwest's offbook accounting for internal-
12 use-software would be corrected to reflect 1999 adoption in Arizona and
13 several other states.¹⁷

14 **Q. MR. CARVER ALSO COMPLAINS THAT "QWEST'S SHIFTING**
15 **PROPOSALS PRESENT THE WORST POSSIBLE SCENARIO FOR**
16 **RATEPAYERS."¹⁸ HOW DO YOU RESPOND?**

17 A. In many instances, Staff's discovery prompted Qwest to investigate and
18 reconsider the correctness of its facts, data and arguments. Not infrequently

¹⁵ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 8, l. 21.

¹⁶ Docket No. T-01051B-03-0454; Rebuttal Testimony of Philip E. Grate, p. 23, l.14 to p. 24, l. 2.

¹⁷ Docket No. T-01051B-03-0454; Rebuttal Testimony of Philip E. Grate, p. 29, l. 15 to p. 30, l. 5.

¹⁸ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 8, l. 22.

1 Qwest corrected its ratemaking calculations and positions because of
2 information revealed while answering Staff's many questions. The absolute
3 value of the changes to revenue requirement made over the course of
4 discovery and reflected in Qwest's June, October and November test year
5 updates was \$85 million. Qwest made all \$85 million of these changes before
6 Staff or RUCO filed their direct testimony.

7 The net of this \$85 million of changes reduced Qwest calculated revenue
8 requirement by \$5 million. In rebuttal testimony I corrected the assumption I
9 had used in direct testimony for calculating a change in depreciation rates.
10 The correction reduced Qwest's calculated revenue requirement a further \$46
11 million. I made that correction based not on any other witness' testimony but
12 upon my reevaluation of the assumption I had employed in direct testimony.

13 Now in rejoinder testimony Mr. Carver finds fault with Qwest's and RUCO's
14 conclusion that Qwest adopted SOP 98-1 in 1999. His dissatisfaction is not
15 because he disagrees with the correctness of my rebuttal testimony
16 presentation or analysis of the facts and circumstances attendant to Arizona
17 accounting and ratemaking. Instead, without so much as the pretense of
18 impartiality he opposes the conclusion because he believes the outcome is
19 unfavorable to ratepayers.

1 **Q. SHOULD THE COMMISSION ADOPT STAFF'S PROPOSED**
2 **ADJUSTMENTS FOR SOP 98-1 (INTERNAL USE SOFTWARE)?**

3 A. No. Adjustments B-6 and C-11 are premised on Mr. Carver's erroneous
4 belief that SOP 98-1 was not adopted in 1999. Staff is the only party that
5 maintains this incorrect position. Nothing in the settlement agreement or the
6 Commission's order in Qwest's last rate case provides for non-adoption.
7 Moreover, it has long been the Commission's practice to follow its own
8 accounting rule and automatically incorporate, into ratemaking, changes in
9 accounting methods under the rule. Accordingly, adjustments B-6 and C-11
10 must be rejected.

11 ***Accounting for OPEBs (Staff B-8, C-1)***

12 **Q. STAFF'S CONSULTANTS CONTINUE TO MAINTAIN THAT THE**
13 **ACCRUAL ACCOUNTING FOR OPEBS BEGAN FOR RATEMAKING**
14 **PURPOSES IN 1999.¹⁹ DO YOU HAVE ANY EVIDENCE TO SUGGEST**
15 **THAT PRIOR TO YOUR FILING TESTIMONY IN THIS CASE STAFF'S**
16 **CONSULTANTS BELIEVED ACCRUAL ACCOUNTING FOR OPEBS DID**
17 **NOT YET APPLY TO QWEST?**

18 A. Yes. In the consultancy proposal Utilitech prepared for Staff regarding this
19 case, Utilitech included a discussion of its anticipated review of accumulated
20 deferred income taxes. Included in that discussion was the following:

¹⁹ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver; p. 20, l. 29 to p. 21, l. 2.

1 In addition, component parts of the [accumulated deferred income tax]
2 reserve will be compared to the regulatory treatment of associated
3 balance sheet accounts for consistency between transactions and their
4 related tax effects. For example, given the ACC's historical treatment of
5 FAS106 costs, deferred taxes associated with this accounting change may
6 be treated as non-jurisdictional. (emphasis added)²⁰

7 In Qwest data request No. 10-20, Qwest asked Staff to admit or deny that the
8 presumed treatment of accumulated deferred income taxes on OPEBs as
9 non-jurisdictional was because unlike the FCC, Arizona employs cash basis
10 cost recognition for Qwest's FAS 106 costs. A copy of the data request and
11 Utilitech's response can be found in Qwest Corporation—Exhibit PEG-RJ07.
12 Staff's response neither admits nor denies anything. Instead it is a recitation
13 of facts about the history of the parties' advocacy with regard to accounting
14 for OPEBs that was well known to both parties. I interpret Staff's failure to
15 either admit or deny as an admission that in March of 2003 when it prepared
16 its consultancy proposal, Utilitech believed Qwest was using the pay-as-you-
17 go method to account for OPEBs.

18 **Q. DID YOU SERVE FOLLOW UP DISCOVERY ASKING STAFF WHAT THE**
19 **RESPONSE TO QWEST DATA REQUEST NO. 10-20 MEANT?**

20 A. Yes. Qwest asked Staff to explain whether its response to Qwest data
21 request 10-20 was an unqualified admission, a qualified admission or a

²⁰ Third paragraph of page 16 of document dated March 26, 2004, 3:00 p.m. and entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO."

1 denial. Staff's response does not answer whether Staff's original response
2 was an admission, qualified admission or denial.²¹

3 **Q. IN SETTling THE AMOUNT OF THE REVENUE REQUIREMENT IN**
4 **QWEST'S LAST RATE CASE, DID STAFF AND QWEST SPECIFICALLY**
5 **AGREE TO INCLUDE AN ADJUSTMENT REFLECTING THE CHANGE**
6 **FROM PAY-AS-YOU-GO TO ACCRUAL ACCOUNTING FOR OPEBS?**

7 A. No. I was not privy to the settlement negotiations in Qwest's last Arizona rate
8 case. However, I prepared a question asking Staff to provide a summary of
9 the calculation of the revenue requirement to which the parties agreed in the
10 settlement agreement that separately identified the amount of and purpose of
11 each pro forma adjustment incorporated into that calculation. The question
12 also asked Staff to provide any and all documents evidencing an agreement
13 as to any pro forma adjustment. This question was served on Staff as Qwest
14 data request 10-3.

15 Staff's consultants replied: "Mr. Carver is unaware of any specific document
16 memorializing the explicit components of the revenue requirement negotiated
17 by Company and Staff in ACC Docket No, T-1051B-99-0105. A careful
18 reading of Mr. Carver's testimony will reveal no claim that such a document
19 exists."

²¹ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-3.

1 **Q. DOES STAFF BELIEVE THE COMMISSION ISSUED AN ORDER**
2 **DIRECTING THE COMPANY TO CHANGE THE METHOD OF**
3 **ACCOUNTING FOR OPEBS IT ORDERED IN THE COMPANY'S 1994**
4 **RATE CASE?**

5 A. No. I apologize for misinterpreting Mr. Carver's testimony on this point. In
6 data request Qwest 10-17, Qwest asked Staff to identify the decision or order
7 where the Commission notified Qwest that it was authorized to use SFAS 106
8 to account for OPEBs. Staff's consultants responded: "Mr. Carver is not
9 aware of any decision or order of the ACC so notifying Qwest. Mr. Carver's
10 direct testimony in the current Docket does not claim that such a decision or
11 order has been issued." Unfortunately, I did not have an opportunity to read
12 Staff's reply to this question before preparing my rebuttal testimony or before
13 answering discovery Staff posed to Qwest on this question.

14 **Q. IF STAFF AGREES THERE IS NO ORDER DIRECTING THE COMPANY**
15 **TO ADOPT ACCRUAL ACCOUNTING WHY DOES STAFF BELIEVE**
16 **ACCRUAL ACCOUNTING FOR OPEBS WAS ADOPTED?**

17 A. Assuming I now correctly understand Mr. Carver's testimony, it is because
18 Qwest proposed that it be adopted in Qwest's last rate case and Staff did not
19 oppose such adoption. Mr. Carver believes that despite Mr. Carver's
20 vigorous opposition to accrual accounting for OPEBs in Qwest's 1994 rate
21 case, Staff's silence in the next rate case signaled Staff' agreement with

1 Qwest's adoption of accrual accounting. He concludes that accrual
2 accounting was adopted for ratemaking purposes in the Company's last rate
3 case by the "regulatory intent" of Qwest as expressed by its testimony and
4 Staff as expressed by its silence.²²

5 **Q. ASSUMING YOU NOW BETTER UNDERSTAND MR. CARVER'S**
6 **POSITION, DO YOU AGREE WITH IT?**

7 A. No. I continue to believe that the Commission's ratemaking order in Decision
8 No. 58927—which required the Company to continue using the pay-as-you-
9 go method of accounting for OPEBs for ratemaking purposes in contravention
10 of its own regulatory accounting rule—remains in effect until the Commission
11 orders the adoption of accrual accounting in this case. In Qwest's last rate
12 case, nothing in the Settlement Agreement or the Commission's decision
13 approving the Settlement Agreement provides for the adoption of accrual
14 accounting for OPEBs. If the parties intended for the adoption of accrual
15 accounting it needed to be set out as part of the stipulation, precisely because
16 it says: "There are no understandings or commitments other than those
17 specifically set forth herein."

²² Docket No. T-01051B-03-0454; Direct Testimony of Steven C. Carver; pp. 56-71.

1 **Q. DO YOU FIND THE CURRENT POSITION OF STAFF'S CONSULTANTS**
2 **PERPLEXING?**

3 A. Yes. The consultants' current position appears to contradict the position they
4 took in Qwest's 1994 rate case. Under cross examination in Docket No.
5 E-1051-93-183, Mr. Brosch was asked about his understanding of a passage
6 of Mr. Carver's direct testimony²³ concerning a rate case stipulation:

7 Q. * * * Do you agree with Mr. Carver's position?

8 A. Yes, I agree with his position.

9 Q. And what are you agreeing to?

10 A. It's my impression that in the context of a stipulated case, **if either**
11 **party desires a finding or a conclusion that can be relied upon in**
12 **subsequent proceedings, that finding or conclusion needs to be set**
13 **out as part of the stipulation**. And in particular, whether it's language
14 that expressly states that parties are not reaching any specific finding or
15 conclusion of precedential value, no one should rely upon it for that
16 purpose.²⁴ (emphasis added)

17 Mr. Carver and Mr. Brosch were Staff's consultants in Docket No. E-1051-93-
18 183 and they are Staff's consultants in this case. It perplexes me that their
19 opinion regarding the meaning of the absence of language in a stipulation
20 then appears to be diametrically different now.

21 **Q. MR. CARVER DESCRIBES THE SETTLEMENT AGREEMENT'S SILENCE**
22 **ON ACCOUNTING FOR OPEBS IN QWEST'S LAST RATE CASE AS AN**

²³ The testimony of Mr. Carver about which Mr. Brosch was being questioned can be found on page 8 of the Direct Testimony of Steven C. Carver, in ACC Docket No. E-1051-93-183.

²⁴ Transcript from ACC Docket No. E-1051-93-183, dated 6/3/94, page 3201, line 22 to page 3202, line 6.

1 **“UNFORTUNATE OVERSIGHT.”²⁵ DO YOU AGREE THAT IT WAS AN**
2 **OVERSIGHT?**

3 A. No. If the 1997 Southwest Gas Corporation settlement (to which Staff was a
4 party) included language explicitly adopting accrual accounting for OPEBs,
5 then clearly the settlement agreement between Staff and Qwest in the
6 Company’s last rate case could have too. Given that in 1994 Mr. Brosch
7 gave testimony that he and Mr. Carver believed that “if either party desires a
8 finding or a conclusion that can be relied upon in subsequent proceedings,
9 that finding or conclusion needs to be set out as part of the stipulation,” I
10 cannot accept Mr. Carver’s claim that the omission was an oversight,
11 particularly where Mr. Carver and Mr. Brosch were Staff’s consultants in the
12 docket in which the Settlement Agreement was reached.

13 **Q. SHOULD THE COMMISSION ADOPT STAFF’S PROPOSED**
14 **ADJUSTMENTS FOR OPEBS?**

15 A. No. Staff is the only party that takes the position accrual accounting for
16 OPEBs was adopted for ratemaking purposes in 1999. Staff, RUCO and
17 Qwest agree that the Settlement Agreement did not provide for adoption of
18 accrual accounting for OPEBs and that the Commission did not order Qwest
19 to adopt accrual accounting for OPEBs in 1999. Adjustments B-8 and C-18
20 rely on language that could have been easily included in the settlement but

²⁵ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 21, l. 11.

1 was not. By offering Adjustments B-8 and C-18, Staff and its consultants
2 directly contradict the consultants' prior testimony regarding the absence of
3 language in stipulations and flout the terms of the settlement agreement.
4 Adjustments B-8 and C-18 must be rejected.

5 **RATEMAKING METHODS**

6 ***Method of Annualization***

7 **Q. WHAT ASSUMPTION UNDERLIES THE USE OF A TEST YEAR?**

8 A. The use of a historical test year presupposes the relative financial stability of
9 a monopoly utility. In other words, the assumption underlying the use of a
10 test year is that a relatively recent twelve months of financial data is a
11 reasonably good predictor of the future financial performance that a monopoly
12 utility—with its relatively stable and predictable customer base and operating
13 environment—is likely to experience. If a business is not a monopoly utility,
14 the test year concept is less useful because the assumption that next year will
15 be largely similar to last year may not be reasonable. Competitive market
16 forces are a factor that tend to make financial performance of non-monopoly
17 businesses less consistent and predictable than those of monopoly utilities,
18 as evidenced by Qwest's financial performance since the price cap plan was
19 adopted.

1 In this docket the Commission had required Qwest to file test year information
2 under Rule R14-2-103 (Rule 103). However, the probability that a 2003 test
3 year is a good predictor of Qwest's future financial performance in Arizona is
4 not as high as it was during the monopoly era of Qwest's business.

5 **Q. BESIDES ARIZONA, HOW MANY OF THE TWELVE JURISDICTIONS IN**
6 **WHICH UTILITECH HAS GIVEN COST-OF-SERVICE TESTIMONY**
7 **REQUIRES AN END OF PERIOD RATE BASE?**

8 A. Six.²⁶

9 **Q. HOW MANY OF THE FOURTEEN STATES WHERE QWEST IS AN**
10 **INCUMBENT LOCAL EXCHANGE COMPANY (ILEC) REQUIRE AN END**
11 **OF PERIOD RATE BASE?**

12 A. One, which is Arizona.

13 **Q. WHAT IS THE PURPOSE OF THE ANNUALIZATION ADJUSTMENT?**

14 A. Given that Arizona ratemaking rules require the use of an end-of-test-year
15 rate base, the purpose of the annualization adjustment is to synchronize test
16 year revenues and expenses with an end-of-test-year rate base so that the
17 revenue requirement calculation reflects the same test period for revenues,
18 expenses and rate base.²⁷ In other words, because Arizona requires that rate

²⁶ Staff response to Data Request No. Qwest 23-1.

²⁷ In their consultancy proposal to Staff, Staff's consultants described their revenue annualization adjustment work as follows: "Our analysis will focus on assessing the reasonableness of the adjustments proposed by USWC and investigating available options to synchronize ongoing

1 base be measured on a single day—the last day of the test year—the
2 calculation of test year volumes must be brought forward to the last day of the
3 test year so that revenues and expenses are measured at the same point in
4 time that rate base is measured. Separate adjustments are made for
5 changes in prices (such as the prices of services that generate the
6 Company's revenues and the price of labor expressed in wage rates) so that
7 the prices reflected in test year data reflect the prices on the last day of the
8 test year.

9 As proven by Staff's and Qwest's competing annualization methodologies,
10 using an end-of-test year rate base presents a ratemaking challenge. The
11 goal of annualization is, in effect, to calculate a full year's revenue and
12 expenses measured on a single day, the last day of the test year. Obviously,
13 the Company does not generate a full year's revenues and expenses in a
14 single day. So the challenge is to make a calculation that yields an annual
15 level of revenues and expenses generated on the single day that rate base is
16 measured. Another way of conceptualizing the challenge of annualization is
17 that it requires devising a method of calculating the revenues and expenses
18 generated over the course of a year whose midpoint falls on the day that rate
19 base is measured. But this calculation must be made without any data from

revenue levels with end-of-period rate base." (emphasis added) Document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and provided in Staff's supplemental response to Qwest data request 2-42. Third full paragraph on the page numbered 18.

1 the last half of that year (because it falls after the end of the test period and is,
2 therefore, not available). Consequently, an annualization adjustment must be
3 made.

4 **Q. WHAT IS THE GOAL OF THE ANNUALIZATION ADJUSTMENT?**

5 A. The goal of the annualization adjustment is to make the test year more likely
6 to be representative of a monopoly utility's future financial performance. Of
7 course the underlying assumption--which is dubious in Qwest's case--is that
8 the test year itself will be representative of the firm's ongoing conditions.

9 **Q. HOW DID STAFF'S CONSULTANTS DESCRIBE THE OBJECTIVE OF THE**
10 **ANNUALIZATION WORK THEY WOULD DO FOR STAFF?**

11 A. In their written bid for the consultancy contract in this docket, Staff's
12 consultants described the work they would perform in this regard as follows:

13 UTI will analyze decreasing as well as increasing cost of service
14 components to determine whether test year **operating results** are
15 **reasonable overall** and indicative of future events.²⁸ (emphasis
16 added)

17 * * *

18 **Annualized Sales and Revenue Levels – Monthly revenue activity is**
19 **analyzed** by FCC account during and subsequent to the test period, along
20 with new product/service deployment plans, customer statistical data and
21 other information **to determine a normalized, ongoing level of sales,**
22 **and revenues** consistent with the cutoffs employed throughout the
23 balance of the case (for example, year-end rate base). It is not uncommon
24 for a utility to adjust revenues to eliminate prior period adjustments, cost

²⁸ Document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and provided in Staff's supplemental response to Qwest data request 2-42. Second full paragraph on the page numbered 16.

1 study true-ups, sales of exchanges, and employee concession service.
2 Notably, telephone companies often fail to adjust revenues to reflect end-
3 of-period sales and revenue levels. **Our analyses will focus on**
4 **assessing the reasonableness of the adjustments proposed by**
5 **USWC and investigating available options to synchronize ongoing**
6 **revenue levels with end-of-period rate base.**

7 **Price cap revenue changes and the revenue impact of pricing flexibility**
8 **must be analyzed and annualized** into the revenue requirement
9 calculations. Qwest will undoubtedly propose ratemaking adjustments for
10 price reductions that require verification and testing. UTI will also
11 investigate offsetting volume impacts and instances where service
12 bundling may distort the recorded amounts of regulated revenues.²⁹
13 (emphasis added)

14 **Q. HOW DID QWEST APPROACH THE RATEMAKING CHALLENGE OF**
15 **ANNUALIZING TEST YEAR REVENUES AND EXPENSES?**

16 A. Qwest employed a comprehensive annualization of test period operating
17 income. Qwest analyzed all significant USOA revenue and expense accounts
18 and, using a consistently applied statistical method, annualized those
19 accounts. Where a statistically significant exogenous factor could be identified
20 that would be a statistically reliable indicator of year end levels, Qwest
21 calculated an adjustment tied to that indicator. I explained Qwest's
22 methodology in detail in my direct testimony.

²⁹ *Ibid.* Third and fourth full paragraphs on the page numbered 18.

1 **Q. IS THE STATISTICAL REGRESSION ANALYSIS THAT QWEST USED TO**
2 **ANNUALIZE REVENUES IMPRACTICAL?**

3 A. No. However, it does require the exercise of judgment. Mr. Brosch and I
4 agree on this point. Mr. Brosch asserts,

5 "...it is impractical to suggest that a formulistic approach to revenue or
6 expense annualization can be applied rigidly to all elements of the income
7 statement and produce reasonable results. Some informed judgment and
8 critical analysis of the results of each annualization calculation is required
9 to ensure that known and measurable changes are properly reflected in a
10 matched and balanced manner.³⁰

11 Like Mr. Brosch I do not believe that a rigidly applied formulistic approach to
12 revenue or expense annualization is appropriate. Mr. Brosch explained how
13 his review of Qwest' regression analysis identified some spurious results and
14 how Qwest agreed that the adjustment based on the spurious results were
15 made in error.³¹ Exercising its judgment, Qwest corrected the error and
16 notified the parties of such correction before Mr. Brosch filed his direct
17 testimony.

³⁰ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 19, ll. 20-24.

³¹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 19, ll. 10-24.

1 **Q. MR. CARVER CLAIMS THAT YOU ADVOCATE ACHIEVING TEST YEAR**
2 **CONSISTENCY BY DEVELOPING AND BLINDLY APPLYING A SINGLE**
3 **MATHEMATICAL OR FORMULISTIC TECHNIQUE TO EACH AND EVERY**
4 **SIGNIFICANT ELEMENT OF THE INCOME STATEMENT.³² IS THIS TRUE?**

5 A. No. Mr. Carver's claim is incorrect. I advocate the consistent application of a
6 sound annualization methodology as opposed to the piecemeal
7 methodological approach that Staff's consultants appear to prefer.

8 Mr. Carver's surrebuttal testimony criticizes Qwest's use of a different
9 annualization method in each of the three most recent rate cases. His
10 criticism is ill founded. The Commission did not accept the annualization
11 methods Qwest used in the prior two rate cases.³³

12 Hence, my aim in this case was to employ a more robust analytical technique
13 than either the Company or Staff had used in prior rate cases. I chose to use
14 statistical regression analysis of 36 months of exogenous business drivers
15 because I believed that such an analysis was more likely to produce a
16 reasonable and reliable overall annualization result than either of the methods
17 Qwest used in past cases or than the piecemeal methodological approach
18 that Staff has used in past rate cases.

³² Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 24, l. 6.

³³ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 26, l. 17 to p. 27, l. 33.

1 Contrary to Mr. Carver's assertion, I do not advocate the blind application of
2 mathematical formulae. On the contrary, statistical regression analysis
3 requires the exercise of considerable judgment and an understanding of the
4 exogenous business drivers that could be expected to drive revenues and
5 costs. It also requires that one recognize and deal with spurious results.

6 **Staff Adjustments C-2, C-3, C-4 and C-5**

7 **Q. HOW DID STAFF APPROACH THE ANNUALIZATION OF TEST YEAR**
8 **REVENUES AND EXPENSES?**

9 A. Mr. Brosch's rebuttal testimony explains:

10 Staff's approach in this case, as in all prior Arizona rate cases, is to
11 analyze available data to seek a reasonable annualization approach that
12 produces reasonable results, without constraining the analysis to a
13 particular methodology or algorithm. The differences in proposed
14 annualized revenues between Staff and Qwest regarding Access Charge
15 Revenues (Grate Rebuttal pages 48-50), Toll Service Revenues (Grate
16 Rebuttal page 50) and Directory Assistance Revenues (Grate Rebuttal
17 page 51) all have to do with Qwest's notion that one must rigidly apply the
18 same calculation algorithm to every single account, or a reasonable
19 annualization cannot be quantified.³⁴ (emphasis added)

20 * * *

21 Staff evaluated Mr. Grate's new regression approach and results and
22 accepted them in certain instances where the results were reasonable,
23 while making further adjustments if the results of Mr. Grate's new
24 approach were not reasonable.³⁵ (emphasis added)

³⁴ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.

³⁵ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 18, ll. 23-26.

1 **Q. HOW DID STAFF'S CONSULTANTS VERIFY THE OVERALL**
2 **REASONABLENESS OR RELIABILITY OF ANNUALIZED TEST YEAR**
3 **REVENUES THAT THEIR "FURTHER ADJUSTMENTS" PRODUCED?**

4 A. I do not know. Staff did not indicate that its consultants had conducted any
5 overall tests of their proposed adjustments to show their claim of reliability to
6 be true. So far as I know, they simply assumed the individual "further
7 adjustments" they made were reasonable (in their opinion) and concluded
8 that aggregating these adjustments would yield overall reasonable and
9 reliable test year revenues. In this regard it appears that they assumed that
10 making individual adjustments that were reasonable and reliable (in their
11 minds) would produce a reasonable and reliable result overall.

12 **Q. DID YOU PERFORM ANY TEST TO DETERMINE WHETHER QWEST'S**
13 **AND/OR STAFF'S REVENUE ANNUALIZATION CALCULATION**
14 **PRODUCES TEST YEAR REVENUES THAT ARE REASONBLE OVERALL**
15 **AND RELIABLE?**

16 A. Yes. As I explained in response to the earlier question about the purpose of
17 the annualization adjustment, the challenge of annualization is that it requires
18 devising a method of calculating the revenues or expenses generated over
19 the course of a year whose midpoint falls on the single day that rate base is
20 measured (in this case December 31, 2003) while making due without any
21 data from the last half of that year (January through June of 2004). Enough

1 time has passed since Qwest prepared its revenue annualization adjustment
2 that the data from the last half of that year (January through June of 2004) is
3 now available to test the accuracy of the revenue annualization calculations
4 Staff and Qwest have proposed.

5 Consequently, Qwest performed a test of Staff's and Qwest's proposed
6 annualization adjustments to determine which was more reasonable overall.
7 The test compares the annual revenue amount calculated by Staff's
8 adjustments and Qwest's adjustments against the actual Arizona intrastate
9 revenues over the twelve month period whose midpoint is December 31,
10 2003—the last day of the test year. Qwest Corporation—Exhibit PEG-RJ02
11 presents the detail behind the test, including data, assumptions, and
12 adjustments used.

13 **Q. WHAT DID THE TEST REVEAL?**

14 A. Following are two schedules summarizing the results of the test.

<u>Intrastate Revenue (\$Millions):</u>	Normalized Actual Results July 2003 - June 2004	Company End-of- period Revenue Calculation for Test Year 2003	Test Year Revenue is Higher/Lower (+/-) Than Normalized Actuals
	A	B	C = B-A
1) Company Estimates			
Local Service Revenue	787.0	790.6	3.6
Network Access Service Revenue	76.3	75.8	(0.5)
Long Distance Network Service Revenue	9.6	8.8	(0.8)
Miscellaneous (1)	114.5	117.6	3.1
TOTAL	987.4	992.8	5.4

1

<u>Intrastate Revenue (\$Millions):</u>	Normalized Actual Results July 2003 - June 2004	ACC Staff End-of- period Revenue Calculation for Test Year 2003	Test Year Revenue is Higher/Lower (+/-) Than Normalized Actuals
	A	D	E = D - A
2) ACC Staff Estimates			
Local Service Revenue	787.0	794.3	7.3
Network Access Service Revenue	76.3	75.7	(0.6)
Long Distance Network Service Revenue	9.6	9.9	0.3
Miscellaneous (1)	114.5	117.6	3.1
TOTAL	987.4	997.5	10.1

2

3

4

Note (1): Miscellaneous Revenue excludes FCC Deregulated Revenue and Rent Compensation Revenue.

5

6

7

8

9

The schedules show that both Staff's and Qwest's annualization adjustments yielded test year revenue amounts that were more than the actual revenue generated during the twelve months whose midpoint is December 31, 2003 (the date rate base is measured). Qwest's annualization was \$5.4 million more. Staff's was \$10.1 million more. The difference was nearly twice as

1 large with Staff's annualization adjustments as it was with Qwest's
2 annualization adjustment because Staff made "further adjustments" to
3 Qwest's annualization calculation.

4 The annualization approach Staff's consultants used in this case (and which
5 Mr. Brosch asserts they have used in all prior Arizona rate cases³⁶) was to
6 "analyze available data... without constraining the analysis to a particular
7 methodology or algorithm."³⁷ The test shows that this approach was less
8 reliable than the annualization approach Qwest used. Consequently—and
9 not surprisingly—the test proves that Qwest's consistent application of its
10 statistical regression analysis produced annualization results that were more
11 reasonable overall than the piecemeal annualization approach that Staff
12 employed.

13 Staff claims to "analyze available data to seek a reasonable annualization
14 approach that produces reasonable results..."³⁸ However, there is no
15 indication that Staff tested its results for overall reasonableness. Qwest's test
16 demonstrates the considerable gap between Staff's rhetoric and the reality.
17 Accordingly, Staff's proposed "further adjustments" to Local Service
18 Revenues (C-2), Access Charge Revenues (C-3), Toll Service Revenues (C-
19 4) and Directory Assistance Revenues (C-5) should be rejected.

³⁶ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, ll. 23-27.

³⁷ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.

³⁸ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch; p. 16, l. 29 to p. 17, l. 1.

1 **RUCO Operating Adjustment #2**

2 **Q. MS. DIAZ CORTEZ ARGUES IN SURREBUTTAL THAT "THE PROFORMA**
3 **DECREASE IN REVENUES IS BASED ON A NUMBER OF**
4 **ASSUMPTIONS, WHICH INCLUDE THE ASSUMPTION THAT A CHANGE**
5 **IN CERTAIN INDEPENDENT VARIABLES WILL HAVE A ONE-TO-ONE**
6 **IMPACT ON THE DEPENDENT VARIABLE, WHICH IN QWEST'S**
7 **PROPOSED ADJUSTMENT IS ITS REVENUE."³⁹ DO YOU AGREE WITH**
8 **THIS ASSERTION?**

9 A. No. Ms. Diaz Cortez's assertion is inconsistent with the basic elements of
10 regression analysis. Regression analysis assumes that changes in some
11 values (dependent variables) are driven by changes in the things
12 (independent variables) that produce those values. For example, in the case
13 of Qwest's revenue annualization adjustment, the assumption is that changes
14 in customer revenues can be explained in terms of changes in the drivers that
15 produce these revenues – primarily lines.

16 **Q. DO YOU EXPECT TO FIND A ONE-TO-ONE RELATIONSHIP BETWEEN**
17 **THESE DEPENDENT AND INDEPENDENT VARIABLES?**

18 A. No. If we were able to find a one-to-one relationship, there would be no point
19 in relying on regression analysis. The business and scientific community rely
20 on regression analysis to provide a statistically reliable and trustworthy

³⁹ Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez, p. 11, l. 11.

1 explanation of real-world events. As I explain in my direct testimony, the
2 point of regression analysis is to identify those variables that best explain
3 changes in the thing being analyzed based on known and measurable data.
4 As shown by the test Qwest performed of its revenue annualization
5 adjustment, Qwest's regression analysis reliably and accurately explains
6 these changes. Ms. Diaz Cortez's Operating Adjustment #2 should be
7 rejected.

8 **STAFF Adjustment C-16**

9 **Q. STAFF CLAIMS "THE REALITY IS THAT QWEST ANNUALIZED**
10 **VIRTUALLY EVERY ONE OF THE SIGNIFICANT INTRASTATE REVENUE**
11 **ACCOUNTS, BUT THE COMPANY HAS NOT ANNUALIZED ANY OF ITS**
12 **WAGE OR NON-LABOR EXPENSES AT YEAR END."⁴⁰ IS STAFF**
13 **CORRECT?**

14 A. No. Qwest's adjustment PFN-03 is Qwest's comprehensive annualization of
15 test period operating income. Qwest analyzed all significant USOA revenue
16 and expense accounts and, using a consistently applied statistical method,
17 annualized those accounts. Where a statistically significant factor could be
18 identified that would be a statistically reliable indicator of year end levels
19 Qwest calculated an adjustment tied to that indicator. I explained Qwest's
20 methodology in detail in my direct testimony,

⁴⁰ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 16, ll. 11-13.

1 The fact that the regression analysis did not support adjusting expenses does
2 not mean expenses were not tested for annualization. Mr. Brosch's criticism
3 is based on the outcome, not the reality of what Qwest did.

4 **Q. MR. CARVER ASSERTS, "THE QUANTITIES AND PRICES THAT DRIVE**
5 **EXPENSES ARE DIFFERENT FROM REVENUES."⁴¹ PLEASE RESPOND.**

6 A. It seems Mr. Carver still fails to grasp difference between exogenous
7 (external) variables and endogenous (internal) variables. Access lines and
8 customers are external (exogenous) variables that influence revenues and
9 costs. Exogenous variables are outside the direct control of the Company but
10 they do drive revenues and, ultimately, costs. Through advertising, service
11 quality and other means, the Company tries to influence the number of
12 customers that buy its products.

13 The variables that Mr. Carver's identifies at page 25 of his surrebuttal
14 testimony (employees, number of hours worked, and so on) are all
15 endogenous variables that the company can, and does, directly control.
16 These are not external variables and therefore, cannot be included in a
17 meaningful regression analysis. Logically, it's the same as arguing that salary
18 expense is caused by employees. Of course employees cause salary
19 expense but that's not the key question. The key question is what are the
20 external variables (drivers) that influence the number of required employees?

⁴¹ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 25, ll. 1-2.

1 The answer is based on the complex relationship among customer demands,
2 the condition of telephone plant, weather conditions and other external
3 variables that are beyond the Company's direct control.

4 **Q. MR. CARVER COMPLAINS: "UNDER MR. GRATE'S FORMULISTIC**
5 **APPROACH, MANY OF THE MORE TYPICAL RATE CASE**
6 **ADJUSTMENTS MIGHT NEVER BE MADE, AS MR. GRATE'S UNIQUE**
7 **TECHNICAL METHOD MIGHT NOT IDENTIFY A CORRELATION**
8 **SUFFICIENT TO SUPPORT AN ADJUSTMENT."⁴² PLEASE COMMENT.**

9 A. The observation Mr. Carver makes is correct, but ill founded. The fact that
10 "typical rate case adjustments might never be made" suggests the "typical"
11 rate case adjustments are incorrect. The evidence shows that typical rate
12 case adjustments bear no imprimatur of infallibility. Consider, for example
13 how poorly the revenue requirement upon which the parties settled in Qwest's
14 last rate case underestimated Qwest's true revenue requirement during the
15 years that followed. Had all of Staff's proposed adjustments in that case been
16 adopted, the outcome would have been significantly worse than it was.

⁴² Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 26, ll. 9-11.

1 **Q. MR. CARVER ASSERTS, "MR. GRATE WOULD HAVE THIS**
2 **COMMISSION BLINDLY ENDORSE AND ADOPT A COMMON**
3 **APPROACH FOR THE SAKE OF CONSISTENCY AND IGNORE KNOWN**
4 **AND MEASURABLE CHANGES."⁴³ PLEASE COMMENT**

5 A. This assertion is incorrect. I am not suggesting the Commission blindly
6 endorse anything. As I have already explained, because of the unique test-
7 year construction in Arizona that relies on an end-of-test-period rate base, I
8 believe the Commission should establish and communicate a policy that
9 requires those who propose annualization adjustments to show that they are
10 1) applying a technically defensible methodology and 2) they are applying it
11 consistently to all elements of operating results, not just a few as Staff's
12 adjustment C-16 does.

13 Mr. Carver complains because I would not adjust for a change that is known
14 and measurable. This complaint is ill founded. By virtue of the statistical
15 regression methodology Qwest employed, Qwest's comprehensive review of
16 all significant expense accounts took into account all known and measurable
17 changes including the effect of the decline in employee levels. This is
18 because the effect of employee level declines was fully imbedded in the 36
19 months of expense data that Qwest reviewed. When the effect of all known

⁴³ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 26, ll. 17-19.

1 and measurable changes is accounted for, no adjustment to expenses is
2 required or appropriate.

3 Mr. Carver isolated a single known and measurable phenomenon and
4 adjusted for that single phenomenon without regard to the comprehensive
5 testing of expenses that Qwest had already conducted. His adjustment fails
6 to recognize that on an overall basis—taking into account all expenses—no
7 adjustment is required or appropriate. His adjustment for employee levels is,
8 in colloquial terms, cherry-picking.

9 The determination of just and reasonable rates is more likely to be
10 accomplished with a disciplined application of a sound annualization
11 methodology consistently applied than with a piecemeal approach, as
12 employed and advocated by Staff.

13 **Q. MR. CARVER ARGUES IT IS "INAPPROPRIATE TO RECOGNIZE AN**
14 **ANNUALIZATION ADJUSTMENT FOR WAGE RATE LEVELS (PRICES)**
15 **THAT INCREASE DURING THE TEST YEAR AND IGNORE QWEST'S**
16 **DOWNWARD TREND IN EMPLOYEE STAFFING LEVELS (QUANTITIES)**
17 **THAT OCCURRED DURING THE TEST YEAR."**⁴⁴ **PLEASE RESPOND.**

18 A. Mr. Carver's assumption—that Qwest's regression analysis of expenses
19 ignored the downward trend in employee staffing levels—is incorrect. The

⁴⁴ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 28, ll. 21-24.

1 expense data that Qwest's regression analysis tested included the effect of
2 the downward trend in employee levels.

3 **Q. MR. CARVER CLAIMS THAT REGULATORS TYPICALLY DO NOT**
4 **PREDETERMINE SPECIFIC RATEMAKING METHODOLOGIES,**
5 **PRACTICES OR APPROACHES.⁴⁵ PLEASE RESPOND.**

6 A. I am not suggesting that the Commission to prescribe a particular
7 annualization methodology. However, I do believe the Commission should
8 expect the parties to apply a sound methodology consistently instead of using
9 a piecemeal, scattershot approach.

10 **Q. MR. CARVER ARGUES UTILITECH HAS SOUGHT TO CONSISTENTLY**
11 **ANNUALIZE KNOWN AND MEASURABLE CHANGES IN ARIZONA RATE**
12 **CASE PROCEEDINGS. DO YOU AND HE DISAGREE ON THE MEANING**
13 **AND APPLICATION OF THE CONSISTENCY CONCEPT?⁴⁶**

14 A. Indeed we do. I believe annualization is more reliable when one applies a
15 sound methodology consistently to all significant revenue and expense
16 accounts. Mr. Carver consistently applies the same piecemeal approach in
17 all rate cases. Consistently using an inferior approach does not make the
18 approach correct.

⁴⁵ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 22, ll. 22-24.

⁴⁶ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 27, l. 35 to p. 28, l. 2.

1 ***Pro Forma Adjustment to Accrued Expenses (Staff B-7; RUCO***
2 ***RBA#1)***

3 **Q. WHAT IS THE RATEMAKING METHODOLOGY ISSUE RAISED BY STAFF**
4 **ADJUSTMENT B-7 AND RUCO RATE BASE ADJUSTMENT #1?**

5 A. The methodology issue pertains to pro forma adjustments to accrued
6 expenses (such as depreciation expense) for changes (such as changed
7 depreciation rates) that will occur after the close of the test year. The
8 question is whether rate base should be adjusted to reflect the effect of the
9 accrued expense adjustment.

10 **Q. WHAT IS MR CARVER'S POSITION?**

11 A. Mr. Carver argues that when a pro-forma adjustment is made to the test year
12 for an event that will occur after the test year, an adjustment may be made for
13 the income statement effect of that event but no adjustment may be made for
14 the rate base effect of that same event.

15 **Q. WHAT IS YOUR UNDERSTANDING OF MR. CARVER'S REASONING IN**
16 **SUPPORT OF THIS POSITION?**

17 A. So far as I can tell from reading his rebuttal testimony, his argument that rate
18 base is not adjusted for post-test-year events because these events cannot
19 affect rate base at the end of the test year. For convenience sake I've set
20 forth the substance of his argument.

1 Because Qwest will not commence booking any rate base effect
2 associated with revised depreciation rates the Commission might approve
3 until well beyond the 2003 test year, Staff Adjustment B-7 excludes the
4 pro forma effect of any capital recovery adjustment from rate base.⁴⁷

5 * * *

6 Stated more simply, the components of rate base generally represent
7 recorded balances obtained from the Company's balance sheet at test
8 year-end, with the exception of lead lag study valuations of cash working
9 capital. While there are circumstances that require further adjustments to
10 those year-end balances (e.g., disallowances, corrections, normalizations,
11 etc.), post-test year adjustments to a historic rate base are typically limited
12 to discrete known and measurable events that materially impact utility
13 operations or represent one of the primary factors contributing to the filing
14 of a rate case, such as completed construction projects or asset sales that
15 are matched with related revenue gains, improved efficiencies, added
16 costs or cost reductions. Each such situation is different and must be
17 evaluated in the context of its unique facts and circumstances.⁴⁸

18 * * *

19 In order to implement changes in depreciation accrual rates proposed
20 within the context of a pending revenue requirement investigation, a pro
21 forma adjustment to depreciation expense must be recognized in the
22 quantification of overall revenue requirement.⁴⁹ * * * In contrast, a rate
23 base depreciation reserve adjustment is only appropriate if the regulator
24 orders the subject utility to retroactively record the new depreciation rates
25 to the first day of the historic test year.⁵⁰

26 * * *

27 I have reviewed Mr. Grate's rebuttal testimony, Qwest's discovery
28 responses (Data Request UTI 15-17(c) and RUCO Data Request 4-1),
29 and the relevant portions of the ACC orders (Decision No. 53849, Docket
30 No. E-1051-83-035 and Decision No. 54843, Docket No. E-1051-84-100)
31 issued in the 1980's. The Commission did agree with the depreciation
32 reserve adjustment proposed by the Staff witnesses; but this was over
33 twenty years ago. However, with all due respect to the witnesses
34 sponsoring Staff's testimony and the Commission's past findings over
35 twenty years ago, I do not concur with and have consistently opposed that

⁴⁷ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 36, l. 21-25 quoting Direct Testimony of same witness page 26, ll. 21-24.

⁴⁸ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 36, ll. 29-38.

⁴⁹ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 37, ll. 18-21.

⁵⁰ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 37, ll. 28-30.

1 approach, regardless of the rate base impact (i.e., increasing or
2 decreasing rate base).⁵¹
3

4 **Q. WHAT IS YOUR ANALYSIS OF THIS REASONING?**

5 A. It is circular. Mr. Carver claims rate base should not be adjusted for post-test-
6 year events because they cannot affect rate base as measured at the end of
7 the test period. By definition, neither the income statement effect nor the rate
8 base effect of a post-test-year event can actually affect the test year. Mr.
9 Carver does not explain why it is appropriate to adjust the test year for the
10 income statement effect but not the rate base effect of a post-test-year event
11 that, in reality, cannot actually affect either the test year income statement or
12 the rate base. Mr. Carver never addresses why his inconsistent treatment of
13 rate base and income statement makes sense.

14 Before Utilitech was Staff's revenue requirement consultant in Arizona, the
15 Commission agreed with Staff's consultant that both the income statement
16 and rate base should be adjusted to reflect the effect of post-test-year
17 events—such as changes in depreciation rates. While Mr. Carver offers
18 several paragraphs that repeat his conclusion—that for any given post-test-
19 year event, the income statement should be adjusted and the rate base
20 should not—repeating that conclusion does make it any less illogical. Staff's
21 proposed adjustment B-7 should be rejected.

⁵¹ Docket No. T-01051B-03-0454; Surrebuttal Testimony of Steven C. Carver, p. 38, l. 30 to page 39, l. 7.

1 **Q. WHAT IS RUCO'S ARGUMENT AGAINST ADJUSTING RATE BASE FOR**
2 **A POST-TEST-YEAR CHANGE IN DEPRECIATION EXPENSE?**

3 A. Ms. Diaz Cortez argues:

4 If Qwest is allowed to restate its test year Accumulated Depreciation, as if
5 the test year depreciation had never been collected through rates, Qwest
6 will recover the test year depreciation expense twice, once in the rates
7 that were in place during the test year and again through the rates and
8 tariffs set in this docket.⁵²

9 **Q. IS THIS ARGUMENT CORRECT?**

10 A. No. Ms. Diaz Cortez is confused about the relationship between the rate
11 base in a test year and the recovery of rate base through depreciation. The
12 calculation of a rate base amount for a test year does not provide rate base
13 recovery. The test year rate base is used as a proxy or estimate of the rate
14 base that will be in effect during the rate effective period and it is used to
15 establish rates for services.

16 However, rate base is not recovered by the setting of rates in a rate case. It
17 is recovered as depreciation and amortization accruals are recorded to the
18 books of account. The amount of rate base calculated in the test year does
19 not determine the amount of depreciation expense recorded to the books of
20 account during the rate effective period. Instead the amount of depreciation
21 expense recorded on the books of account during the rate effective period is

⁵² Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez; p. 2, l. 21.

1 determined by the depreciation rates prescribed and the amount of gross
2 investment on the books of account when the depreciation accruals are
3 recorded. RUCO's Rate Base Adjustment #1, Accumulated Depreciation,
4 should be rejected.

5 **DISALLOWANCE STANDARDS**

6 ***The Commission's Disallowance Standards***

7 **Q. STAFF'S CONSULTANT ARGUES THAT TO THE EXTENT QWEST**
8 **SPONSORS A TRADITIONAL REVENUE REQUIREMENT CASE FOR**
9 **CONSIDERATION IN THIS DOCKET, EITHER THE REVENUE**
10 **REQUIREMENT SHOULD BE PREPARED USING ESTABLISHED**
11 **COMMISSION REGULATORY POLICIES OR THE COMPANY SHOULD**
12 **BEAR A BURDEN OF PROOF TO JUSTIFY ANY PROPOSED**
13 **DEPARTURE FROM SUCH POLICIES.⁵³ HOW DO YOU RESPOND?**

14 **A.** Qwest neither intended nor desired to sponsor a traditional revenue
15 requirement in this case. The price cap plan the Commission approved in
16 2001 does not call for Qwest to sponsor a traditional revenue requirement
17 filing. Qwest vigorously opposed Staff's proposal to require a Rule 103
18 revenue requirement filing in this case. This docket is a traditional revenue
19 requirement case because Staff aims to make it so.

⁵³ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 9, ll. 16-19.

1 The regulatory policies that Staff would have the Commission impose on
2 Qwest were established during the monopoly era of telecommunications in
3 Arizona that began shortly after the Commission was formed in 1912 and that
4 persisted when the Commission decided Qwest's last fully litigated rate case
5 more than 10 years ago.

6 The application of monopoly-era disallowance policies to Qwest now would
7 be prejudicial and unjust because the circumstances that gave rise to those
8 policies no longer exist.

9 **Q. WHAT CIRCUMSTANCES HAVE CHANGED SINCE THOSE POLICIES**
10 **WERE ESTABLISHED?**

11 A. A year after the Commission decided Qwest's last fully litigated rate case,
12 Congress enacted the Telecommunications Act of 1996. It included Section
13 271 which provided that Qwest's parent corporation could enter the interLATA
14 long distance business once Qwest had satisfied a "competitive checklist" that
15 contained requirements designed to open local telephone service markets to
16 competition. In September 2003 the Commission concluded as a matter of
17 law that Qwest had satisfied all the criteria for a determination that provision
18 of interLATA service by Qwest's parent was in the public interest. Among

1 those criteria was a determination that the local markets for telephone service
2 are open to competition in Arizona.⁵⁴

3 **Q. IS THERE EVIDENCE OF COMPETITION IN THE ARIZONA**
4 **TELECOMMUNICATIONS MARKETPLACE?**

5 A. Yes. Mr. Teitzel's testimony discusses at length the evidence of competition
6 in Arizona telecommunications marketplace.

7 **Q. DO CHANGES IN QWEST'S ACCESS LINE COUNTS AND FINANCIAL**
8 **PERFORMANCE ALSO DEMONSTRATE ROBUST COMPETITION IN**
9 **ARIZONA?**

10 A. Yes. Except during the Great Depression, the Company and its predecessors
11 in Arizona enjoyed continuous access line growth for the first 120 years that
12 the Company did business in Arizona. REDACTED
13 REDACTED
14 even as Arizona's population grew. Given Qwest's long history
15 of continuous access line growth, nothing except robust retail competition
16 adequately explains how Qwest could REDACTED
17 REDACTED particularly in a state with a rapidly growing
18 population.

⁵⁴ In the Matter of U.S. West Communications, Inc.'s Compliance with Section 271 of the Telecommunications Act of 1996, Docket No. T-00000A-97-0238, ACC Decision No. 66319, p. 34, ll. 6-15.

1 Wholesale access line growth also demonstrates that Qwest operates in a
2 competitive marketplace. Mr. Brosch's surrebuttal testimony observes that
3 Qwest's wholesale access lines have increased.⁵⁵ In fact, since February
4 2001 when Qwest's REDACTED Qwest's wholesale
5 access line count has REDACTED
6 Absent competition in the Arizona telecommunications marketplace none of
7 these wholesale access lines would exist. In early 1995 when the
8 Commission decided Qwest's last fully litigated rate case, Qwest had virtually
9 no wholesale access lines.

10 In the face of competition in Arizona, Qwest's Arizona return on investment
11 REDACTED as discussed in the section of
12 my rejoinder testimony entitled "Qwest's Financial Performance".

13 **Q. WHY DOES STAFF BELIEVE THAT, DESPITE A PROFOUND GROWTH IN**
14 **COMPETITION, MONOPOLY-ERA POLICIES DISALLOWING IMAGE**
15 **ADVERTISING AND INCENTIVE COMPENSATION SHOULD CONTINUE**
16 **TO BE APPLIED TO QWEST IN THIS CASE?**

17 A. In response to discovery on this question, Mr. Brosch explained: "Qwest is
18 distinct from its non-regulated competitors in being subject to cost of service

⁵⁵ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 11-12.

1 revenue and rate regulation by the ACC, as the dominant incumbent local
2 exchange carrier in the State."⁵⁶

3 Qwest also asked Mr. Brosch about the portion of his direct testimony that
4 stated that increased competition or other changed circumstances do not
5 justify inclusion of corporate advertising costs at this time. He replied:

6 As long as Qwest remains subject to regulation of its revenues and rates,
7 competitive pressures must be assumed to be insufficient to justify
8 deregulation. The corollary to this view is that Qwest will be free to seek
9 recovery of all costs (including image advertising) as well as an unlimited
10 profit in Arizona at the time competition is determined to be sufficient to
11 justify deregulation of the Company's services."⁵⁷

12 **Q. HOW DO YOU RESPOND TO MR. BROSCH'S ARGUMENT?**

13 A. It is indisputable that Qwest's competitors are not subject to cost-of-service
14 rate regulation while Qwest is. However, Staff's consultants ignore two
15 important points. First, in the 2003 test year Qwest generated over REDACTED of its
16 total Arizona unadjusted intrastate regulated revenue from flexibly-priced
17 competitive services in Basket 3 under the current Qwest Price Cap Plan.
18 Second, regulated revenues from so-called Basic/Essential Non-competitive
19 Services in Basket 1 have declined because Qwest has REDACTED
20 REDACTED since February 2001. Despite the obvious
21 competitive pressure on Qwest's retail services in Arizona, Staff's consultants

⁵⁶ Staff's response to data request No. Qwest 15-2(e) (2).

⁵⁷ Staff's response to data request No. Qwest 15-3.

1 would have the Commission impose monopoly-era disallowance policies on
2 Qwest.

3 Mr. Brosch describes Qwest as the "dominant" incumbent local exchange
4 carrier in the State. "Dominant" means "commanding, controlling or prevailing
5 over all others."⁵⁸ "Dominant" does not describe a business that: REDACTED

6 REDACTED

7 REDACTED

8 **Q. DOES BEING SUBJECT TO COST OF SERVICE REVENUE AND RATE**
9 **REGULATION BY THE COMMISSION AFFORD QWEST PROTECTION**
10 **FROM MARKET FORCES IN ARIZONA?**

11 A. Qwest asked Staff this question in discovery. Staff's answer was "no."⁵⁹
12 Clearly, Mr. Brosch's surrebuttal testimony relies on a dichotomy between
13 cost-of-service regulated firms and unregulated firms that does not
14 acknowledge, much less fully consider, the unique facts and circumstances of
15 the marketplace in which Qwest operates in Arizona. In Arizona there is not
16 one competitive marketplace for telecommunications and for cost-of-service
17 regulated firms that is protected from the competitive marketplace. There is
18 one marketplace for telephony in Arizona and it is competitive both as a
19 matter of law and as a matter of fact. In order for the interests of both

⁵⁸ Webster's Ninth New Collegiate Dictionary, © 1984. Merriam-Webster, Inc.

⁵⁹ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-8 and 22-9.

1 ratepayers and investors to be protected, the disallowance standard against
2 which Qwest's behavior should be measured must take into account that
3 Qwest has no monopoly in Arizona and, instead, competes head to head with
4 other providers of telephony.

5 The disallowance standard that protects the legitimate interests of both
6 ratepayers and investors is the standard of commercial reasonableness,
7 which is also the standard to which the behavior of Qwest's competitors is
8 held. Disallowance policies forged in the monopoly era that hold Qwest to a
9 more burdensome standard fail to protect the interests of Qwest investors to
10 recover the reasonable costs of conducting business in a competitive
11 marketplace.

12 The facts are clear: the Commission's cost of service revenue and rate
13 regulation affords Qwest no protection from competition in Arizona's
14 commercial marketplace. Staff's consultants would ignore this fact and,
15 instead, rely on cost of service ratemaking policies forged during the
16 monopoly era. Disallowance policies that presume the disallowance of
17 commercially reasonable costs afford Qwest's investors inadequate
18 protection, particularly in a manifestly competitive marketplace where prudent
19 commercial behavior is the de facto standard of reasonable conduct in
20 Arizona.

1 **Q. STAFF'S CONSULTANTS MAINTAIN THAT THE COMMISSION'S**
2 **DECISION IN A PARTICULAR RATE CASE MUST BE BASED ON THE**
3 **UNIQUE FACTS, CIRCUMSTANCES AND EVIDENCE OF THAT CASE.⁶⁰**
4 **DO YOU AGREE?**

5 A. Yes. The revenue requirement should be determined based on the particular
6 facts and circumstances attendant to the case. In the current case, whether
7 any of Qwest's test year costs should be disallowed must be determined by
8 the facts and circumstances that exist now, not the facts and circumstances
9 of the past.

10 **Q. STAFF'S CONSULTANTS ALSO CONTEND THAT THE COMMISSION**
11 **NEED NOT ESTABLISH SPECIFIC "DISALLOWANCE STANDARDS" TO**
12 **GOVERN THE DISALLOWANCE OF UTILITY COSTS.⁶¹ HOW DO YOU**
13 **RESPOND?**

14 A. As either a ratepayer or as an investor I would find this viewpoint troubling.
15 Mr. Brosch claims that the Commission "need not predetermine any specific
16 disallowance standards so as to better protect investor interests."⁶² Instead,
17 he asserts that "the Commission is only required to consider and weigh all
18 relevant evidence before determining whether any specific utility-incurred

⁶⁰ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 23, ll. 7-8.

⁶¹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 23-25.

⁶² Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 23-25

1 costs are properly included in ratemaking proceedings.”⁶³ How Staff and its
2 consultant can remain unperturbed by the lack of a balanced disallowance
3 standard is perplexing.

4 If there are no standards, how can Staff know what is “properly” included?
5 Propriety, by definition, presumes a standard of conduct. A review of all the
6 relevant facts and circumstances for cost disallowance without a clear
7 understanding of the standard by which the review is to be conducted would
8 be pointless.

9 Without standards for disallowance, how is Staff to know what facts and
10 circumstances are relevant? In the absence of balanced ratemaking
11 standards, ratemaking litigants would be left, at best, to devise their own
12 criteria for disallowance or worse, to provide evidence and arguments that
13 appeal to prejudice and bias. Fortunately, as I will explain, there is a well
14 established body of ratemaking precedents that provide a sound foundation
15 for ratemaking standards.

⁶³ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 4, ll. 25-27

1 **Q. DOES STAFF RELY ON ANY ADMINISTRATIVE RULE OR JUDICIAL**
2 **OPINION TO SUPPORT ITS PROPOSED DISALLOWANCE OF IMAGE**
3 **ADVERTISING AND INCENTIVE COMPENSATION?**

4 A. No. According to Mr. Brosch, "Staff is not relying upon any administrative rule
5 or judicial opinion in support of its proposed treatment of corporate image
6 advertising or incentive compensation..."⁶⁴ He points out that there is no
7 Commission rule that would "presume costs are reasonable" or that would
8 impose a "clear and convincing evidence" standard upon Staff in support of
9 proposed disallowances.

10 **Q. IS THERE A RULE IN ARIZONA THAT PRESUMES UTILITY COSTS ARE**
11 **REASONABLE?**

12 A. The rule the Commission promulgated into the Arizona Administrative Code is
13 that all investments shall be presumed to have been prudently made, and
14 such presumptions may be set aside only by clear and convincing evidence
15 that such investments were imprudent, when viewed in the light of all relevant
16 conditions known or which in the exercise of reasonable judgment should
17 have been known, at the time such investments were made.⁶⁵ Although the
18 Commission has not promulgated a similar rule with regard to expenses, in
19 the Company's 1985 rate case, the Commission's Decision said:
20 "Expenditures of a public utility made in the ordinary course of its business

⁶⁴ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 8, ll. 20-23.

⁶⁵ Arizona Administrative Code R 14-2-103 (l).

1 have a presumption of legitimacy. See West Ohio Gas Co. v. Pub. Util.
2 Comm. of Ohio, 294 U.S. 63 (1935).⁶⁶ In other words, the Commission,
3 relying on a time-tested U. S. Supreme Court case, concluded that
4 expenditures (which includes both investments and expenses) are presumed
5 reasonable unless shown to be otherwise. Because the Commission's
6 promulgated rule requires clear and convincing evidence to rebut the
7 presumption as it pertains to investments, there is no logical reason why the
8 same requirement for clear and convincing evidence would be inapplicable to
9 expenses.

10 **Q. DOES STAFF BELIEVE THAT ARIZONA REGULATORY**
11 **JURISPRUDENCE DOES NOT PRESUME OPERATING EXPENSE ITEMS,**
12 **SUCH AS ADVERTISING, LOBBYING, CORPORATE CONTRIBUTIONS**
13 **AND INCENTIVE COMPENSATION, TO BE REASONABLE?**

14 A. Qwest asked Staff this question in discovery. Mr. Brosch responded that he
15 had no opinion regarding what is permitted under Arizona jurisprudence.⁶⁷
16 Curiously, in response to Qwest's data request 22-3, Mr. Brosch describes
17 the review standard that I advocate as an "erroneous regulatory review
18 standard."⁶⁸

⁶⁶ Docket No. E-1051-84-100, Decision No. 54843 page 20, line 4.

⁶⁷ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-1.

⁶⁸ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-3(a).

1 **Q. UPON WHAT DO STAFF'S CONSULTANTS RELY TO JUSTIFY**
2 **PROPOSED DISALLOWANCES?**

3 A. According to Mr. Brosch, Utilitech analyzes utility expenses for disallowance
4 in many different ways, with attention given to:

- 5 1. whether the expense item in question is required to provide regulated
6 services or can instead be viewed as discretionary,
- 7 2. whether the Company can produce evidence of economic justification for
8 the amounts expended,
- 9 3. whether the expenses have been found objectionable by the regulator in
10 previous proceedings and
- 11 4. whether the expense produces any tangible benefits to the Company and
12 its customers.⁶⁹

13 Before I address each of Utilitech's review criteria in turn it is necessary to set
14 forth—as I did in direct testimony—the ratemaking principles that have been
15 widely accepted in the United States:

- 16 1. A regulatory agency is not the owner of the utility and therefore is not its
17 financial manager. A commission is not empowered to substitute its
18 judgment for that of the owners, who are responsible for the rendition of
19 service, unless the owners have abused their discretion.
- 20 2. Good faith is presumed on the part of management.
- 21 3. In the absence of a showing of inefficiency, improvidence, waste or bad
22 faith on the part of management, a commission cannot legally ignore the
23 necessary fair and reasonable expenses of operations incurred in the
24 rendition of service by the utility but must give heed to, consider and allow

⁶⁹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, ll. 4-11. Mr. Carver articulates a combination of these criteria that he would apply to incentive compensation costs: "[T]he utility is expected to demonstrate that certain discretionary costs do results in tangible benefits to ratepayers or should otherwise provide adequate justification to support cost recovery." Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 46, ll. 2-4.

1 all such expenses constituting charges upon income during the term of the
2 regulation.

3 4. Only where affirmative evidence is offered challenging the reasonableness
4 of the operating expenses incurred, on the ground that they are exorbitant,
5 unnecessary, wasteful, extravagant, or incurred in the abuse of discretion
6 or in bad faith, or are of a nonrecurring character not likely to recur in the
7 future, does a commission have reasonable discretion to disallow any part
8 of the expenses actually incurred.⁷⁰

9 **Q. PLEASE ADDRESS UTILITECH'S FIRST CRITERION: WHETHER THE**
10 **EXPENSE ITEM IN QUESTION IS REQUIRED TO PROVIDE REGULATED**
11 **SERVICES OR CAN INSTEAD BE VIEWED AS DISCRETIONARY.**

12 A. As set forth above, widely accepted ratemaking principles presume that costs
13 are discretionary. This presumption is appropriate because all costs are
14 incurred at the discretion of management. Hence the appropriate test is not
15 whether there was a cost that was discretionary, but whether management
16 abused its discretion by incurring the cost. The fact that a cost is
17 discretionary is not, by itself, an appropriate test for disallowance.

18 Merely inquiring whether a cost is necessary to the provision of regulated
19 services does not adequately protect the interests of investors. A regulated
20 firm must do more than simply provide regulated services. For example, it
21 must pay taxes, comply with various laws, represent itself in front of
22 regulators, participate in litigation brought by it and against it, advertise, and,

⁷⁰ *Alabama Public Serv. Comm'n v. Southern Bell Tel. & Tel. Co.*, 253 Ala. 1, 42 So.2d 655, 84 P.U.R. (n.s.) 221, (1949). Cited in Priest, *Principles of Public Utility Regulation* (1969) p. 50.

1 because it is subject to heavy regulation, actively participate in the legislative
2 processes that affect its business. Investors can only be protected from
3 confiscatory rates if the question asked is whether a particular cost is
4 necessary and reasonable in the operation of the firm that provides regulated
5 services.

6 **Q. PLEASE ADDRESS THE SECOND CRITERION: WHETHER THE**
7 **COMPANY CAN PRODUCE EVIDENCE OF ECONOMIC JUSTIFICATION**
8 **FOR THE AMOUNTS EXPENDED.**

9 A. Mr. Brosch explains the process this way: "Staff has applied ACC precedent
10 as well as the other criteria described in its Direct Testimony to certain costs
11 and challenged Qwest to justify the rate case inclusion of such costs. Qwest
12 then has the opportunity and responsibility to respond to this challenge in its
13 Rebuttal, in hearings and in briefing to support the reasonableness of rate
14 case recovery of such costs."⁷¹ (emphasis added) Mr. Carver asserts: "Once
15 a ratemaking adjustment is proposed, Qwest then has an opportunity and
16 responsibility to respond in order to support the reasonableness of rate case
17 recovery of such costs."⁷² (emphasis added)

18 Utilities can have no quarrel with challenges based on evidence of a failure to
19 meet a just disallowance standard. However, where the challenge is based

⁷¹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 8, ll. 26-30.

⁷² Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 43, ll. 22-24.

1 on no particular disallowance standard—as Utilitech admits its challenges
2 are—the asserted “responsibility to respond” to such arbitrary challenges is
3 an unjustifiable attempt to shift the burden of proof to the utility and make it
4 defend business practices that no evidence has shown to unreasonable.

5 **Q. WHY DO YOU SAY STAFF’S CHALLENGES ARE ARBITRARY AND**
6 **BASED ON NO PARTICULAR DISALLOWANCE STANDARD?**

7 A. In discovery Qwest asked Staff if any of the “other criteria” described in the
8 direct testimony filed on behalf of Staff relied on a standard of disallowance
9 that compares Qwest’s costs to commercially reasonable costs (i.e. costs that
10 would be considered reasonable and prudent by competent managers of
11 unregulated large commercial enterprises). Staff’s answer was in the
12 negative.⁷³

13 **Q. DOES UTILITECH ATTEMPT TO SHIFT THE BURDEN OF PROOF TO**
14 **QWEST IN THIS CASE?**

15 A. Yes. In this case Utilitech seeks to shift the burden of proof to Qwest with
16 challenges that are either 1) not relevant to the question of reasonableness or
17 2) not based on substantial evidence or 3) both. For example, consider Mr.
18 Carver’s challenges to Qwest’s incentive compensation expense:

19 First, a significant portion of Qwest’s Bonus Plan is linked to the corporate-
20 wide financial results of Qwest Communications International, Inc.

⁷³ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-3.

1 (“QCII”). Second, Qwest’s Arizona employees have limited ability or
2 opportunity to materially affect the consolidated financial results of QCII.
3 (footnote omitted) Third, during calendar years 2001 through 2003, the
4 consolidated financial results of QCII were dismal – generating over \$40
5 billion dollars of net losses during this three year period. Fourth, QCII was
6 only able to show positive net income in 2003 because of the sale of its
7 directory publishing business, while reporting a loss from continuing
8 operations. (footnote omitted).⁷⁴

9 Mr. Carver’s challenges go to defects that he perceives in Qwest’s bonus
10 plan. However, none of these perceived defects go to the question of
11 whether the amount of employee compensation that Qwest paid or the
12 incentive compensation plan that Qwest used in the test year were
13 commercially reasonable. For example, why would QCII’s consolidated
14 financial results during calendar years 2001 through 2003 have any bearing
15 on the reasonableness of the amount Qwest paid in employee compensation
16 during the test year or the reasonableness of the design of its incentive
17 compensation plan? Why would an incentive compensation plan in which
18 “Arizona employees have the ability to materially impact the consolidated
19 financial results of QCII” be reasonable while a plan that lacks this
20 characteristic would not be? These challenges are plainly arbitrary. As it
21 pertains to the relevant question regarding disallowance—whether Qwest’s
22 employee compensation costs were reasonable—Mr. Carver’s challenges are
23 irrelevant.

⁷⁴ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 42, ll. 9-16.

1 **Q. IS THE SAME FLAW FOUND IN THE ARGUMENTS AGAINST IMAGE**
2 **ADVERTISING THAT MR. BROSCH MAKES?**

3 A. Yes. Mr. Brosch offered several "reasons why corporate image advertising
4 should not be included in Qwest's Arizona Intrastate ratemaking expenses
5 that are recoverable from ratepayers." Several were based on Mr. Brosch's
6 opinion regarding marketing and advertising, a subject upon which he lacks
7 expertise.⁷⁵ Others were based on speculation.⁷⁶ As such, all were arbitrary.
8 The ratemaking process in Arizona is not well served when utilities are made
9 to bear the burden of answering to challenges based on irrelevant issues,
10 unsubstantiated opinion of non-experts, and speculation.

⁷⁵ These include:

- Expenditures made to promote favorable public opinion, such as charitable contributions, image advertising and event sponsorship are discretionary costs that are not required to provide regulated services and provide no tangible direct benefit to the Company.
- Image advertising is no substitute for consistent provision of high quality regulated services and simply providing good service at reasonable rate levels will contribute to favorable public opinion with no need for self promotion within image advertising. --If the reputation of a regulated entity has been harmed by poor service quality or questionable business practices, customers of regulated services should not be required to bear image advertising costs designed to improve the corporate image.
- Image advertising is redundant to product specific advertising that is used by telephone companies to promote specific services - product specific advertising can be used to maintain public awareness of the availability and value associated with using regulated products and services.

⁷⁶ These include:

- Promotion of the corporate brand or image may provide a subsidy for non-regulated services offered by corporate affiliates as a result of either the incurrence of costs not needed for the regulated business or because of excessive allocation of such costs to the regulated entity.
- Test year image advertising cost levels were increased relative to prior years, in an apparent effort to enhance Qwest's reputation, credibility and image after experiencing widely publicized financial difficulties, accounting investigations and senior management turnover.

1 **Q. PLEASE ADDRESS THE THIRD CRITERION: WHETHER THE EXPENSES**
2 **HAVE BEEN FOUND OBJECTIONABLE BY THE REGULATOR IN**
3 **PREVIOUS PROCEEDINGS.**

4 A. Mr. Brosch explains Utilitech's position this way:

5 [I]t is my opinion that the revenue requirement should be prepared using
6 established Commission regulatory policies or that the Company [should]
7 bear a burden of proof to justify any proposed departure from such
8 policies.⁷⁷

9 This position squarely conflicts with the axiom that a commission's decision in
10 a particular rate case must be based on the unique facts, circumstances and
11 evidence of that case.⁷⁸ A standing policy of disallowance of ordinary
12 business expenses is a finding of fact prior to any presentation of facts. It is,
13 by its very nature, prejudicial. It does not protect the interest of investors
14 because it presumes that by incurring a cost a utility was intrinsically
15 unreasonable or dishonest or wasteful. The presumption that costs are
16 imprudent is contrary both to well established ratemaking principles and to the
17 Commission's own statement that, "Expenditures of a public utility made in
18 the ordinary course of its business have a presumption of legitimacy."⁷⁹

19 The Commission should hold all of the parties to a just disallowance standard
20 that provides balanced protection to ratepayers and investors.

⁷⁷ Docket No. T-01051B-03-0454; Direct Testimony of Michael L. Brosch, p. 9, ll. 17-19.

⁷⁸ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 23, ll. 7-8.

⁷⁹ Docket No. E-1051-84-100, Decision No. 54843 page 20, line 4.

1 **Q. PLEASE ADDRESS UTILITECH'S FOURTH CRITERION: WHETHER THE**
2 **EXPENSE PRODUCES ANY TANGIBLE BENEFITS TO THE COMPANY**
3 **AND ITS CUSTOMERS.**

4 A. The criterion articulated in the question is set forth in Mr. Brosch's rebuttal
5 testimony. Mr. Carver invokes the same criterion but states it differently:
6 "[R]egulators need not allow recovery of all discretionary costs incurred by a
7 utility, absent a showing that such costs provide direct, tangible benefits to
8 ratepayers."⁸⁰ (emphasis added) The differences are that Mr. Carver 1) adds
9 the requirement that the benefits be direct and 2) makes no allowance for
10 benefits to the Company. Neither Mr. Carver nor Mr. Brosch rely on the
11 precise criteria Mr. Brosch articulates for a proposed disallowance but Mr.
12 Carver relies on his rendition of the criterion to support his proposed
13 disallowance of incentive compensation costs. Moreover, Utilitech routinely
14 relies on the direct-tangible-benefit-to-ratepayers criteria in Arizona.⁸¹
15 Consequently I will address my comments to the direct-tangible-benefits-to-
16 ratepayers version upon which Mr. Carver relies instead of the somewhat
17 softened version that Mr. Brosch articulates.

⁸⁰ Docket No. T-01051B-03-0454, Surrebuttal of Steven C. Carver, p. 43, ll. 11-13 quoting Direct Testimony of Steven C. Carver, p. 40.

⁸¹ Docket No. T-01051B-99-105, Direct Testimony of Steven C. Carver, p. 106 ll. 15-18. Docket No. E-01345A-03-0437, Direct Testimony of James R. Dittmer, p. 37, l. 35 to p. 38, l. 1. Docket No. E-01345A-03-0437, Direct Testimony of Steven C. Carver, p. 63 ll. 18-20. Docket No. E-1051-93-183, Direct Testimony of Michael L. Brosch, p. 127, l. 11 which reads: "In my opinion, legislative affairs cost do not provide tangible benefits to telephone ratepayers, sufficient to justify the recovery..."

1 My direct testimony explains why the direct-tangible-benefit-to-ratepayers
2 criterion is unjust to investors.⁸² A direct-tangible-benefit-to-ratepayers
3 criterion cannot be reconciled with a regulated entity's right under Arizona law
4 to charge regulated rates that provide a reasonable opportunity to recover its
5 costs and a fair rate of return on its rate base. A wide and abundant variety of
6 prudent, reasonable and necessary costs incurred at the discretion of
7 management in the operation of a regulated entity provide no direct, tangible
8 benefit to ratepayers. Examples of such costs include:

- 9 a) Employees' paid vacations and sick leave;
- 10 b) Employees' healthcare benefits;
- 11 c) Employees' retirement savings plan benefits;
- 12 d) Employees' post employment benefits;
- 13 e) Employee training expenses;
- 14 f) Cost of compliance with immigration laws;
- 15 g) Cost of compliance with environmental laws;
- 16 h) Cost of compliance with safety laws;
- 17 i) Cost of compliance with and workers' compensation laws;
- 18 j) Costs of operating Qwest's accounts receivable department;
- 19 k) Costs of operating Qwest's accounts payable department;
- 20 l) Costs of operating Qwest's customer billing department;
- 21 m) Costs of operating Qwest's customer credit department;
- 22 n) Costs of operating Qwest's legal department;
- 23 o) Costs of operating Qwest's tax department;
- 24 p) Costs of operating Qwest's human resources department;
- 25 q) Costs of operating Qwest's risk management department; and
- 26 r) Costs of operating Qwest's real estate department.

27 In surrebuttal, Mr. Brosch argues these costs "are representative of costs that
28 do provide tangible, direct benefits to the Company and its ratepayers."⁸³

⁸² Docket No. T-01051B-03-0454; Direct Testimony of Philip E. Grate, pp. 21-22.

⁸³ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, l. 17 to p. 8, l. 9.

1 When asked in discovery to identify and explain how each of the following
2 costs provides benefits to ratepayers that are both tangible and direct, Mr.
3 Brosch replied that with regard to employee benefit costs, (listed item items a
4 through e), "it is obvious that... these elements of...compensation...represent
5 costs associated with human resources that are of direct tangible benefit to
6 Qwest customers." Mr. Brosch described the cost of compliance with laws as
7 essential and non-discretionary and the various departmental costs as
8 essential business functions that provide tangible benefits to the Company
9 and its customers. He argued that all such costs were distinguishable from
10 corporate image advertising and incentive compensation costs but offered no
11 reason why this was so except to say that image advertising and incentive
12 compensation were "largely discretionary and subject to heightened
13 regulatory scrutiny...as a matter of regulatory policy."⁸⁴

14 **Q. DO YOU AGREE?**

15 A. No. Mr. Brosch's analysis is purely rhetorical. It makes distinctions without a
16 meaningful difference. If customers receive a direct, tangible benefit from the
17 dollar of pay an employee receives as vacation pay or sick leave or life
18 insurance or retirement, they receive no greater or less benefit from that
19 employee for the dollar she receives as incentive compensation. If the listed
20 departmental expenses provide the Company and its customers a direct

⁸⁴ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-2.

1 tangible benefit, so too does image advertising aimed at generating greater
2 sales.

3 In other words, if the costs listed above satisfy the direct-tangible-benefit-to-
4 ratepayers test, incentive compensation and image advertising would also,
5 and for the same reason. If incentive compensation and image advertising
6 fail the direct-tangible-benefit-to-ratepayers test, so too would all of these
7 costs.

8 Uniform application of the direct-tangible-benefits-to-ratepayers criterion
9 would render all of the listed costs unrecoverable despite the absence of
10 evidence that they are commercially unreasonable. However, Utilitech does
11 not use apply the criterion uniformly.

12 **Q. HOW DOES UTILITECH USE OF THE DIRECT-TANGIBLE-BENEFITS-TO-**
13 **RATEPAYERS CRITERION?**

14 A. Selectively. Their testimony explains their use of this criterion as follows:

15 Q....Is "direct tangible benefit to ratepayers" the sole criteria used by
16 Utilitech to determine which operating expenses should be allowed or
17 disallowed?

18 A. No.⁸⁵

19 Utilitech has not proposed to apply this approach to all costs Qwest incurs,
20 instead limiting its disallowance recommendations to areas that regulators
21 often find problems with rate case recovery.⁸⁶

⁸⁵ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, ll. 2-4.

1 This highly selective use of the criterion masks its defect. Utilitech applies the
2 tangible-benefit-to-ratepayers criterion surgically to a few issues likely to
3 appeal to pre-existing prejudice and biases against commercially reasonable
4 but socially or politically unpopular business activities. Such activities include
5 spending money to enhance a business' image in the public, providing
6 variable compensation based on business success, and involving the utility in
7 the legislative process. These commercially reasonable but emotionally
8 unpopular costs are targets of opportunity against which Utilitech selectively
9 employs its tangible-benefit-to-ratepayers device.

10 **Q. DOES STAFF HAVE ANY EVIDENCE THAT IN ESTABLISHING REVENUE**
11 **REQUIREMENT UNDER COST OF SERVICE RATEMAKING, THE**
12 **FEDERAL COMMUNICATIONS COMMISSION DISALLOWS TEST YEAR**
13 **COSTS FOR THE REASON THAT THE DISALLOWED COSTS PROVIDE**
14 **RATEPAYERS NO DIRECT TANGIBLE BENEFIT?**

15 A. No.⁸⁷

16 **Q. DO YOU HAVE ANY OTHER COMMENTS ABOUT UTILITECH'S**
17 **ANALYSIS CRITERIA?**

18 A. Mr. Brosch explains that Utilitech analyzes utility expenses for disallowance in
19 "many different ways."⁸⁸ Qwest is concerned whether these many ways serve

⁸⁶ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 43, l. 11

⁸⁷ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-9.

1 an agenda that does not equally prioritize protecting Qwest's investors with
2 protecting ratepayers. Given Staff's role as the investigatory arm of the
3 Commission, Qwest believes Staff's consultant should articulate and follow a
4 disallowance standard that provides Qwest some level of assurance that Staff
5 aims to equally protect the interests of ratepayers and shareholders.

6 ***Incentive Compensation Costs (Staff C-17; RUCO OA#9)***

7 **Q. DOES MR. CARVER HAVE ANY QUALIFICATIONS TO EVALUATE THE**
8 **REASONABLENESS OF THE PERFORMANCE CRITERIA IN QWEST'S**
9 **INCENTIVE COMPENSATION PLANS FROM THE PERSPECTIVE HELD**
10 **BY AN EMPLOYEE COMPENSATION EXPERT?**

11 A. According to Staff's response to discovery, the answer is no.⁸⁹

12 **Q. DOES STAFF HAVE ANY EVIDENCE DEMONSTRATING THAT THE**
13 **FEDERAL COMMUNICATIONS COMMISSION HAS EVER RELIED ON**
14 **THE PROPOSITION THAT THE PARTY WHO BENEFITS FROM A**
15 **PARTICULAR TRANSACTION OR ACTIVITY SHOULD BEAR THE**
16 **RELATED FINANCIAL BURDEN AS JUSTIFICATION TO DISALLOW**
17 **INCENTIVE COMPENSATION COSTS FOR RATEMAKING PURPOSES?**

18 A. According to Staff's response to discovery, the answer is no.⁹⁰

⁸⁸ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 7, ll. 4-5.

⁸⁹ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-4.

⁹⁰ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 25-5.

1 **Q. DOES STAFF HAVE EVIDENCE TO SHOW THAT QWEST'S**
2 **UNADJUSTED REVENUE REQUIREMENT BASED ON THE 2003 TEST**
3 **YEAR WOULD HAVE BEEN GREATER HAD THE AMOUNTS PAID OUT**
4 **UNDER THE 2003 BONUS PLAN BEEN PAID INSTEAD AS BASE**
5 **SALARY?**

6 A. According to Staff's response to discovery, the answer is no.⁹¹

7 **Q. DOES STAFF HAVE EVIDENCE TO SHOW THAT THE LEVEL OF**
8 **QWEST'S MANAGEMENT COMPENSATION, INCLUDING BASE SALARY,**
9 **INCENTIVE COMPENSATION AND NON-CASH BENEFITS IN THE TEST**
10 **YEAR, WAS UNREASONABLE WHEN COMPARED WITH THE LEVELS**
11 **OF COMPENSATION PAID IN THE PREVAILING LABOR MARKET IN THE**
12 **UNITED STATES?**

13 A. According to Staff's response to discovery, the answer is no.⁹²

14 **Q. DOES STAFF AND ITS CONSULTANTS HAVE EVIDENCE TO SHOW**
15 **THAT QWEST EMPLOYEES' PURSUIT OF 2003 BONUS PLAN**
16 **PERFORMANCE TARGETS CAUSED RATEPAYERS DIRECT TANGIBLE**
17 **HARM?**

18 A. According to Staff's response to discovery, the answer is no.⁹³

⁹¹ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-6.

⁹² See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-7.

⁹³ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 23-9.

1 **Q. DOES MR. CARVER'S DIRECT OR SURREBUTTAL TESTIMONY SHOW**
2 **THAT THE INCENTIVE COMPENSATION EXPENSE IN QWEST'S TEST**
3 **YEAR IS COMMERCIALY UNREASONABLE?**

4 A. No.

5 **Q. DOES MR. CARVER'S DIRECT OR SURREBUTTAL TESTIMONY SHOW**
6 **THAT THE INCENTIVE COMPENSATION EXPENSE IN QWEST'S TEST**
7 **YEAR IS INJURIOUS TO RATEPAYER INTERESTS?**

8 A. No. None of the reasons Mr. Carver argues for disallowing Qwest's incentive
9 compensation costs explain how they represent a utility's financial exploitation
10 of its position in the marketplace from which ratepayers require protection.

11 **Q. WAS QWEST OBLIGATED UNDER AN AGREEMENT WITH ITS UNIONS**
12 **TO PAY THE INCENTIVE COMPENSATION COSTS TO ITS UNION**
13 **EMPLOYEES?**

14 A. Yes. The letter of agreement between the Communications Workers of
15 America and the Company provided—in its entirety—as follows:

16 Addendum 7 of the 2003 collective bargaining agreement between
17 Communications Workers of America and Qwest Corporation
18 describes a lump sum payment opportunity for occupational
19 employees for 2004 and 2005. The Company acknowledges that it
20 will not permit a situation in 2004 or 2005 in which the management
21 bonus would pay out while the occupational Lump Sum Payment
22 set forth in Addendum 7 would not.

1 Under this letter of agreement, Qwest was obligated to pay the occupational
2 Lump Sum payment when Qwest paid out the management bonus.

3 **Q. WHAT DO YOU CONCLUDE ABOUT MR. CARVER'S PROPOSED**
4 **DISALLOWANCE OF QWEST'S INCENTIVE COMPENSATION COSTS?**

5 A. Mr. Carver challenges Qwest's incentive compensation costs based on
6 criteria and arguments that do not go to the question of whether ratepayers'
7 interests are compromised. None of his arguments so much as pretends to a
8 concern for investors' interests. As explained in the affidavit of Felicity
9 O'Herron attached as an exhibit to my rebuttal testimony,⁹⁴ Qwest's incentive
10 compensation plan is reasonable and the amount it pays its employees in
11 incentive compensation in total is reasonable. Adjustment C-17 should be
12 rejected.

13 **Q. MS. DIAZ CORTEZ ASSERTS THAT "BY DEFINITION," QWEST'S**
14 **"INCENTIVE COMPENSATION REWARDS ARE UNREASONABLE**
15 **EXPENSES WHEN THE COMPANY OPERATED AT A LOSS, YET**
16 **REWARDED ITS EMPLOYEES ANYWAY."⁹⁵ DO YOU AGREE?**

17 A. No. Ms. Diaz Cortez is not an incentive compensation expert or an expert in
18 the management of a corporation with tens of thousands of employees. As
19 the affidavit of Felicity O'Herron makes clear, the design of Qwest's 2003

⁹⁴ Qwest Corporation—Exhibit PEG-R12.

⁹⁵ Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez, p. 14, ll. 10-12.

1 Bonus Plan was both prudent and reasonable. Payout was made under the
2 terms of the plan, which was not a profit sharing plan. Qwest's board of
3 directors approved the payout.

4 Ms. Diaz Cortez's criticisms of the plan and Qwest's decision to pay out under
5 it should be disregarded and her proposed operating adjustment #9 should be
6 rejected.

7 ***Marketing and Advertising Costs (Staff C-9)***

8 **Q. DOES MR. BROSCH CONTINUE TO MAINTAIN THAT QWEST'S IMAGE**
9 **ADVERTISING COSTS ARE SIGNIFICANTLY HIGHER THAN NORMAL IN**
10 **THE TEST YEAR?**

11 A. Apparently so. In direct testimony Mr. Brosch argued:

12 Test year image advertising cost levels were increased relative to prior
13 years, in an apparent effort to enhance Qwest's reputation, credibility and
14 image after experiencing widely publicized financial difficulties, accounting
15 investigations and senior management turnover.⁹⁶

16 My rebuttal testimony identified errors in his schedule of image advertising. In
17 rebuttal Mr. Brosch argues:

18 [A]fter correction, it is still obvious that both recorded and adjusted Brand

⁹⁶ Docket No. T-01051B-03-0454; Direct Testimony of Michael L. Brosch, p. 13, ll. 9-12.

1 Advertising amounts were larger in 2003 relative to 2002 and that a
2 reasonable overall level of "Allowable Advertising" results after
3 implementation of Staff's proposed adjustment.⁹⁷

4 **Q. WERE QWEST'S IMAGE ADVERTISING COSTS SIGNIFICANTLY HIGHER**
5 **THAN NORMAL IN THE TEST YEAR?**

6 A. No. Following is a schedule showing the correct amounts of product
7 advertising and image advertising over the four-year period 2000 to 2003 and
8 the three-quarters ending October 2004 annualized.

Arizona Advertising Costs by Category (\$000)

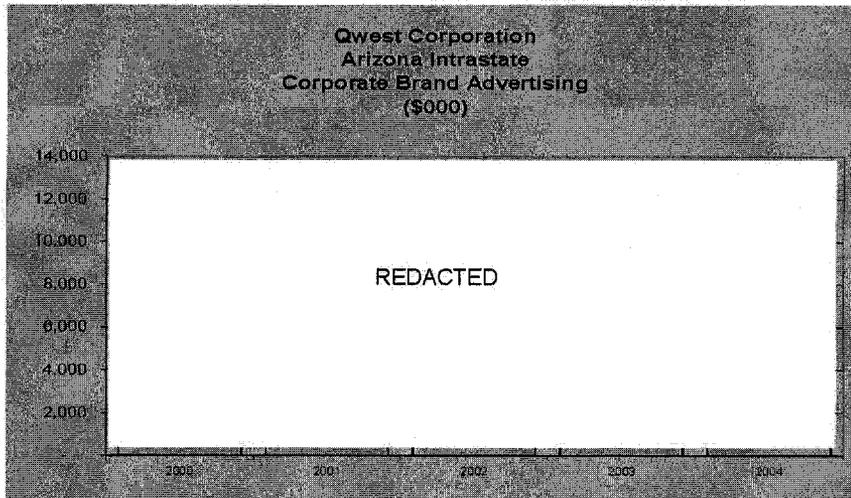
	2000	2001	2002	2003*	Oct 2004 Annualized
	REDACTED				
	REDACTED				
	REDACTED				

9 With regard to this data Mr. Brosch makes the following observation:

10 Corporate Brand Advertising is much larger in the 2003 test year than in
11 2002, as Qwest's financial difficulties, accounting investigations and senior
12 management turnover started to be widely publicized. Brand Advertising
13 expenses are also slightly higher in 2003 than the average expense levels
14 for 2000 through 2002.⁹⁸

15 These observations, while true, are strikingly misleading. The following graph
16 charts image advertising costs over the four and three quarter year period of
17 the data. The nine months of 2004 data are annualized.

⁹⁷ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 11, ll. 5-8.
⁹⁸ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 10, ll. 18-22.



1

2

The graph reveals that corporate brand (image) advertising in 2003 was

3

greater than 2002, just as Mr. Brosch claims. However, it also reveals that

4

image advertising costs in 2002 were REDACTED

5

REDACTED

6

REDACTED

7

Q. WHY WERE QWEST'S IMAGE ADVERTISING COSTS SO MUCH LESS IN

8

2002?

9

A. I am not certain of the reasons for the unusually low level of image advertising

10

costs in 2002 but I would note that in June, 2002 Richard C. Notebaert

11

replaced Joseph P. Nacchio as Qwest's chairman and chief executive officer.

12

Under Mr. Notebaert, the Corporation changed its brand image from a

13

technology focus with its "ride the light" slogan to a commitment to "The Spirit

1 of Service™” Mr. Notebaert explained The Spirit of Service in a letter to
2 shareholders in Qwest’s 2002 annual report as follows:

3 **Cultural Transformation**

4 How has Qwest achieved such progress despite the headwind created by
5 a tough economic climate, significant industry challenges, and substantial
6 energies directed toward research and remedying previous corporate
7 issues? Part of the answer lies in a remarkable transformation in
8 corporate culture—a transformation embraced by Qwest employees,
9 welcomed by Qwest customers, encouraged by constituencies from our
10 unions to our regulators and celebrated by our communities.

11 The foundation of this new culture is our Spirit of Service. A valued part of
12 our heritage, this focus also has critical implications for our future. It
13 demands, for instance, that we see the world through the eyes of our
14 customers—in the end, the only viewpoint that really counts. The Spirit of
15 Service commends Qwest’s commitment to transparency and the highest
16 ethical behavior in every area of our business. And it mandates vigorous
17 re-engagement in the life and success of the communities where we do
18 business.⁹⁹ (emphasis added)

⁹⁹ Letter addressed “Dear Fellow Qwest Stockholders” signed Richard C. Notebaert, Chairman and Chief Executive Officer, October, 16, 2003 printed immediately inside the front cover of the 2002 Annual Report of Qwest Communications International, Inc.

1 **Q. DOES MR. BROSCH BELIEVE THAT ARIZONA REGULATORY**
2 **JURISPRUDENCE IMPOSES ON THE UTILITY THE BURDEN OF PROOF**
3 **TO SHOW WHY IMAGE ADVERTISING SHOULD NOT BE DISALLOWED**
4 **AND PERMITS DISALLOWANCE OF IMAGE ADVERTISING IN**
5 **RATEMAKING UNLESS A UTILITY MEETS A BURDEN OF PROVIDING**
6 **ECONOMIC JUSTIFICATION FOR IT?**

7 A. Qwest asked these questions in discovery. Mr. Brosch declined to provide
8 any opinion in response.¹⁰⁰

9 **Q. DO STAFF'S CONSULTANTS BELIEVE THAT ARIZONA REGULATORY**
10 **JURISPRUDENCE IMPOSES ON THE UTILITY THE BURDEN OF**
11 **PROVING THAT ITS IMAGE ADVERTISING IS EFFECTIVE, THE BURDEN**
12 **OF PROVING THAT ITS IMAGE ADVERTISING IS REASONABLE AND**
13 **THE BURDEN OF PROVING THAT ITS IMAGE ADVERTISING IS COST**
14 **EFFECTIVE.**

15 A. Qwest asked these questions in discovery. Mr. Brosch declined to provide
16 any opinion in response.¹⁰¹

17 **Q. DOES STAFF BELIEVE THAT IT HAS OFFERED EXPERT OPINION**
18 **SHOWING THAT QWEST'S TEST YEAR IMAGE ADVERTISING**

¹⁰⁰ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-5 and 22-6(a).

¹⁰¹ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(b), (c) and (d).

1 **EXPENDITURES WERE COMMERCIALY UNREASONABLE OR**
2 **WASTEFUL OR IMPRUDENT?**

3 A. Qwest asked this question in discovery. Staff declined to provide any
4 substantive answer responsive to the question.¹⁰²

5 **Q. HAS STAFF OFFERED SUBSTANTIAL COMPARATIVE DATA SHOWING**
6 **THAT QWEST'S TEST YEAR IMAGE ADVERTISING EXPENDITURES**
7 **WERE COMMERCIALY UNREASONABLE OR WASTEFUL OR**
8 **IMPRUDENT OR INEFFECTIVE?**

9 A. I am not aware of any. Qwest asked this question in discovery. Staff
10 declined to provide any substantive answer responsive to the question.¹⁰³

11 **Q. HAS STAFF OFFERED EXPERT OPINION SHOWING THAT COMPARED**
12 **TO COMMERCIAL STANDARDS OF CONDUCT, QWEST'S TEST YEAR**
13 **IMAGE ADVERTISING EXPENDITURES WERE COMMERCIALY**
14 **UNREASONABLE OR WASTEFUL OR IMPRUDENT OR INEFFECTIVE?**

15 A. I am not aware of any. Qwest asked this question in discovery. Staff
16 declined to provide any substantive answer responsive to the question.¹⁰⁴

¹⁰² See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(e).

¹⁰³ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(f).

¹⁰⁴ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(g).

1 **Q. DOES STAFF KNOW PRECISELY THE STANDARD OF REVIEW THAT**
2 **APPLIES TO THE INCLUSION OF AN ARIZONA UTILITY'S IMAGE**
3 **ADVERTISING IN CALCULATING THE COST OF SERVICE FOR**
4 **PURPOSES OF ESTABLISHING REVENUE REQUIREMENT?**

5 A. Qwest asked Staff this question in discovery. Staff indicated that it did not
6 know what the precise standard of review was.¹⁰⁵

7 **Q. DOES STAFF KNOW WHAT BURDEN OF PROOF ARIZONA UTILITIES**
8 **MUST BEAR IN ORDER TO INCLUDE IMAGE ADVERTISING COSTS IN**
9 **THE CALCULATION OF COST OF SERVICE FOR PURPOSES OF**
10 **ESTABLISHING REVENUE REQUIREMENT?**

11 A. Qwest asked Staff this question in discovery. Staff did not answer the
12 question asked but instead reiterated its position that Qwest must "convince
13 the Commission that changed circumstances now warrant revision of past
14 regulatory policy in Arizona that excluded corporate image advertising costs.
15 Staff offered no authority in support of its position."¹⁰⁶

16 **Q. MR. BROSCH ARGUES THAT THE COMMISSION'S REGULATORY**
17 **POLICY OF DISALLOWING IMAGE ADVERTISING SHOULD NOT BE**
18 **CHANGED MERELY BECAUSE IMAGE ADVERTISING PROMOTES AND**

¹⁰⁵ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(h).

¹⁰⁶ See Qwest Corporation—Exhibit PEG-RJ08, Staff response to Data Request No. Qwest 22-6(i).

1 circumstances and evidence of this case, Mr. Brosch argued that changes in
2 the degree of competition should be disregarded and monopoly-era
3 disallowance policy used instead.

4 In surrebuttal, Mr. Brosch finally acknowledges Qwest's competitive losses
5 but only to observe that "Qwest's product and image advertising efforts and
6 costs have been relatively ineffective at increasing or even sustaining sales of
7 intrastate regulated products and services."¹⁰⁹ (emphasis added). This claim
8 is as obvious as it is specious. Mr. Brosch has presented no evidence that
9 Qwest's product and image advertising was ineffective or wasteful. He has
10 no facts or analysis showing that had Qwest not incurred the image
11 advertising costs he seeks to disallow, Qwest's test year financial
12 performance would have been better overall.

13 Much more importantly, the test for reasonableness cannot rely on a
14 retrospective analysis of management's decisions. With 20-20 hindsight it is
15 far too easy to engage in Monday morning quarterbacking. The question must
16 be whether, given the information available to management at the time it
17 made a decision to incur a cost, a reasonable and prudent manager would
18 have incurred the cost. Judging advertising costs by whether or not the
19 advertising was successful cannot be reasonable unless one can show that

¹⁰⁹ Docket No. T-01051B-03-0454; Surrebuttal of Michael L. Brosch, p. 12, ll. 10-12.

1 reasonable and prudent managers rarely or never incur unsuccessful
2 advertising expenditures.

3 **Q. MR. BROSCH ARGUES THAT QWEST'S IMAGE ADVERTISING SHOULD**
4 **BE DISALLOWED BECAUSE QWEST HAS OFFERED NO EVIDENCE OR**
5 **PROOF OF COST-EFFECTIVENESS OR REASONABLENESS FOR THE**
6 **IMAGE ADVERTISING INCLUDED IN THE TEST YEAR. PLEASE**
7 **RESPOND.**

8 A. As will be discussed in Qwest's legal brief, the burden of disallowance falls to
9 those who would disallow a cost, and the decision to disallow must be made
10 against a disallowance standard that protects the interests of investors as well
11 as the interests of ratepayers. Mr. Brosch has presented no facts, data or
12 evidence showing Qwest's image advertising costs were commercially
13 unreasonable. Instead he invokes a monopoly-era disallowance policy that is
14 *ipso facto* prejudicial. He also argues that Qwest should bear the burden of
15 proving the reasonableness of its costs against a disallowance standard that
16 is, at best, undefined and at worst, nonexistent.

17 My direct, rebuttal and rejoinder testimony and that of Mr. Teitzel provide
18 extensive evidence documenting the competition that Qwest faces in Arizona.
19 Exhibit PEG-R12 to my rebuttal testimony is the affidavit of a marketing
20 expert that shows why Qwest's image advertising is reasonable and prudent

1 and why the arguments in Mr. Brosch's rebuttal testimony against it are
2 incorrect and reveal his lack of marketing expertise. In light of this, the
3 Commission should reject Mr. Brosch's proposed adjustment C-9.

4 **OTHER REVENUE REQUIREMENT ISSUES**

5 ***DSL (Staff B-3, C-6)***

6 **Q. MR. DUNKEL'S SURREBUTTAL ADDRESSES IN GREAT DETAIL THE**
7 **DIRECT ASSIGNMENT OF DSL-RELATED COSTS AND ASSERTS THAT**
8 **QWEST IS NOT COMPLYING WITH THE REQUIREMENTS OF THE FCC'S**
9 **SEPARATIONS FREEZE ORDER.¹¹⁰ IS THERE ANY MERIT TO THESE**
10 **ARGUMENTS?**

11 A. No. Repeating the same argument he made in his rebuttal, Mr. Dunkel
12 asserts Qwest should be directly assigning DSL-related investment and
13 associated expenses to the interstate jurisdiction under the Separations
14 Freeze. This argument is incorrect.

15 There is no question that Qwest has not "directly" assigned DSL-related costs
16 to the interstate jurisdiction during the Separations Freeze. However, the
17 FCC's Freeze Order does not allow Qwest or any other "Price Cap" ILEC to
18 directly assign such costs if it would have the effect of changing "frozen"
19 category relationships and/or allocation factors. And that is what would have

¹¹⁰ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel, p. 22, l. 6 to p. 25 l. 14.

1 occurred had Qwest begun to directly assign DSL costs to interstate during
2 the Separations Freeze because Qwest was not directly assigning DSL-
3 related costs to the interstate jurisdiction during the 2000 calendar year
4 (which is the base period for freezing factors and category relationships under
5 the Separations Freeze).

6 As I noted in my rebuttal testimony, it is impossible to directly assign DSL
7 costs during the Freeze period and maintain "frozen" category relationships.
8 With guidance from the FCC, Qwest concluded that it was required to
9 maintain frozen category relationships. As I mentioned in my rebuttal
10 testimony, Qwest believes that this position is also supported by the specific
11 language applying to price cap carriers in Part 36(b) which controls over any
12 general language in other portions of Part 36 or in the FCC's Freeze Order.

13 **Q. MR. DUNKEL ASSERTS THAT PARAGRAPH 23 OF THE FCC'S**
14 **SEPARATIONS FREEZE ORDER CONTAINS EXCEPTION LANGUAGE**
15 **THAT SUPPORTS HIS INTERPRETATION REGARDING THE DIRECT**
16 **ASSIGNMENT OF COSTS ASSOCIATED WITH DSL.¹¹¹ HAS MR.**
17 **DUNKEL GIVEN A PROPER READING TO THE FREEZE ORDER'S**
18 **DIRECTIVES?**

19 A. No. Mr. Dunkel ignores the precursor statement that limits the very exception
20 that he cites regarding the treatment of directly assigned costs. Paragraph 23

¹¹¹ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p 28, ll. 1-18.

1 of the FCC's Separations Freeze Order sets forth the process and procedures
2 involved in the "freezing" of cost categories and portions of cost categories.
3 The process relieves carriers from performing or expanding special study
4 work, and it restricts cost categories and Separations allocation factors to
5 those that were in effect at the initiation of the Freeze.

6 Simply put, the FCC limited changes in "directly assigned" costs to changes in
7 the level (increase or decrease) of directly assigned costs that were already
8 being studied and/or directly assigned prior to the initiation of the freeze.

9 Paragraph 23 clearly limits the direct assignment of costs to those costs that
10 were "directly assigned in the past"—that is, being directly assigned prior to
11 the freeze date. Taken in full context, Paragraph 23 of the Freeze Order
12 confirms this conclusion:

13 Similarly, we find that ***in order to relieve all carriers of performing***
14 ***traffic or relative-use studies for separations purposes, all***
15 ***allocation factors used to assign Part 36 categories,***
16 ***subcategories, or further subdivisions to the state or interstate***
17 ***jurisdictions shall be frozen*** utilizing the factors calculated for the
18 calendar year 2000. ***Categories or portions of categories that have***
19 ***been directly assigned in the past, however, will continue to be***
20 ***directly assigned to each jurisdiction. In other words, the frozen***
21 ***factors shall not have an effect on the direct assignment of costs***
22 ***for categories, or portions of categories, that are directly***
23 ***assigned.*** Since those portions of facilities that are utilized exclusively
24 for services within the state or interstate jurisdiction are readily
25 identifiable, we believe that the continuation of direct assignment of
26 costs will not be a burden on carriers, nor will it adversely impact the
27 stability of separations results throughout the freeze.¹¹² (*Emphasis*
28 *added*)

¹¹² See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*,
FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001 at ¶ 23.

1 By ignoring the introduction and eight key words that precede the word
2 “however” that Mr. Dunkel relies on for his position regarding direct cost
3 assignments, he mischaracterizes the Order’s expected handling of DSL
4 costs under the freeze.

5 **Q. HAS THE FCC PROVIDED ANY GUIDANCE THAT FURTHER EXPLAINS**
6 **THE INTENT BEHIND PARAGRAPH 23 OF THE FREEZE ORDER?**

7 A. Yes. The correct reading of Paragraph 23 is reinforced by guidance from the
8 FCC in the form of responses to frequently asked questions (FAQs), where
9 the FCC further clarified what was required under the Freeze regarding
10 “previously directly assigned costs”, cost categories, sub-categories and
11 allocation factors. In their FAQs the FCC said:

12 **Frozen allocation factors will not have an effect on the direct**
13 **assignment of costs for categories, or portions of categories, that**
14 **were previously directly assigned** to jurisdictions. These will not have
15 an effect on the direct assignment of costs for categories, or portions of
16 categories, that were previously directly assigned to jurisdictions. **These**
17 **categories or portions of categories will continue to be directly**
18 **assigned** to each jurisdiction **in the same manner as before the**
19 **freeze**. It is important to note, **however**, that **if a company elects to**
20 **freeze its category relationships at the calendar year 2000 cost**
21 **study levels**, the proportion of costs assigned to categories or **portions**
22 **of categories that are directly assigned** (e.g., DSL costs in COB
23 Category 4.11) **will also be affected. This could result in some costs**
24 **that are typically directly assigned being apportioned based on the**
25 **frozen category relationships to categories of costs that are not**
26 **directly assigned.**¹¹³ (Emphasis added)

¹¹³ See June 19, 2001 memo to all Member Companies, *Separations Category Freeze Election – Please Respond by June 29, SEPARATIONS FREEZE FREQUENTLY ASKED QUESTIONS (FAQs)*, at page 3, A8.

1 Mr. Dunkel's position cannot be reconciled with this explanatory guidance.

2 **Q. DID QWEST DIRECTLY ASSIGN ITS DSL COSTS IN 2000?**

3 A. No. As I explained in my rebuttal testimony, in calendar year 2000 (the base
4 year that the FCC used for establishing frozen factors and category
5 relationships) Qwest's DSL costs were not being directly assigned. DSL
6 service was in its infancy at Qwest and costs were not being uniquely
7 recorded or separately studied by Qwest for Separations processing.
8 Therefore, Qwest's DSL costs, which were not being directly assigned in the
9 Separations process prior to the Freeze, are not covered by the exception in
10 paragraph 23 upon which Mr. Dunkel relies.

11 However, Qwest's DSL-related costs were assigned in part to the interstate
12 jurisdiction throughout the freeze period as a result of frozen cost categories
13 and cost allocation factors in place at the initiation of the freeze. As I
14 described in my rebuttal testimony,¹¹⁴ making the changes advocated by Mr.
15 Dunkel would cause unauthorized changes to the category relationships that
16 were frozen by the Freeze Order. Furthermore, Staff adjustments B-3 and C-
17 6 fail to consider the effect of the Separations Freeze on the jurisdictional
18 Separation of DSL investment. Mr. Dunkel's proposed adjustment would
19 remove costs from the test year that are not in the test year to begin with

¹¹⁴Docket No. T-01051B-03-0454; Rebuttal Testimony of Philip E. Grate, pp. 86–106.

1 because they are already assigned to the Interstate jurisdiction through the
2 application of frozen Separations factors.

3 **Q. QUOTING QWEST'S RESPONSE TO A DATA REQUEST, MR. DUNKEL**
4 **ARGUES THAT THE FCC HAS NEVER REJECTED ANY OF THE**
5 **COMPANY'S 2001, 2002 OR 2003 PART 36 COST STUDIES FOR THE**
6 **REASON THAT DSL COSTS HAD BEEN DIRECTLY ASSIGNED.¹¹⁵ HOW**
7 **DO YOU RESPOND?**

8 A. Mr. Dunkel's data request and response are a red herring, as is his testimony
9 concerning them. Staff data request WDA 20-014 asked for confirmation of
10 facts that are as obvious as they are irrelevant.

11 In response to WDA 20-014 Qwest confirmed that it can not identify or
12 provide any instance where the FCC has rejected a Company separations
13 cost study because the Company had directly assigned the DSL investments
14 to interstate. Qwest could give no other answer because, as Mr. Dunkel
15 knows, Qwest does not directly assign DSL investment to interstate.

16 As I have observed in this testimony and my rebuttal testimony, Qwest has
17 followed the FCC Freeze Order's directives to not expand the use of special
18 studies during the freeze period. Because Qwest had not been performing
19 special studies or directly assigning DSL prior to the freeze, the FCC could

¹¹⁵ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p 26, l. 13 to p. 27. l. 16.

1 not possibly reject Qwest Part 36 for directly assigning its DSL costs to
2 interstate.¹¹⁶

3 **Q. IF MR. DUNKEL HAD BEEN INTERESTED IN OBTAINING RELEVANT**
4 **INFORMATION, WHAT INQUIRY COULD HE HAVE MADE INSTEAD OF**
5 **THE INQUIRY HE MADE IN WDA 20-014?**

6 A. The inquiry Mr. Dunkel did not make but could have made if he wanted
7 relevant and useful information was whether Qwest's Part 36 cost studies
8 have been rejected by the FCC for not directly assigning DSL costs, i.e. for
9 including DSL costs in frozen cost categories and subcategories. Said
10 differently, discovery aimed at garnering relevant facts would have asked
11 whether the Company's Separations filings that did not directly assign DSL to
12 interstate, but instead included DSL costs in frozen categories and
13 subcategories, have been accepted as filed. Another inquiry of relevant facts
14 would have been to ask whether the jurisdictionally separated
15 interstate/intrastate results that Qwest has filed with the FCC have been
16 widely employed by the FCC and state commissions in determining a variety
17 of rate and pricing issues since, and during, the freeze period.

¹¹⁶ In order to comply with the FCC's "Separations Freeze" order, FCC 01-162, CC Docket No. 80-286, and specifically paragraph 14, Qwest, as a price cap carrier, was required to maintain the FCC's frozen categories and not to modify or expand the underlying analysis in any manner that would alter the frozen FCC Separations factors affected in 2001. As a result of this preemptive FCC directive, no new studies or analyses were required and none have been initiated that would uniquely identify and separately categorize the DSL investment for the purpose of direct assignment and factor modification.

1 The answer to all of these relevant questions is "yes." The relevant facts are
2 that the FCC only inquired about one of Qwest's Separations filings since the
3 Freeze was enacted and that inquiry had nothing whatsoever to do with costs
4 to interstate or whether Qwest had included DSL costs in frozen cost
5 categories. Qwest's response to WDA 14-006 and 21-004 explained to Mr.
6 Dunkel why the FCC inquired about that particular Separations filing.

7 **Q. IN ITS SEPARATIONS FREEZE ORDER, DID THE FCC SERVE NOTICE**
8 **OF ITS INTENT TO REVISIT AND FURTHER RESOLVE INDUSTRY**
9 **CONCERNS REGARDING JURISDICTIONAL ASSIGNMENT ISSUES**
10 **INVOLVING INTERNET TRAFFIC AND DSL?**

11 A. Yes. The FCC was well aware of the Separations issues facing the industry
12 and clearly indicated in its Freeze Order that its present action was only a
13 temporary measure aimed at addressing changes in the industry and
14 technology-related cost shifts affecting jurisdictional cost assignments. The
15 FCC indicated that it would be addressing such issues at a later time as a
16 part of comprehensive separations reform.¹¹⁷ In contemplating its interim
17 Freeze Order, the FCC assessed issues raised by, and facing the industry.
18 For example, NECA stated in its comments in that proceeding that:

¹¹⁷ See *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001 at ¶2. The FCC stated: "We further conclude that several issues, including the separations treatment of Internet traffic, should be addressed in the context of comprehensive separations reform."¹¹⁷ⁿ fn 2 See *infra*, ¶¶34-42.

1 Reform of the Commission's separations rules necessarily will be a
2 complex endeavor, requiring careful study of the effects of any
3 recommended changes. Unfortunately, significant distortions in
4 separations results are occurring now, as a direct result of changes in
5 technology and network usage patterns (especially, growth in Internet
6 traffic). These dramatic changes have not yet been reflected in the
7 Commission's separations rules. As an immediate remedy for this
8 anomaly, pending more comprehensive reform, various parties have
9 recommended an interim separations freeze. A freeze would halt
10 Internet related distortions, and would enable the Joint Board and
11 Commission to evaluate and proceed carefully with other needed reforms,
12 in interstate access and universal service, while maintaining the *status*
13 *quo*, on a time-limited basis.¹¹⁸

14 **Q. MR. DUNKEL ARGUES HIS PROPOSED ADJUSTMENT IS NOT ONE-**
15 **SIDED BUT THAT QWEST'S OPPOSITION TO IT IS.¹¹⁹ HOW DO YOU**
16 **RESPOND?**

17 A. By implementing the Separations Freeze, and rolling back the clock on the
18 jurisdictional assignment splits, the FCC took action to limit perceived
19 misallocation of costs between jurisdictions. That is, by using calendar year
20 2000 as a base year for calculating frozen factors and category
21 relationships—a time when the effects of the Internet explosion and
22 widespread deployment of DSL were not as strong—the FCC was attempting
23 to minimize increases in the assignment of such costs to the intrastate

¹¹⁸ See NECA's comments *In the Matter of Jurisdictional Separations Reform And Referral to the Federal State Joint Board Separations Simulation*, CC Docket No. 80-286DA 99-2677. See also, NECA letter Re: Jurisdictional Separations Reform and Referral to the Federal-State Joint Board - CC Docket No. 80-286 Request for an En Banc Meeting of the Full, dated July 13, 1999; which states: "NECA and other industry representatives repeatedly have called for rapid interim relief to "freeze" separations factors, so as to preserve the *status quo* pending Commission action on separations reform."

¹¹⁹ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p 29, ll. 10-18.

1 jurisdiction during the time period covered by freeze.¹²⁰ Mr. Dunkel's one-
2 sidedness argument disregards this point.

3 The Separations Freeze was intended to suspend the normal Separations
4 process until the Joint Board and the FCC had an opportunity to more
5 comprehensively reform the defects perceived in Part 36. The "Glide Path"
6 policy paper prepared by the state members of the Separations Joint Board
7 observed that three years earlier the state members of the Joint Board stated
8 their concern that the then-existing separations process was "cumbersome,
9 pretended to accuracy it could not achieve, and was fundamentally
10 disconnected from pricing decisions."¹²¹ The "Glide Path" policy paper
11 devoted three pages to observations about the changing environment
12 including: technology changes; economic changes; legal changes;
13 jurisdictional changes; and political changes.¹²² Mr. Dunkel's proposed
14 adjustment fails to consider any of the other Separations affecting changes
15 that have occurred that could also affect the way costs are jurisdictionally

¹²⁰ See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001 at ¶12, which states: "Since the *NPRM* was released in 1997, there have been rapid changes in the telecommunications infrastructure, such as the growth in Internet usage and the increased usage of packet switching. We believe that these types of changes may produce cost shifts in separations results because these and other new technologies, such as digital subscriber line (DSL) services, as well as a competitive local exchange marketplace, are not sufficiently contemplated by the current Part 36 rules. We believe, therefore, that the most effective action at this time will be to freeze the separations process on an interim basis, until the Commission and the Joint Board have had the opportunity to more comprehensively reform Part 36."

¹²¹ Separations Joint Board "Glide Path," a paper entitled *Options for Separations, A Paper Prepared by the State Members of the Separations Joint Board*, Approved December 17, 2001, page 2

¹²² *Ibid*, pp. 4-6.

1 separated. His adjustment is aimed at one isolated issue instead of at a
2 balanced assessment of the Separations of all costs. Consequently, there
3 can be no assurance that when jurisdictional Separations of all costs is
4 considered as a whole, his adjustment is appropriate. He is, in the vernacular
5 of ratemaking, "sharp shooting" a single, isolated Separations issue.

6 **Q. MR. DUNKEL CLAIMS "WE HAVE THE DSL INVESTMENT FIGURES WE**
7 **NEED FOR THE ADJUSTMENT STAFF PROPOSES."¹²³ IS HE**
8 **CORRECT?**

9 A. No. Mr. Dunkel relies on Qwest' response to Staff's data request WDA 04-
10 032 which asked for "the amount of DSL investment by
11 account/subaccount(s) where such investment is recorded." Qwest
12 responded by providing direct incremental DSL investments, by Field
13 Reporting Code (FRC) and FCC USOA account.

14 However, this level of data alone is not granular enough to reprocess
15 Separations and recalculate direct assignments and/or jurisdictional
16 separations splits between interstate and intrastate. In order for Qwest's
17 systems to process such data in the Separations process, the data must
18 contain—and the systems must have the ability to process—additional
19 intelligence in the form of Equipment Category Numbers (ECNs).

¹²³ Docket No. T-01051B-03-0454; Surrebuttal Testimony of William Dunkel p 29, ll. 7-8.

1 ECN intelligence facilitates the translation and assignment of account/FRC
2 data into the various Separations categories and sub-categories. Due to the
3 FCC's Freeze Order, the requisite system modifications to recognize DSL-
4 related ECNs have yet to be made to Qwest's systems. Absent the ECN
5 identifiers, the "special studies" and the system modifications to identify and
6 split off directly assigned costs, Separations reprocessing can not be
7 conducted. Without ECNs and expansion of special studies, there is no basis
8 to apply the FCC prescribed Separation rules that would be involved in a
9 recalculation of "cost category allocation factors" (previously frozen) and no
10 Separations reprocessing can occur. Without Separations reprocessing,
11 identification and quantification of the full and complete financial effects
12 (pluses and minuses) of directly assigning DSL amounts and changing
13 allocation factors is not possible.

14 Hence, there can be no assurance that the investment amount Qwest
15 provided in response to WDA 04-032 would be the same amount that would
16 be directly assigned to interstate in a reprocessed Separations study.

1 **Q. HAS THE FCC MADE CLEAR THAT IT RECOGNIZES THE ISSUES THAT**
2 **SURROUND THE ASSIGNMENT OF DSL AND INTERNET TRAFFIC-**
3 **RELATED COSTS?**

4 A. Yes. The FCC also clearly stated its intentions to assess solutions to this and
5 other technology issues in future Separations Reform proceedings.
6 Specifically, in its Separations Freeze order the FCC stated¹²⁴:

7 The interim freeze will be in effect for five years or until the
8 Commission has completed comprehensive separations reform,
9 whichever comes first. We further conclude that several issues,
10 including the separations treatment of Internet traffic, should be
11 addressed in the context of comprehensive separations reform.
12 (Emphasis added)

13 Since the NPRM was released in 1997, there have been rapid
14 changes in the telecommunications infrastructure ... We believe that
15 these types of changes may produce cost shifts in separations results
16 because these and other new technologies, such as digital subscriber
17 line (DSL) services, as well as a competitive local exchange
18 marketplace, are not sufficiently contemplated by the current Part 36
19 rules. (Emphasis added)

20 **Q. MR. DUNKEL CLAIMS THAT THE NATIONAL EXCHANGE CARRIER**
21 **ASSOCIATION (NECA) PROVIDES CURRENT GUIDANCE ON THE**
22 **SUBJECT OF DIRECTLY ASSIGNING DSL COSTS DURING THE FCC'S**

¹²⁴ See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001 FCC 01-162, at ¶ 2 and ¶ 12.

1 **FREEZE PERIOD.¹²⁵ ARE THE NECA INSTRUCTIONS MR. DUNKEL**
2 **CITES PERTINENT TO QWEST OR THIS PROCEEDING?**

3 A. No. Mr. Dunkel quotes from Exhibit WDA-S2 which is an April 6, 2004 cost
4 study filing instruction memo from NECA to its member "Cost Company Pool
5 Participants". This document is another red herring. It is irrelevant because it
6 is wholly inapplicable to Qwest. The document was addressed to NECA Cost
7 Company Pool Participants. Qwest is not a NECA Cost Company Pool
8 Participant. Qwest is a "Price Cap" ILEC.

9 Adherence to the FCC's Freeze Order's provisions was elective for some of
10 NECA's Cost Company Pool Participant members. The memo Mr. Dunkel
11 cites is only germane to those NECA companies that had the option and
12 elected not to follow the FCC's Freeze Order requirements --choosing instead
13 to continue performing and modifying cost studies used to prepare their
14 Separations data.

15 Unlike Cost Company Pool Participants, Price Cap ILECs such as Qwest are
16 required to follow the FCC's Freeze Order guidance in the preparation of
17 jurisdictionally separated data. They may not follow NECA's guidance to Cost
18 Company Pool Participants. Price Cap ILECs are not allowed to modify or
19 enhance their studies, or to add to or alter direct assignment of costs for costs
20 (such as DSL-related costs) that were not directly assigned prior to the

¹²⁵ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p 28, ll. 1-18.

1 initiation of the FCC's freeze.¹²⁶ Instead, the Freeze Order relieves Price Cap
2 ILECs of cost study work.

3 The NECA memo cited by Mr. Dunkel does not apply to Qwest. It follows that
4 Mr. Dunkel's offer of proof is a red herring wholly inapplicable to Qwest and
5 wholly unresponsive of Staff's adjustments B-3 and C-6.

6 **Q. MR. DUNKEL ARGUES THAT "[I]F QWEST IS NOT FOLLOWING THE**
7 **PART 36 PROCEDURES IN AN INTRASTATE PROCEEDING, THEN THE**
8 **STATE COMMISSION HAS THE RESPONSIBILITY OF ENFORCING THE**
9 **PART 36 REQUIREMENTS."¹²⁷ DO STATE COMMISSIONS HAVE THE**
10 **AUTHORITY TO DETERMINE THE MEANING OF AN FCC SEPARATIONS**
11 **RULE IF THERE IS A DISPUTE?**

12 A. No. I am informed by counsel that Mr. Dunkel is mistaken about the role of
13 the States in the formulation, interpretation and enforcement of the FCC's
14 Separations Rules. Contrary to Mr. Dunkel's assertion,¹²⁸ the Joint Board
15 does not "establish" Part 36 procedures (i.e., Separations Rules). The Joint
16 Board prepares "Recommended Decisions" on separations matters. The
17 FCC normally puts the Joint Board's Recommended Decisions out for

¹²⁶ See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, FCC 01 – 162, CC, Docket No. 80-286 Adopted: May 11, 2001, Released: May 22, 2001, at ¶ 23, which states: Similarly, we find that in order to relieve all carriers of performing traffic or relative-use studies for separations purposes, all allocation factors used to assign Part 36 categories, subcategories, or further subdivisions to the state or interstate jurisdictions shall be frozen utilizing the factors calculated for the calendar year 2000.

¹²⁷ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 29, l.19 to p. 30, l. 15.

¹²⁸ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 30, ll. 6-7.

1 comment and, at some later date, issues an Order adopting, modifying or
2 rejecting the Joint Board's recommendations.

3 This is exactly what occurred with respect to the Separations Freeze – the
4 Joint Board issued its Recommended Decision on July 21, 2000 and the FCC
5 issued its Order on May 22, 2001. Thus, it is the FCC that “establishes”
6 Separations Rules, not the Joint Board.

7 Similarly, the FCC is the final arbiter of the meaning of its rules, not the
8 States.¹²⁹ Qwest agrees with Mr. Dunkel that it is not up to Qwest to decide
9 how the FCC's rules are to be interpreted if there is lack of clarity.¹³⁰ Qwest
10 also agrees that the Arizona Commission and Qwest (and the FCC itself)
11 have an obligation to comply with the Separations Rules. However, if there is
12 a dispute over a Separations Rule/FCC Order or the timing, or propriety of
13 implementing Separations reform without FCC directives – as there clearly is
14 here – only the FCC has the authority to make such a determination, not the
15 various State regulatory agencies. Qwest will address this issue in further
16 detail in its legal briefs in this docket.

17 While Mr. Dunkel remains steadfast in his “opinion” that Qwest is not
18 complying with the requirements of the FCC's Freeze Order, Mr. Dunkel's

¹²⁹ Even the Courts refer matters to the FCC, under the doctrine of primary jurisdiction, when issues arise with respect to the meaning of a FCC rule or order in a given case.

¹³⁰ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel p. 30, l. 5.

1 comments are no more than his opinion and in no way constitute an
2 authoritative finding that Qwest has not complied with the FCC's Separations
3 Rules. On the basis of discussions with FCC personnel and numerous other
4 indicia, Qwest believes that it is properly complying with the Freeze Order's
5 requirements. Qwest has employed the same methodology in all fourteen
6 states within its service area. If the Commission accepts Mr. Dunkel's
7 hypothesis, the Commission should refer the matter to the FCC for resolution.
8 The Courts have already found—as will be discussed in Qwest's legal brief—
9 that there can only be one set of separations procedures, not a different set
10 for each State.

11 ***BSI – Construction Related Charges (Staff B-4, C-7)***

12 **Q. ARE THERE ANY CONCLUSIONS IN MR. DUNKEL'S SURREBUTAL**
13 **WITH WHICH YOU AGREE?**

14 **A. Mr. Dunkel makes the following conclusions with which I agree:**

15
16
17
18
19
20
21
22
23

REDACTED

¹³¹ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel, p. 17, ll. 19-22.

1
2

REDACTED

3 **Q. WHY DO YOU AGREE WITH THOSE CONCLUSIONS?**

4 A. I referred Mr. Dunkel's surrebuttal testimony to a task force consisting of
5 representatives from Network, Finance, Costing and Public Policy who are
6 familiar with BSI's operations and with the accounting and billing for BSI. I
7 asked that they evaluate the correctness of his testimony. They confirmed
8 the correctness of the quoted passages above. Attached to this testimony as
9 Qwest Corporation—Confidential Exhibit PEG-RJ06 is a two page document
10 that memorializes the group's reasoning and conclusions. I found their
11 analysis sound and believe their conclusions to be correct.

12 **Q. WHAT WAS THE TASK FORCE'S CONCLUSION?**

13 A. The task force's conclusion is stated as follows:

14
15
16

REDACTED

17 **Q. BECAUSE YOU AGREE WITH MR. DUNKELS' AND THE TASK FORCE'S**
18 **CONCLUSIONS QUOTED ABOVE, DO YOU NOW AGREE WITH STAFF'S**
19 **ADJUSTMENTS B-4 AND C-7 THAT MR. DUNKEL PROPOSES?**

20 A. No. I continue to believe that Staff's proposed adjustments B-4 and C-7 are
21 incorrect. I believe that it is proper for Qwest's investment in multiuse

¹³² Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel, p. 18, ll. 22-28.

1 cabinets and cables to be in Qwest's Arizona regulated rate base. Qwest
2 owns the cabinets and cable. They are available for use by any CLEC that
3 makes a bona fide request to use them. They are available for Qwest to use
4 as the need arises. Consequently, the inclusion of these assets in the rate
5 base is not incorrect and Staff's proposed adjustments B-4 and C-7, which
6 serves to remove the cabinets and cables from the calculation of rate base, is
7 incorrect and should be rejected.

8 **Q. WHAT IS THE CORRECT TEST YEAR ADJUSTMENT?**

9 A. Including the cables and cabinets in the Arizona intrastate rate base is not
10 incorrect. The assets are Arizona regulated intrastate assets. REDACTED

11 REDACTED

12 REDACTED

13 REDACTED

14 REDACTED

15 REDACTED

16 REDACTED

17 REDACTED

18 REDACTED

19 REDACTED

1 **Q. MR. DUNKEL'S SURREBUTTAL STATES, "THERE ARE ALSO**
2 **APPROXIMATELY REDACTED OTHER QWEST REMOTE TERMINALS**
3 **WHICH CONTAIN BOTH QWEST VOICE CARDS AND BSI VIDEO CARDS**
4 **("SHARED REMOTES"). MY ADJUSTMENT ADDRESSES ONLY THE**
5 **"VIDEO ONLY" REMOTE TERMINALS."¹³³ DOES ADJUSTMENT PFN-18**

6 REDACTED

7 **A.** REDACTED

8 REDACTED

9 ***FCC Deregulated Products (Staff C-19)***

10 **Q. DOES MR. CARVER CONTINUE TO BELIEVE THAT STAFF**
11 **ADJUSTMENT C-19 IS NECESSARY?**

12 **A. Yes. Mr. Carver argues:**

13 Because Qwest has included the FCC deregulated services above-the-
14 line for purposes of determining its Arizona intrastate operating results,
15 this treatment causes the Company's overall revenue requirement to be
16 higher than if their related revenues, expenses and rate base amounts
17 were simply excluded (or recognized below-the-line). Staff Adjustment C-
18 19 conservatively seeks to minimize the revenue requirement
19 overstatement and mitigate a portion of the resulting cross-subsidy.¹³⁴

20 **Q. DO YOU AGREE?**

21 **A. No. First, I do not agree that including FCC deregulated services in the**
22 **calculation of Arizona revenue requirement is improper. These services are**

¹³³ Docket No. T-01051B-03-0454; Surrebuttal of William Dunkel, p. 20, ll. 1-3.

¹³⁴ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver, p. 47, ll. 21-27.

1 regulated in Arizona. Until they are deregulated—as Staff proposes that
2 Voice Messaging be—they are properly included in the calculation of Arizona
3 revenue requirement. No adjustment should be made to remove any portion
4 of the effect they have on revenue requirement. Consequently, Adjustment
5 C-19 is not warranted.

6 Second, I do not accept Mr. Carver's interpretation of the concept of subsidy.
7 Mr. Carver argues that including these services in revenue requirement
8 causes it to be higher than it would be without them. However, their
9 incremental effect on revenue requirement does not measure whether they
10 receive or provide a subsidy. I explained this position in my rebuttal
11 testimony and will not elaborate further here.

12 Finally, even if one accepts that an adjustment must be made for FCC
13 deregulated services and uses the formula that reflects Mr. Carver's definition
14 of subsidy (any return below 9.5%) a correct calculation of adjustment C-19
15 yields an increase in revenue requirement, not a decrease.

16 **Q. PLEASE EXPLAIN WHY A CORRECT CALCULATION OF ADJUSTMENT**
17 **C-19 USING MR. CARVER'S FORMULA YIELDS A REVENUE**
18 **REQUIREMENT INCREASE.**

19 A. Mr. Carver's calculation of Adjustment C-19 includes several input errors,
20 some of which relate to omissions he made and some of which relate to

1 errors in Qwest's adjustment PFN-01 that Qwest discovered while preparing
2 this rejoinder testimony. Following is a listing of the errors and omissions that
3 I will discuss in more detail below:

- 4 ▪ Errors discovered in Qwest adjustment PFN-01, Out of Period Revenues
5 and Expenses
- 6 ▪ Omission of adjustment PFN-09, Call Centers (an adjustment FCC
7 deregulated revenue)
- 8 ▪ Failure to remove the portion of adjustments PFN-01 and PFN-03 related
9 to FCC deregulated products in Arizona price cap Baskets and Voice
10 Messaging.

11 Qwest Corporation—Exhibit PEG-RJ03 sets forth Qwest's calculation of Staff
12 Adjustment C-19 corrected for these three items.

13 **Q. PLEASE EXPLAIN THE ERRORS DISCOVERED IN QWEST**

14 **ADJUSTMENT PFN-01, OUT OF PERIOD REVENUES AND EXPENSES.**

15 A. In the process of reviewing Mr. Carver's calculation of Adjustment C-19,
16 Qwest discovered that it had made calculation errors in Adjustment PFN-01,
17 Out of Period Revenue and Expenses. These errors will be detailed in a
18 supplemental response to Staff data request UTI 1-1 that will be filed no later
19 than February 3, 2005. In general the errors relate to applying the wrong
20 "plus or minus" sign on certain numbers as they were brought forward from
21 debit and credit entries to revenue requirement adjustment entries. Qwest's
22 correction of adjustment PFN-01 pertaining to FCC Deregulated revenue is
23 included in column G of Qwest's recalculation of Adjustment C-19.

1 **Q. PLEASE EXPLAIN WHY ADJUSTMENT PFN-09, CALL CENTERS,**
2 **SHOULD NOT HAVE BEEN OMITTED FROM THE CALCULATION OF**
3 **ADJUSTMENT C-19.**

4 A. As I explain in my direct testimony, Adjustment PFN-09 is a pro forma
5 normalizing adjustment that adjusts the assignment of expenses and
6 revenues associated with customer call centers to the states actually served
7 by those call centers. The revenue portion of Adjustment PFN-09 is for
8 revenue in the FCC deregulated product Joint Marketing, which is one of the
9 FCC deregulated products included in Mr. Carver's calculation of Staff
10 Adjustment C-19. The expense portion of PFN-09 is unrelated to FCC
11 Deregulated products.

12 The portion of Qwest's adjustment PFN-09 related to FCC deregulated
13 revenue should have been included in Column (G) of Adjustment C-19
14 because Column (G) recognizes the portion of Qwest Adjustments that
15 significantly affect FCC deregulated service revenues included in the
16 calculation of the test year. Qwest has placed the revenue portion of
17 Adjustment PFN-09 related to FCC Deregulated products in column G1 of
18 Qwest's recalculation of Adjustment C-19.

19 **Q. PLEASE EXPLAIN WHY MR. CARVER'S FAILURE TO REMOVE**
20 **PORTIONS OF ADJUSTMENTS PFN-01 AND PFN-03 RELATED TO FCC**

1 **DEREGULATED PRODUCTS IN ARIZONA PRICE CAP BASKETS AND**
2 **VOICE MESSAGING IS INCONSISTENT WITH THE PURPOSE OF THE**
3 **ADJUSTMENT.**

4 A. A portion of the adjustments PFN-01 and PFN-03 found in column G of Mr.
5 Carver's calculation of Adjustment C-19 pertain to products provisioned
6 pursuant to ACC approved tariff, are included in one of the Arizona Price Cap
7 Plan "baskets" or pertain to Voice Messaging. Columns E and F of Mr.
8 Carver's calculation of Adjustment C-19 remove these services. Because
9 these services are removed from the calculation of Adjustment C-19,
10 consistency requires that the portion of adjustments PFN-01 and PFN-03 in
11 Column G of Mr. Carver's calculation of Adjustment C-19 related to these
12 services should also be removed. Column G2 of Qwest's recalculation of
13 Adjustment C-19 accomplishes this removal.

14 **Q. WHAT IS THE RESULT OF THESE CORRECTIONS?**

15 A. Using Mr. Carver's algorithms and the three corrections to the data input,
16 Adjustment C-19 causes a revenue requirement increase of \$4.4 million—
17 instead of the \$6.6 million decrease that Mr. Carver calculates—because the
18 FCC deregulated services, when properly adjusted, provide a considerable
19 subsidy (as defined by Mr. Carver) to Arizona's other services.

1 **Q. DO YOU BELIEVE THE REVENUE REQUIREMENT SHOULD BE**
2 **ADJUSTED FOR THIS AMOUNT?**

3 A. No. I continue to believe that Adjustment C-19 should not be made.
4 However, if the Commission believes that it is necessary to make an
5 adjustment for FCC deregulated services based on Mr. Carver's algorithms,
6 the calculation of it should be as set forth in Qwest Corporation—Exhibit
7 PEG-RJ03.

8 **Q. IS THE INCONSISTENCY IN MR. CARVER'S FAILURE TO REMOVE**
9 **PORTIONS OF ADJUSTMENTS PFN-01 AND PFN-03 FROM HIS**
10 **ADJUSTMENT C-19 ALSO SEEN IN HIS ADJUSTMENT C-24 FOR VOICE**
11 **MESSAGING?**

12 A. Yes. As described by Mr. Carver in his direct testimony, Adjustment C-19 is
13 designed to remove the FCC deregulated Voice Messaging Service (VMS)
14 product from the test year entirely because Staff has recommended
15 deregulation of this service. Mr. Carver removes the income statement and
16 rate base amounts for VMS in Column C of Adjustment C-24. However, the
17 amounts he removes are not the only amounts in the test year relating to
18 VMS. As I discussed earlier, Qwest pro forma adjustments PFN-01 and PFN-
19 03, included in Staff's test year, also include amounts pertaining to VMS.
20 Again, Mr. Carver fails to employ a consistent method because he fails to
21 remove these amounts in his C-19 adjustment.

1 **Q. HAVE YOU RECALCULATED MR. CARVER'S ADJUSTMENT C-24?**

2 A. Yes. Exhibit PEG-RJ03 sets forth Qwest's calculation of Staff Adjustment
3 C-24 using Mr. Carver's algorithms but correctly removing the portions of
4 PFN-01 and PFN-03 relating to VMS. With this correction Adjustment C-24
5 causes a \$0.5 million revenue requirement reduction instead of the \$3.7
6 million revenue requirement increase that Mr. Carver calculated.

7 ***Telephone Plant Under Construction (Staff B-5, C-7; RUCO***
8 ***RBA#3, OA#7)***

9 **Q. MR. CARVER ARGUES THAT INCLUDING TELEPHONE PLANT UNDER**
10 **CONSTRUCTION (TPUC) IN RATE BASE WOULD VIOLATE THE**
11 **MATCHING CONCEPT.¹³⁵ HOW DO YOU RESPOND?**

12
13 A. If TPUC were included in rate base but no revenue requirement offset were
14 made I would agree that a matching concept violation occurs. However,
15 under revenue requirement offset method the effect of including TPUC in rate
16 base is nullified by treating the allowance for funds used during construction
17 (AFUDC) for the current period as a revenue amount for ratemaking
18 purposes. Consequently, the method prevents a violation of the matching
19 principle.

¹³⁵ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 52, l. 19 to p. 53, l. 25.

1 **Q. MR. CARVER CONCLUDES THAT TREATING AFUDC FOR THE**
2 **CURRENT PERIOD AS A REVENUE AMOUNT DOES NOT ANSWER HIS**
3 **CONCERN ABOUT MATCHING BECAUSE THE CHANGE FROM THE**
4 **CAPITALIZATION METHOD TO THE REVENUE REQUIREMENT OFFSET**
5 **METHOD INCREASES REVENUE REQUIREMENT \$4.1 MILLION.¹³⁶ HOW**
6 **DO YOU RESPOND?**

7 A. Mr. Carver mischaracterizes the transitional revenue requirement effect of
8 adopting the new method as if it were the accounting effect of the method
9 itself. The transition from the capitalization method to the revenue
10 requirement offset method does indeed cause a transitional increase to
11 revenue requirement of approximately \$4.1 million (\$2.7 million by Mr.
12 Carver's calculation). When the Commission ordered the transition from the
13 rate base method to the capitalization method in the Company's 1994 rate
14 case, there was a similar transitional effect that reduced revenue requirement
15 \$4.3 million (by Mr. Carver's calculation).

16 However, the transitional revenue requirement effect does not represent a
17 defect in the revenue requirement offset method of accounting for AFUDC.

18 **Q. MR. CARVER ARGUES THAT THE REVENUE REQUIREMENT OFFSET**
19 **METHOD DOES NOT CAPTURE ANY IMPROVED EFFICIENCIES, COST**
20 **SAVINGS AND/OR ADDITIONAL CUSTOMER REVENUES THAT WILL BE**

¹³⁶ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 54. ll. 4 to 12.

1 **REALIZED AFTER THE CONSTRUCTION PROJECTS ARE COMPLETED**
2 **AND PLACED IN SERVICE.¹³⁷ HOW DO YOU RESPOND?**

3 A. This argument would have validity if Qwest's proposal were to use the rate
4 base method, which includes TPUC in rate base without any compensating
5 adjustment. However, under the revenue requirement offset method, the
6 inclusion of AFUDC in revenues removes the burden of financing the plant
7 under construction from the revenue requirement so that rates calculated on
8 that revenue requirement do not include the cost of financing TPUC that is not
9 yet in service. Consequently, Mr. Carver's argument—that ratepayers are
10 bearing the cost of including TPUC in rate base without benefiting from
11 improved efficiencies, cost savings and/or additional customer revenues—is
12 without merit.

13 **Q. MR. CARVER CLAIMS THAT YOUR ANALYSIS OF THE EFFECT OF**
14 **CHANGING FROM THE RATE BASE METHOD TO THE CAPITALIZATION**
15 **METHOD IN 1995 AND FROM THE CAPITALIZATION METHOD TO THE**
16 **REVENUE REQUIREMENT OFFSET METHOD IN THIS CASE IS A RED**
17 **HERRING. IS IT?**

18 A. No. However, Mr. Carver's critique is. His quibbling with the calculations
19 distracts from and ignores the conclusion to be gleaned from them.

¹³⁷ Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 54. ll. 14 to 17.

1 Mr. Carver's direct testimony argued the FCC's conclusion—that the revenue
2 requirement offset method was the preferred method of accounting for
3 TPUC—was inapplicable to Arizona because the adoption of the revenue
4 requirement offset method reduced revenue requirement in the federal
5 jurisdiction but not in the state jurisdiction.¹³⁸ Mr. Carver concluded that
6 because the transitional effect of adopting the revenue requirement offset
7 method increases revenue requirement in Arizona but reduced revenue
8 requirement in the federal jurisdiction, the FCC's reasons for preferring the
9 revenue requirement offset method did not apply in Arizona.¹³⁹

10 In response to this testimony my rebuttal testimony explained that reason for
11 the difference was that Arizona was starting with the capitalization method
12 while the FCC started from the rate base method (which is the method from
13 which Arizona started when it required the Company to change methods in
14 1995). The starting point for the transition to the revenue requirement offset
15 method explains the difference.

¹³⁸ Docket No. T-01051B-03-0454; Direct Testimony of Steven C. Carver; p. 21.

¹³⁹ I disagree with the FCC's rationale on several key points for intrastate regulatory purposes. * *
* Second, the FCC relied on its assessment of the revenue requirement impact of the change to
this method, which was believed to actually "reduce rates in the initial years of implementation."
Unfortunately for the Company's Arizona intrastate customers, the FCC's assessment does not
portray the realities of Qwest's proposed adoption of this method. One must look no further than
the Company's own quantification of the revenue requirement effect of its Adjustment PFA-04 to
see that an immaterial amount of AFUDC revenues are dwarfed by the current return realized on
the TPUC balance included in rate base - resulting in an increase to revenue requirement of
about \$4.1 million.[footnote omitted] This result is contrary to the cited expectation of the FCC of
reduced revenue requirements for carriers as a group. (emphasis added) Docket No. T-01051B-
03-0454; Direct Testimony of Steven C. Carver; p. 21, l. 28 to p. 22, l. 8.

1 I also explained that Arizona revenue requirement had previously absorbed
2 the benefit of changing TPUC accounting methods when the Commission
3 ordered the transition from the rate base method to the capitalization method
4 in 1995. Using Mr. Carver's calculation of the revenue requirement effect in
5 1995 and my calculation of the effect in this case, we can see the following:

<u>Case</u>	<u>Method Change</u>	<u>Rev. Req. Effect</u>
1995 Rate Case	RB to Cap	\$4.3M decrease
Current Case	Cap to RRO	<u>\$4.1M increase</u>
	Net	\$0.2M decrease

10 Using Mr. Carver's calculation of the revenue requirement effect of both
11 transitions, we can see the following:

<u>Case</u>	<u>Method Change</u>	<u>Rev. Req. Effect</u>
1995 Rate Case	RB to Cap	\$4.3M decrease
Current Case	Cap to RRO	<u>\$2.7M increase</u>
	Net	\$1.6M decrease

16 While Mr. Carver's surrebuttal quibbles with the calculations, it ignores the
17 conclusion to be reached from them. The Arizona ratepayer already enjoyed
18 a considerable revenue requirement decrease when the rate base method
19 was abandoned in favor of the capitalization method in 1995. Even with the
20 effect of adopting the revenue requirement offset method (in full accord with
21 the Commission's own accounting rule) ratepayers still come out ahead, in
22 terms of revenue requirement (regardless of whose calculation is used).

1 **Q. MR. CARVER ARGUES "THE COMMISSION SHOULD FOCUS**
2 **ATTENTION ON THE REAL IMPACT OF THE COMPANY'S**
3 **RECOMMENDATION ON OVERALL REVENUE REQUIREMENT..."¹⁴⁰ DO**
4 **YOU AGREE.**

5 A. No. Mr. Carver's testimony on this point is disturbing. As an initial
6 observation, Mr. Carver's position is troubling because the method Qwest is
7 proposing enjoys a presumption that it is preferable because it is the method
8 that, absent the Commission's order to the contrary in Qwest's 1995 rate
9 case, would be used under the Commission's own accounting rule. Nothing
10 in Mr. Carver's testimony correctly shows why that presumption is incorrect.

11 More importantly, Mr. Carver's admonition to the Commission to reject a
12 change in accounting method because it increases the revenue requirement
13 demonstrates an unmistakable bias in favor of ratepayers and against Qwest.
14 Such bias has no place Staff's analysis of the revenue requirement.
15 Accordingly, the Commission should reject Staff's proposed adjustments B-5,
16 Telephone Plant Under Construction (TPUC), and C-8, Telephone Plant
17 Under Construction (TPUC).

¹⁴⁰ "[R]ather than distract attention away from the real cost to ratepayers by quibbling over revisions to Mr. Grate's Exhibit PEG-D4, the Commission should focus attention on the real impact of the Company's recommendation on overall revenue requirement: \$4.1 million (based on Qwest's recent R14-2-103 update) using Qwest's proposed weighted cost of capital or \$2.698 million using Staff's recommended capital structure and cost rates." Docket No. T-01051B-03-0454; Surrebuttal of Steven C. Carver; p. 57. ll. 21 to 25.

1 **Q. IN SURREBUTTAL MS. DIAZ CORTEZ ARGUES THAT UNLESS THERE**
2 **IS A RATE CASE EACH YEAR, THE RATE BASE VALUE WILL REMAIN**
3 **UNCHANGED AND THE COMPANY WILL CONTINUE TO EARN ON THE**
4 **UNDEPRECIATED VALUE OF THE TPUC.¹⁴¹ HOW DO YOU RESPOND?**

5 A. This argument is another illustration of Ms. Diaz Cortez's confusion about the
6 relationship between the rate base in a test year and the recovery of rate
7 base through depreciation. I addressed this misunderstanding in rejoinder to
8 Ms. Diaz Cortez's surrebuttal regarding RUCO's Rate Base Adjustment #1,
9 Accumulated Depreciation. For economy's sake, I will not repeat that
10 explanation here. Ms. Diaz Cortez's argument is incorrect and adjustment
11 RUCO's proposed Rate Base Adjustment #3 – Construction Work in Progress
12 and Operating Adjustment #7 – AFUDC Offset Adjustment should be
13 rejected.

14 ***Property Taxes (RUCO OA#8)***

15 **Q. IN REBUTTAL YOU EXPLAINED THAT MS. DIAZ CORTEZ'S PROPERTY**
16 **TAX CALCULATION WAS INCORRECT. DOES SHE AGREE?**

17 A. No. She continues to claim that her calculation properly utilizes the formula the
18 Arizona Department of Revenue (ADOR) uses to calculate property taxes.¹⁴²

¹⁴¹ Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz-Cortez; p. 4.

¹⁴² Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez; p. 12.

1 **Q. MS. DIAZ CORTEZ CLAIMS THAT BY UTILIZING THE TEST YEAR**
2 **ADJUSTED NET PLANT IN HER CALCULATION SHE CAPTURED ONLY**
3 **THE PROPERTY TAX RELATED TO REGULATED ARIZONA**
4 **JURISDICTIONAL PLANT. IS SHE CORRECT?**

5 A. No. Qwest Corporation's property tax assessment (full cash value) is
6 determined by the ADOR based on a detailed reporting of Qwest assets by
7 class, vintage year and un-depreciated historical book cost of all the Arizona
8 property (including construction work in progress and materials & supplies);
9 and then depreciated at statutorily prescribed rates (not Commission
10 prescribed rates) to a minimum residual value of 20%. For Arizona property
11 tax purposes, the 20% residual value is carried for as long as the property
12 value remains on the books.

13 Because the valuation is predicated on historical cost and ADOR prescribed
14 depreciation rates it would be incorrect to use adjusted net book value, as
15 RUCO has done, to estimate property taxes. Qwest pays property taxes on
16 regulated plant in Arizona on the taxable full cash value as determined by the
17 ADOR, not on adjusted net plant determined under Commission depreciation
18 prescription. Ms. Diaz Cortez's assumption that adjusted net plant should
19 form the basis for regulated property tax expense is unsupported by the facts
20 regarding the actual computation of Qwest's Arizona property tax expenses.

1 **Q. MS. DIAZ CORTEZ EXPLAINED THAT SHE OBTAINED THE 0.1218**
2 **PROPERTY TAX RATE THAT SHE EMPLOYED IN HER CALCULATION**
3 **FROM AN ADOR EMPLOYEE IN THE TELEPHONE PROPERTY TAX**
4 **DIVISION.¹⁴³ IS THE RATE SHE USED CORRECT?**

5
6 A. No. In discovery, Qwest asked Ms. Diaz Cortez who provided her the 0.1218
7 tax rate that she employed in her calculation. She answered that she
8 obtained it from Mr. Dave Duran of the ADOR. We contacted Mr. Duran to
9 inquire about this rate and he confirmed that it is the average rate for all
10 property in Arizona, including residential and commercial property. Qwest
11 does not pay the average rate on all residential and commercial property in
12 Arizona. In 2003, Qwest paid at the rate of 0.133. In 2004, the rate is
13 0.16076. The rate Ms. Diaz Cortez employed is wholly unreliable for
14 purposes of calculating Qwest's property taxes.

15 **Q. IS THE 0.133 RATE THAT QWEST PAID IN 2003 UNUSUALLY HIGH?**

16 A. No. According to Qwest's property tax department, from 1998 to 2004 the
17 average tax rate that Qwest has actually paid has been 0.1379824 or
18 137.9824 mills. Qwest's actual tax rates over this period have ranged
19 between 125.66 mills and 160.76 mills. Qwest has never had a rate as low
20 as 121.8 mills. RUCO's Operating Adjustment #8 should be rejected.

¹⁴³ Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez; p. 13.

1 ***Pension Asset (RUCO RBA#5)***

2 **Q. MS. DIAZ CORTEZ'S SURREBUTTAL TESTIMONY CLAIMS THE**
3 **PENSION ASSET SHOULD BE EXCLUDED FROM RATE BASE**
4 **BECAUSE RATE BASE EXCEEDS CAPITAL STRUCTURE ON**
5 **SCHEDULE E-1 OF QWEST'S RULE 103 FILING.¹⁴⁴ PLEASE RESPOND.**

6 A. Ms. Diaz Cortez's concern is ill founded. There should be no expectation that
7 the capital structure used on schedule E-1 will equal rate base because the
8 sources for these two items are different. The source for rate base is the
9 Arizona jurisdictional books. The source for capital structure is not the
10 Arizona jurisdictional books because Qwest does not account for capital by
11 state. The source for the capital structure is an allocation of total company
12 capital structure. Because they are obtained from different sources and
13 because one is based on an allocation while the other is based on
14 jurisdictional books, the two numbers should not be expected to agree. The
15 fact that capital is less than rate base should come as no surprise. The
16 interest synchronization adjustment routinely made in rate cases is necessary
17 because of this phenomenon.

¹⁴⁴ Docket No. T-01051B-03-0454; Surrebuttal of Marylee Diaz Cortez; p. 6.

1 **Q. MS. DIAZ CORTEZ ALSO NOTES THAT THE COMMISSION DENIED**
2 **QWEST'S RATE BASE TREATMENT OF THE PENSION ASSET IN A**
3 **PRIOR CASE.**

4 A. In Docket No. E-1051-93-183 the Commission agreed with the Company that
5 pension assets contributed by shareholders should be included in rate base
6 but then denied inclusion of the pension asset in rate base. The Commission
7 concluded (based on testimony given by Steven C. Carver) the Company had
8 not presented sufficient evidence to clearly demonstrate that its shareholders
9 had advanced the funds for the pension asset.¹⁴⁵ In this docket the same
10 Steven C. Carver has testified that there is sufficient evidence to include the
11 pension asset in rate base. Thus, the objection upon which pension asset
12 was excluded has been overcome, according to the witness that originally
13 raised it. While Qwest disagrees that the objection is valid to begin with, the
14 fact that it has been overcome and the fact that the Commission agreed with
15 the Company that pension assets contributed by shareholders should be
16 included in rate base means that it is appropriate to include it in rate base.
17 Accordingly, RUCO's Rate Base Adjustment #5—Pension Asset, should be
18 rejected.

¹⁴⁵ Docket No. E-1051-93-183, Decision No. 58927 (January 3, 1995) page 5.

1 ***Accumulated Depreciation – Station Apparatus (RUCO RBA#4)***

2 **Q. IN HER SURREBUTTAL TESTIMONY MS. DIAZ CORTEZ REPEATS HER**
3 **ASSERTION THAT QWEST INCLUDES STATION APPARATUS**
4 **INVESTMENT, BUT DOES NOT INCLUDE ITS RELATED DEPRECIATION**
5 **RESERVE. WOULD YOU COMMENT?**

6 A. Yes. Ms. Diaz Cortez is incorrect. As demonstrated in my rebuttal testimony,
7 Station Apparatus depreciation reserve is included in the development of
8 Qwest's rate base.

9
10 **Q. WHY DO YOU THINK MS. DIAZ CORTEZ CONTINUES TO BELIEVE THAT**
11 **STATION APPARATUS' DEPRECIATION RESERVE IS NOT INCLUDED IN**
12 **QWEST'S RATE BASE?**

13 A. Ms. Diaz Cortez refers to the Qwest's response to RUCO 04-06 which shows
14 depreciation reserve by **regulated** plant account. Station Apparatus is
15 deregulated and thus, Station Apparatus depreciation reserve is not included
16 in the response to RUCO 04-06. My rebuttal testimony provided RUCO the
17 components that make up Qwest's total rate base depreciation reserve.
18 Pages 135 and 136 of my rebuttal demonstrated that the Station Apparatus
19 depreciation reserve is a component of the total reserve. Furthermore, my
20 rebuttal provided the data response number (UTI 001-01); the spreadsheet
21 name (az1203.xls) and spreadsheet reference (Tab "Interface – 1990
22 Financials", Col. C, Ln. 51) where the total reserve amounts used to develop

1 the rate base are located. RUCO's rate base adjustment # 4 should be
2 rejected because RUCO is incorrect.

3 **FUTURE REPORTING REQUIREMENTS**

4 **Q. IS QWEST WILLING TO PROVIDE STAFF ITS UNADJUSTED**
5 **SEPARATED RESULTS OF OPERATIONS TO STAFF AS A MATTER OF**
6 **COURSE?**

7 A. Yes. Providing unadjusted standard reports of separated results of
8 operations would not be unduly burdensome.

9 **Q. ARE ALL OF THE ADJUSTMENTS THAT STAFF PROPOSES TO**
10 **QWEST'S UNADJUSTED RESULTS OF OPERATIONS CORRECT?**

11 A. No. As set forth in my rebuttal and rejoinder testimony, Qwest disagrees with
12 the following adjustments:

- 13 ▪ Accrual basis accounting for OPEBs per Carver testimony;
14 ▪ SOP 98-01 accounting for software per Carver testimony; and
15 ▪ FCC Nonregulated Services revenue imputation.

16 **Q. WOULD ANY OF THE ADJUSTMENTS THAT STAFF PROPOSES TO**
17 **QWEST'S UNADJUSTED RESULTS OF OPERATIONS BE REDUNDANT?**

18 A. Yes. Two of the suggested seven proposed adjustments are unnecessary.
19 No adjustment for the Calculation of Depreciation expense/reserves at ACC
20 approved rates is necessary because Qwest's unadjusted separated results
21 of operations will reflect depreciation expense and reserves at ACC approved

1 rates. No adjustment for SOP 98-1 accounting for software is necessary
2 because Qwest's books already reflect the adoption of SOP 98-1.

3 **Q. IS QWEST WILLING TO PREPARE A SEPARATE REPORT THAT**
4 **INCLUDES PRESCRIBED RATE CASE ADJUSTMENTS?**

5 A. No. Qwest should not be burdened with additional reporting responsibilities
6 that its competitors do not bear. This is true particularly because Staff has
7 not demonstrated that a separate report with additional rate case adjustments
8 provides information that is of high enough value or of great enough
9 importance for Qwest to bear the burden of preparing such a report. If Staff
10 believes the report would be useful, it can prepare the report, particularly
11 because two of the seven adjustments are unnecessary (depreciation and
12 SOP 98-1) and two are of a fixed amount (directory imputation and cash
13 working capital). The remaining three adjustments involve issues disputed in
14 this case (pension asset determined by Mr. Carver's retrospective analysis,
15 FCC non-regulated services imputation and assumption that accrual basis
16 accounting for OPEBs began in 1999).

1

REVENUE REQUIREMENT

2 **Q. HAS QWEST UPDATED ITS CALCULATION OF REVENUE**

3 **REQUIREMENT SINCE YOUR REBUTTAL TESTIMONY WAS FILED?**

4 A. No. The short time available for preparing rejoinder testimony did not permit
5 Qwest to update its revenue requirement calculation to reflect all the
6 necessary changes that Qwest has identified. However, Qwest
7 Corporation—Exhibit PEG-RJ05 is a summary of the changes to Qwest's
8 revenue requirement identified since its last updated calculation was
9 prepared. It shows a revenue requirement of approximately \$275 million on
10 an original cost basis rate base and \$355 million revenue requirement on a
11 fair value rate base.

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

13 A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman

WILLIAM A. MUNDELL
Commissioner

MARC SPITZER
Commissioner

MIKE GLEASON
Commissioner

KRISTIN K. MAYES
Commissioner

**IN THE MATTER OF QWEST CORPORATION'S
FILING AMENDED RENEWED PRICE
REGULATION PLAN**

**DOCKET NO.
T-01051B-03-0454**

**IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS**

**DOCKET NO.
T-00000D-00-0672**

REJOINDER EXHIBITS OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation
Rejoinder Exhibits of Philip E. Grate
January 27, 2005

INDEX OF EXHIBITS

DESCRIPTION	EXHIBIT
Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods	PEG-RJ01
Detail of test of Staff's and Qwest's revenue annualization methodology including data, assumptions, and adjustments used.	PEG-RJ02
Corrected calculations of Staff Adjustments C-19 and C-24	PEG-RJ03
Calculation of Qwest Adjustment PFN-18, Imputation of BSI remote collocation revenue	PEG-RJ04
Rolldown estimating revised revenue requirement	PEG-RJ05
Report of task force concerning Broadband Services, Inc. Billing for Physical Remote Collocation	PEG-RJ06
Data request No. Qwest 10-20 to Staff and response of Staff	PEG-RJ07
Staff's responses to Qwest's Twenty-second and Twenty-third sets of Data Request	PEG-RJ08

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Red Herring #1: Offbook accounting system

At page 5, line 21, Mr. Carver's surrebuttal testimony reads:

Mr. Grate does accurately quote Rule R14-2-510(G), at rebuttal page 9:

2. Each utility shall maintain its books and records in conformity with the Uniform Systems of Accounts for Class A, B, C and D Telephone Utilities as adopted and amended by the Federal Communications Commission ...

Other than requiring Qwest to maintain its books and records in conformity with the FCC USOA, this Rule does not address nor is it dispositive of the ratemaking treatment to be afforded any specific accounting change for Arizona regulatory purposes. In fact, Qwest has maintained an offbook accounting system for many years to recognize differences in jurisdictional accounting that exist between the FCC and the state jurisdictions in which the Company provides regulated telecommunications service.

This testimony is a red herring because the issue is not whether, for ratemaking purposes, the Commission can order different accounting than is prescribed by the USOA and incorporated into Arizona regulatory accounting by Rule R14-2-510(G). The issue is whether the Commission did order Qwest to employ different accounting for software than the accounting prescribed by the USOA and incorporated into Arizona regulatory accounting by operation of Rule R14-2-510(G). All parties agree that the answer is "no." Nothing in Mr. Carver's testimony shows the case to be otherwise.

Red Herring #2: Following the USOA is ceding authority to the FCC

At page 6, line 1, Mr. Carver's surrebuttal testimony reads:

Further, I do not believe that this rule should be interpreted, nor to the best of my knowledge has it been in the past with respect to Qwest, as ceding any authority to the FCC regarding accounting methodologies used for Arizona revenue requirement purposes.

Arizona's regulatory accounting follows FCC accounting. As promulgated by the Commission, Rule R14-2-510(G) follows the USOA as adopted and amended by the Federal Communications Commission. Using the accounting methodologies adopted by the USOA does not cede authority to the FCC, it complies with

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Arizona's Administrative Code. The argument that by complying with rules promulgated by the Commission and incorporated into the Arizona Administrative Code the Commission would be ceding any authority to the FCC is specious. The Commission has already promulgated its rule.

Red Herring #3: What Mr. Carver didn't claim about Rule R14-2-510(G).

At page 6, line 6, Mr. Carver's surrebuttal testimony reads:

I have not claimed that R14-2-510(G) requires Arizona utilities to seek ACC approval prior to recognizing an FCC adopted change in accounting method for Arizona accounting and reporting purposes.

This testimony is a red herring because the issue is not about what Mr. Carver didn't claim. Rule R-2-510(G) prescribes the use of the USOA as adopted and amended by the Federal Communications Commission for purposes of regulatory accounting in Arizona. The issue is whether, as Mr. Carver's direct testimony¹ asserts, Qwest must first propose and seek Commission approval of the change in accounting method already incorporated into the USOA and adopted in Arizona by operation of Rule R-2-510(G).

Red Herring #4: Whether or not Rule R14-2-510(G) provides for automatic recognition for ratemaking purposes.

At page 6, line 8, Mr. Carver's surrebuttal testimony reads:

Nor do I believe that the cited Rule provides for the automatic recognition of any FCC interstate accounting change for Arizona intrastate ratemaking purposes.

This testimony is a red herring because the issue at hand is not whether Rule R14-2-510(G) requires automatic recognition of accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R-2-510(G) for ratemaking purposes. The issue is whether accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R-2-510(G) are automatically incorporated into Arizona ratemaking absent a Commission order to the contrary. Nothing in Mr. Carver's direct or surrebuttal testimony suggests they are not. The history of Arizona ratemaking discussed in Qwest Corporation Exhibit PEG-

¹ Docket No. T-01051B-03-0454; Direct Testimony of Steven C. Carver; pp. 50-51.

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

R7 shows that they clearly are. At no point does Mr. Carver's surrebuttal offer any rebuttal to the analysis presented in Exhibit PEG-R7.

Red Herring #5: Mr. Grate changed his interpretation of Rule R14-2-510(G)

At page 6, line 16, Mr. Carver's surrebuttal testimony reads:

Subsequent to the filing of his direct testimony in this proceeding, Mr. Grate has altered Qwest's interpretation of R14-2-510(G) as requiring the adoption of SOP 98-1 (internal use software) in 1999, a matter that will be subsequently addressed in more detail.

This testimony is a red herring because Mr. Grate's direct testimony makes no mention of Rule R14-2-510(G) much less offers an interpretation of it. As Mr. Grate explained in rebuttal testimony, when he filed his direct testimony he was unaware of the existence of Rule R14-2-510(G). Consequently, it would be impossible for him to have interpreted it in his direct testimony and impossible for his interpretation to have changed between his direct testimony and his rebuttal testimony.

Red Herring #6: Qwest inconsistently applied Rule R14-2-510(G)

At page 6, line 18, Mr. Carver's surrebuttal testimony reads:

In any event, Qwest has inconsistently applied and considered this rule [Rule R14-2-510(G)] over the years.

Mr. Carver provides his own testimony in a prior case as an offer of proof for an allegation related to a Company witness' position, instead of offering the Company witness' testimony from that case. From reading Mr. Carver's testimony one cannot tell precisely what position the Company's witness took in the case. However, there is nothing in Mr. Carver's testimony that suggests the Company's interpretation of Rule R14-2-510(G) then was in any way inconsistent with the interpretation Mr. Grate provided in rebuttal testimony.

In any event, Mr. Carver's testimony on this point is a red herring because Qwest's interpretation of Rule R14-2-510(G) in a prior case on a different and unrelated issue has no bearing on the issue at hand now. The issue now is whether accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R-2-510(G) are

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

automatically incorporated into Arizona ratemaking absent a Commission order to the contrary.

Red Herring #7: Qwest says SOP 98-1 “should have been” adopted in 1999

At page 8, line 21, Mr. Carver’s surrebuttal testimony reads:

Now, Mr. Grate has taken the position that SOP 98-1 should have been adopted for Arizona regulatory accounting purposes -- in 1999.

This testimony is both misleading and a red herring because Mr. Grate’s testimony did not say that that SOP 98-1 should have been adopted for Arizona regulatory accounting purposes in 1999. It says it was adopted in 1999. Beginning on page 23, line 14, Mr. Grate’s rebuttal testimony reads:

Q. WHEN WAS SOP 98-1 ADOPTED FOR PURPOSES OF THE FCC’S USOA?

A. January 1, 1999.

Q. WHEN WAS SOP 98-1 ADOPTED FOR PURPOSES OF AND REGULATORY ACCOUNTING UNDER A.A.C. R-14-2-510 G?

A. January 1, 1999.

Q. WHEN DO RUCO AND QWEST BELIEVE SOP 98-1 WAS ADOPTED?

A. January 1, 1999.

Beginning on page 29, line 18, Mr. Grate’s rebuttal testimony also reads:

I concluded that Qwest’s adjustment PFA-03 regarding the adoption of SOP 98-1 was incorrect, because it assumed adoption in 2003 instead of 1999. I notified the parties of this conclusion in Qwest’s supplemental response to Staff’s data request UTI 4-1(a) as follows: “Qwest will revise its test year to reflect the adoption of SOP 98-1 effective January 1, 1999, the same date Qwest adopted SOP 98-1 for FCC reporting purposes.” In response to part (c) of that data request I provided an attachment with a revised calculation of Adjustment PFA-03 to reflect the fact that SOP 98-1 had been adopted January 1, 1999.

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

Red Herring #8: Qwest's position is bad for ratepayers

At page 8, line 22, Mr. Carver's surrebuttal testimony reads:

Qwest's shifting proposals present the worst possible scenario for ratepayers:

- Oppose any regulatory recognition of SOP 98-1 in Docket No. T-1051B-99-105, denying ratepayers the opportunity to enjoy the transition benefits of such adoption;
- Establish and maintain offbook accounting records for Arizona intrastate accounting purposes as if SOP 98-1 had never been implemented; and
- Now that Mr. Grate has concluded that SOP 98-1 should be recognized for Arizona intrastate regulatory purposes, adopt the accounting change retroactively to 1999.

This latest development in the SOP 98-1 saga is disingenuous at best. Unlike the scenario painted by Mr. Redding in the last rate case, Mr. Grate's creative accounting will deny, not delight, ratepayers with the early year benefits of SOP 98-1 adoption and jump right to the higher "permanent rate level" opined by Mr. Redding. It is interesting, though I suppose not surprising, that the Company consistently seeks to deny ratepayers any participation in the positive benefits of transitioning between accounting method changes but pulls out all the stops to make sure that any transition costs (e.g., prospective amortization of the FAS106 transition benefit obligation) are fully reflected in overall revenue requirement. So much for the "goose and gander" barb Mr. Grate casts at Mr. Brosch and myself in footnote 29 at page 41 of his rebuttal testimony.

Mr. Carver asserts that Mr. Grate's rebuttal testimony is "disingenuous at best" but offers no evidence or argument that would show why this is true. Instead, wearing his bias on his sleeve, Mr. Carver critiques Qwest's position to determine whether it is favorable to ratepayers, not whether the rebuttal testimony correctly presents and analyzes the facts.

Red Herring #9: ACC need not follow FCC accounting for ratemaking

At page 8, line 18, Mr. Carver's surrebuttal testimony reads:

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

- Q. Do you have any additional comments regarding Mr. Grate's statement at rebuttal page 14 that "It is clear that absent a Commission order to the contrary, an accounting method change incorporated into the USOA is (and consistently has been) automatically incorporated into Arizona regulatory accounting by operation of Rule R14-2-510 G."
- A. Yes. I have been advised by Counsel that the Arizona courts have held that the Arizona Constitution and the Arizona Statutes convey broad discretion to the Commission over ratemaking. However, Mr. Grate's citation to Rule R14-2-510(G) seems to attempt to construct a regulatory theory that, while not explicitly stated, Qwest is required to follow FCC accounting rules, which the Arizona Corporation Commission is obliged to adopt for ratemaking purposes. In my experience, this is simply not appropriate.

* * *

It defies logic to imply that both Qwest and the ACC must blindly follow for ratemaking purposes the accounting policies established by the FCC when the Arizona Court of Appeals clearly recognizes and defers to this Commission's constitutional authority to make such determinations.

This testimony is a red herring because nothing in Mr. Grate's direct or rebuttal testimony argues directly or indirectly that the ACC is obliged to adopt—blindly or otherwise—FCC accounting rules for ratemaking purposes. Beginning at page 27, line 17, Mr. Grate's rebuttal testimony says:

I concluded that Mr. Carver's testimony in the Company's last rate case was incorrect. With the exception of its order in the Company's 1994 rate case that explicitly rejected FAS 106 and adopted the capitalization method of accounting for STPUC (both at the behest of Mr. Carver), the Commission had adhered to Arizona's regulatory accounting rule for purposes of establishing the Company's revenue requirements.

Beginning at page 30, line 6, Mr. Grate's rebuttal testimony also says:

Analysis of Carver Surrebuttal Regarding Regulatory Accounting Methods

- Q. MR. CARVER COMPLAINS: “THIS REVISED POSITION...IS SPONSORED BY MR. GRATE EVEN THOUGH THE COMPANY HAS NEVER PREVIOUSLY PROPOSED NOR SOUGHT COMMISSION APPROVAL TO RECOGNIZE THIS ACCOUNTING CHANGE FOR INTRASTATE REGULATORY PURPOSES.”² WHAT IS YOUR RESPONSE?**
- A. I discovered in my research that Arizona has no requirement for the Company to seek or the Commission to grant approval of this accounting change. Under Arizona’s regulatory accounting rule, as promulgated by this Commission, the adoption of this change was automatic in 1999. Mr. Carver complains of non-compliance with a nonexistent requirement.

As Mr. Grate’s testimony makes clear, the issue in this case is not whether the ACC must follow FCC accounting rules for ratemaking purposes but whether accounting method changes incorporated into the USOA and adopted into Arizona regulatory accounting by operation of Rule R14-2-510(G) are automatically incorporated into Arizona ratemaking absent a Commission order to the contrary.

² Docket No. T-01051B-03-0454; Direct Testimony of Steven C. Carver; pp. 50-51.

Source File Type	Rev Type	2003-01	2003-02	2003-03	2003-04	2003-05	2003-06	2003-07	2003-08	2003-09	2003-10	2003-11	2003-12
Int: May 2004 Out of Period 2001 & 2002 (Acct 5240.5xxx & 5263.2)	Misc x							0	0	0	0	0	(240,159)
Misc: Jan & Mar 2004 OOP in PFN-01 (Various Accts: 5240, 5250, Int: 5263, 5264)	Misc x							(48,506)	(48,506)	(48,506)	(48,506)	(48,506)	(282,713)
Subtotal - Local								0	0	0	0	0	0
Subtotal - Intra Access								0	0	0	0	0	0
Subtotal - Toll								0	0	0	0	0	0
Subtotal - Intra Misc								0	0	0	0	0	(240,159)
C Manual Overlay in Dec03 1990s:								143,648	154,048	145,975	144,616	146,260	(1,681,232)
Wireless Bc (Overlay in Dec03 for Jan-Dec)	Misc												
Subtotal - Local													
Subtotal - Intra Access													
Subtotal - Toll													
Subtotal - Intra Misc													
D Manual Overlay in Booked Jan04 already reflected in Dec03 1990s:													
AT&T Roaming (Reverse full amount Incl in Dec03 1990s since have Normalized to months in 2004 OOP above)	Acc x							0	0	0	0	0	1,011,563
Subtotal - Local													
Subtotal - Intra Access													
Subtotal - Toll													
Subtotal - Intra Misc													
E Reverse 2004 Price Decrease from Apr-Jun 2004:													
Reverse Local Price Decrease as Shown in PFN-04	Lcl												
Reverse Local Price Decrease Shown as Access in PFN-04	Acc												
Note: Price Decrease for Access was temporarily in effect Apr 1 - Jul 1.	Acc												
Subtotal - Local	Lcl							0	0	0	0	0	0
Subtotal - Intra Access	Lcl							0	0	0	0	0	0
Subtotal - Toll	Acc												
Subtotal - Intra Misc	Acc												
F Sum Normalizing Intrastate Adj's July 2003 - June 2004:													
Local								(160,015)	(160,015)	(1,463,628)	(646,861)	(662,868)	2,749,868
Intra Access								(48,506)	(48,506)	(48,506)	(48,506)	(48,506)	728,850
Toll								(37,815)	0	0	(158,000)	0	0
Intra Misc								(502,694)	19,750	268,561	391,887	(27,295)	3,874,145
TOTAL								(749,030)	(186,772)	(1,243,574)	(461,480)	(738,770)	7,352,962
G Normalized Intrastate July 2003 - June 2004:													
Local								69,477,783	68,328,655	69,016,975	66,315,478	66,466,576	66,127,052
Intra Access								5,938,396	6,221,219	6,165,115	6,588,458	6,135,856	5,719,591
Toll								1,025,647	963,477	900,798	834,807	821,070	779,542
Intra Misc								6,155,383	7,890,248	7,861,266	7,774,308	8,497,693	10,632,039
TOTAL								82,597,219	83,403,586	83,944,153	81,513,051	81,921,294	83,458,224

Rev	Source File	Type	2004-01	2004-02	2004-03	2004-04	2004-05	2004-06	2003 YTD	Jun03-Jun04
	Int: May 2004 Out of Period 2001 & 2002 (Acct 5240.5xxx & 5263.2)									
	Misc Jan & Mar 2004 OOP in PFN-01 (Various Accts: 5240, 5250, Int: 5263, 5264)	Misc	219,580		20,579		2,308,748			2,308,748
	Subtotal - Local		0		0	0	2,484,775			0
	Subtotal - Intra Access		816,283		0	0	6,090,657			2,484,775
	Subtotal - Toll		0		0	0	0			6,381,695
	Subtotal - Intra Misc		219,580		20,579	0	2,308,748			2,308,748
C	Manual Overlay in Dec03 1920s:									
	Wireless B&C (Overlay in Dec03 for Jan-Dec)	Misc								(946,685)
	Subtotal - Local									0
	Subtotal - Intra Access									0
	Subtotal - Toll									0
	Subtotal - Intra Misc									(946,685)
D	Manual Overlay in Booked Jan04 already reflected in Dec03 1990s:									
	AT&T Roaming (Reverse full amount Incl in Dec03 1990s since have Normlzd to months in 2004 OOP above)	Acc								1,011,563
	Subtotal - Local									0
	Subtotal - Intra Access									1,011,563
	Subtotal - Toll									0
	Subtotal - Intra Misc									0
E	Remove 2004 Price Decrease from Apr-Jun 2004:									
	Reverse Local Price Decrease as Shown in PFN-04	Lcl				1,108,333	1,108,333			
	Reverse Local Price Decrease Shown as Access in PFN-04	Acc				416,667	416,667			
	Note: Price Decrease for Access was temporarily in effect Apr 1 - Jul 1.									
	Subtotal - Local					0	0			
	Subtotal - Intra Access					1,108,333	1,108,333			3,325,000
	Subtotal - Toll					416,667	416,667			1,250,000
	Subtotal - Intra Misc									0
F	Sum Normalizing Intrastate Ad's July 2003 - June 2004:									
	Local		0			1,108,333	3,593,108			5,466,254
	Intra Access		816,283			416,667	6,507,324			8,643,258
	Toll		0			0	0			(195,815)
	Intra Misc		219,580		20,579	0	2,308,748			6,573,261
	TOTAL		1,035,863		20,579	1,525,000	12,409,180			20,486,959
G	Normalized Intrastate July 2003 - June 2004:									
	Local		65,693,934	64,301,680	63,636,579	63,662,338	62,063,978	61,898,194		786,985,221
	Intra Access		6,218,648	6,495,203	6,320,966	6,858,073	6,367,302	7,289,758		76,318,682
	Toll		751,372	757,649	712,325	752,676	665,443	604,781		9,569,587
	Intra Misc		8,704,763	7,966,649	8,739,004	9,048,373	8,951,958	9,391,902		101,813,595
	TOTAL		81,368,717	79,521,181	79,408,874	80,321,460	78,048,681	79,184,635		974,691,086

YEAR	2004
JEC	AZ

Sum of AMT	YEAR	MONTH	ACCOUNT	Rev Type	Intra%	DR/<CR>	Adjust
REFID	EGID	EVT_GRP_DESC	EVT_GRP_DESC			Intra \$	May04
2216	2004050000000503	ENTRY TO MOVE MONEY TCS CAN BE REFERRED TO SU	41209000				
			50011100	Local	100.00%	2,484,775	2,484,775
			50842231	Access	100.00%	5,733,914	5,733,914
			50843110	Access	100.00%	356,743	356,743
			52405121	Misc	75.64%	797,062	797,062
			52405531	Misc	75.64%	474,804	474,804
			52405532	Misc	75.64%	203,488	203,488
			52632000	Misc	70.98%	833,394	833,394
2216 Total							
Grand Total							

**5240 Rent Compensation
 DRI<CR> Ledger Amounts**

JEC AZ

Sum of AMT YEAR	MONTH	MANSUB		Grand Total
		52407000	52408000	
2003	01	83,366	1,950,483	2,033,849
	02	83,366	1,950,483	2,033,849
	03	83,366	1,950,483	2,033,849
	04	83,366	1,950,483	2,033,849
	05	83,366	1,950,483	2,033,849
	06	83,366	1,950,483	2,033,849
	07	83,366	1,415,409	1,498,775
	08	83,366	1,415,409	1,498,775
	09	83,366	1,415,409	1,498,775
	10	83,366	1,415,409	1,498,775
	11	83,366	1,415,409	1,498,775
	12	83,366	1,415,409	1,498,775
2003 Total		1,000,392	20,195,352	21,195,744
2004	01	83,366	1,369,901	1,453,267
	02	83,366	1,369,901	1,453,267
	03	83,366	1,369,901	1,453,267
	04	83,366	1,369,901	1,453,267
	05	83,366	1,793,756	1,877,122
	06	83,366	1,454,672	1,538,038

Yr 2003 Intra Factor Intra 14,803,278 **DRI<CR> Ledger Amounts**
 21,195,744 69.841%

Jul2003-Jun2004 18,220,878 69.841% 12,725,607 **DRI<CR> Ledger Amounts**

Az Factors Without FCC Dereg

1990s Intrastate Factor:

5230 FRA
5240 FRA
5250 FRA
5260 FRA

2003 YTD

1.0000
0.7564
0.7588
0.7098

Qwest Corrections to
 Staff Schedule C-19

QWEST CORPORATION
 DOCKET NO. T-010518-03-0454
 FCC DEREGULATED SERVICES -- REVENUE IMPUTATION
 TEST YEAR ENDING 12/31/2003

(000's)
CONFIDENTIAL

Line No.	Description (A)	Qwest ATL FCC Dereg (excl. B&C) (B)	Qwest ATL Remove Payphone (C)	Remove Planning/ Payphone "Correction" (D)	Remove FCC Dereg In AZ Price Cap Baskets (E)	Remove "Corrected" Voice Messaging (State Dereg Rec.) (F)	Pro Forma Adjustments (G)	Qwest Adjustment Omitted by Staff in Error (G1)	Qwest Pro Forma Adjustment (G2)	Remove Qwest Profoma Relating to "FCC Dereg In AZ Price Cap Baskets" & VMS (G2)	Total "Corrected" FCC Dereg Remaining ATL (H) = Sum B:G2	FCC Dereg Staff Revenue 50% Imputation (I)	Adjusted FCC Dereg Remaining ATL (J)
1	Miscellaneous	\$ 98,021	\$ (8,613)	\$ (8,613)	\$ (55,836)	\$ (16,855)	\$ (12,422)	\$ 7,664	\$ 12,146	\$ 24,106	\$ (4,405)	\$ 19,700	
2	Total Operating Revenues	\$ 98,021	\$ (8,613)	\$ (8,613)	\$ (55,836)	\$ (16,855)	\$ (12,422)	\$ 7,664	\$ 12,146	\$ 24,106	\$ (4,405)	\$ 19,700	
3	Expenses												
4	Maintenance	35,372	(2,868)	(2,868)	(30,110)	(2,040)				267			267
5	Engineering Expense	9	(0)	(0)	(3)	(5)				0			0
6	Network Operations	7,840	(440)	(440)	(7,081)	(310)				7			7
7	Network Administration	6	(0)	(0)	(1)	(7)				0			0
8	Other	7	(0)	(0)	(4)	(3)				0			0
9	Total Cost of Services & Products	43,236	(3,310)	(3,310)	(37,199)	(2,366)				275			275
10	Customer Operations	29,640	(6,775)	(6,775)	(8,784)	(4,823)				9,426			9,426
11	Corporate Operations	23,967	(17,755)	(17,755)	(7,529)	(1,942)				3,395			3,395
12	Property & Other Taxes	1,910	(1,024)	(1,024)	(447)	(339)				94	(16)		78
13	Uncollectibles	1,271	110	110	(879)	(248)				253	(81)		172
14	Total Selling, General and Administrative	58,808	(8,944)	(8,944)	(17,639)	(7,353)				13,159	(97)		13,062
15	Other Operating Income & Expense	(1)	(0)	(0)	(0)	(0)				(0)			(0)
16	Depreciation Expense	8,523	(810)	(810)	(3,745)	(2,993)				881			881
17	Total Operating Expense	108,565	(13,064)	(13,064)	(58,582)	(12,712)				14,315	(97)		14,218
18	Income From Operations	(10,544)	4,452	4,452	(4,143)	(4,143)				7,664	(4,306)		5,483
19	Federal Income Tax	(4,210)	1,562	1,562	1,286	(1,235)				2,495	(1,403)		1,593
20	State & Local Income Tax	(2,194)	888	888	611	(725)				846	(300)		631
21	Net Operating Income	(4,140)	2,001	2,001	849	(2,184)				7,345	(2,605)		3,259
22	Rate Base												
23	Telephone Plant In Service	105,400	(23,574)	(23,574)	(38,958)	(26,195)				15,863			15,863
24	Materials and Supplies	370	(12)	(12)	(192)	(121)				43			43
25	Accumulated Depr. & Amort Reserve	(62,394)	12,669	12,669	445	19,878				(8,388)			(8,388)
26	Customer Deposits	(5,901)	1,678	1,678	45	1,816				(589)			(589)
27	End-Of-Period Rate Base	37,438	(9,239)	(9,239)	(16,372)	(4,822)				6,864			6,864
28	Return On Investment	-11.06%				47.25%				85.19%			47.34%
	Revenue Requirement	13,073	(4,869)	(4,869)	(6,287)	(4,065)				(12,420)	4,405		(4,405)

FOOTNOTES:
 (a) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & sheet "Interface-1990Financials".
 (b) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & Adjustment PFN-12, Planning for Enhanced Services.
 (c) Source: Staff Adjustment C-1 & Qwest Adjustments PFN-03, Revised Operating Income Annualization (trending), & PFN-01, Revised Out of Period Revenues.
 (d) Revenue Imputation Adjustment

End-Of-Period Rate Base	Staff Proposed Rate of Return	Operating Income Required	Net Operating Income Available	Operating Income Deficiency	Revenue Conversion Factor	Revenue Deficiency (Excess)	ACC Allowance D. 58927	Staff Proposed Imputation	Change in ACC Staff Revenue Requirement
\$ 6,864	9.50%	654	5,864	(5,210)	1.69098	(8,811)	50%	(4,405)	(6,576)
									4,405
									10,982

(e) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & sheet "Interface-1990Financials".
 (f) Source: Qwest spreadsheet "az1203_Revised 10-27-04.xls" & Adjustment PFN-12, Planning for Enhanced Services.
 (g) Source: Staff Adjustment C-1 & Qwest Adjustments PFN-03, Revised Operating Income Annualization (trending), & PFN-01, Revised Out of Period Revenues.
 (h) Revenue Imputation Adjustment

Change in ACC Staff Revenue Requirement
 C-19 Original (Per Schedule E pg 1 Line 36 Col D)
 With Qwest Corrections to C-19 (using Staff ROR & Rev/Mult)
 Change in ACC Staff Revenue Requirement

Qwest Corrections to
 Staff Schedule C-24

QWEST CORPORATION
 DOCKET NO. T-01051B-03-0454
 VOICE MESSAGING -- STATE DEREGULATED SERVICE
 TEST YEAR ENDING 12/31/2003
 (000\$)

CONFIDENTIAL

Line No.	Description	(A)	(B)	(C)	D	E=D	F=C-E
			"Corrected" Voice Messaging (State Dereg)	Staff Adjustment Removing Voice Messaging	Qwest Profomas Relating to VMS (From Corrected C-19)	Corrected Remove Qwest Profomas Relating to VMS	Corrected Staff Adjustment Removing Voice Messaging
1	Revenues		\$ 16,855			\$ 4,081	
2	Miscellaneous		16,855		(4,081)	4,081	(12,774)
	Total Operating Revenues				(4,081)	4,081	(12,774)
3	Expenses						
4	Maintenance		2,040	(2,040)			(2,040)
5	Engineering Expense		5	(5)			(5)
6	Network Operations		310	(310)			(310)
7	Network Administration		7	(7)			(7)
8	Other		3	(3)			(3)
	Total Cost of Services & Products		2,366	(2,366)			(2,366)
9	Customer Operations		4,823	(4,823)			(4,823)
10	Corporate Operations		1,942	(1,942)			(1,942)
11	Property & Other Taxes		339	(339)			(339)
12	Uncollectibles		248	(248)			(248)
13	Total Selling, General and Administrative		7,353	(7,353)			(7,353)
14	Other Operating Income & Expense		(0)	0			0
15	Depreciation Expense		2,993	(2,993)			(2,993)
16	Total Operating Expense		12,712	(12,712)			(12,712)
17	Income From Operations		4,143	(4,143)	(4,081)	4,081	(62)
18	Federal Income Tax		1,235	(1,235)	(1,329)	1,329	94
19	State & Local Income Tax		725	(725)	(284)	284	(441)
20	Net Operating Income		\$ 2,184	\$ (2,184)	\$ (2,468)	\$ 2,468	\$ 284
21	ACC Staff Adjustment to Remove Test Year Revenues and Expenses Consistent with Staff Recommendation to Deregulated Voice Messaging Services				(2,468)	2,468	
	Revenue Requirement			3,693	(4,173)		(480)

FOOTNOTES:

(a) Source: Staff Workpaper C-19 & Qwest confidential response to Staff Data Request UT1 9-9, Attachment B -- corrected for Planning for Enhanced Services.

Tax Rates Used in Cols D & E:	
Federal Income Tax	32.561%
State & Local Income Tax	6.968%
ACC Staff RevMult Used in Revenue Requirement:	
Revenue Conversion Factor	1.69098

Change in ACC Staff Revenue Requirement	
C-24 Original (Per Schedule E pg 1 Line 41 Col D)	3,685
With Qwest Corrections to C-24 (using Staff RevMult)	(480)
Change in ACC Staff Revenue Requirement	(4,166)

Data Worksheet for Qwest Corrections to ACC Staff Schedules C-19 and C-24:

1) PFN-03 Miscellaneous Dereg Revenue (Acct 5280) Adjustments:

Source file -- Op_Inc_Normal_PriceAdjusted_20041019.xls; tab: Summary; Col: G.

Line	Type	Account	(G)	Input Correction to ACC Staff Adj C-19 Revised Col (G2)	Remove Qwest Profoma Relating to "FCC Dereg In AZ Price Cap Basket" & VMS	Remainde r	Input Correction to ACC Staff Adj C-24 Revised Col D
			PFN-03 Intrastate Increase (Decrease) [\$ 000's]				Profoma Amounts In Test Year Related to VMS
28	Miscellaneous	5280.13 - Miscellaneous - Account Recording	25			25	
29	Miscellaneous	5280.1421 - Miscellaneous - Business Voice Recur	359	(359)		0	359
30	Miscellaneous	5280.1423 - Miscellaneous - Residence Voice Msg Recur	(5,357)	5,357		0	(5,357)
31	Miscellaneous	5280.2210 - Miscellaneous - Wire Mtce Business Recur	323	(323)		0	
32	Miscellaneous	5280.2221 - Miscellaneous - Wire Mtce Residence Recur	(8,936)	8,936		0	
33	Miscellaneous	5280.2222 - Miscellaneous - Wire Mtce Residence NonRecur	1,469	(1,469)		0	
34	Miscellaneous	5280.2239 - Miscellaneous - Wire Mtce Bus NonRecurring	(533)	533		0	
35	Miscellaneous	5280.53 - Miscellaneous - Enhanced Directory Assistance	(407)	407		0	
Subtotal			(13,058)	13,083		25	(4,999)
			Subtotal matches ACC Staff Schedule C-1 pg.1 Line 12.				

2) PFN-01 Miscellaneous Dereg Revenue (Acct 5280) Adjustments:

Source file -- Out_of_Period_2003_Revised_01-25-05 Rejoinder.xls; TABS: "5) UTI 10-8 Att A NONREG" and "14) UTI 3-36S1 Con Att B"

NOTE: Data from tab "5) UTI 10-8 Att A NONREG" was revised 1-25-04 to correct sign reversal and show impacts as 100% intrastate

Category	YEAR	Account Descr	MAINSUB	Total (\$Whole) {DR/<CR>}	PFN-01 Intrastate Increase (Decrease) [\$ 000's]	Remove Qwest Profoma Relating to "FCC Dereg In AZ Price Cap Basket" & VMS	Remainde r	Profoma Amounts In Test Year Related to VMS
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	160,011	(160)	160	0	(160)
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	(5,830)	6	(6)	0	6
Miscellaneous	2004	Voice Messaging - Tariffed Expense	52803130	24,194	(24)	24	0	(24)
Miscellaneous	2004	National Dir Asst Listings	52803420	(18,940)	19	(19)	0	
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,150	27	(27)	0	27
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	14,504	15	(15)	0	15
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	(7,371)	(7)	7	0	(7)
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	7,926	8	(8)	0	8
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	7,762	8	(8)	0	8
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	56,009	56	(56)	0	56
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	(28,143)	(28)	28	0	(28)
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,773	28	(28)	0	28
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,651	28	(28)	0	28
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	27,418	27	(27)	0	27
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	236,454	236	(236)	0	236
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	288,267	288	(288)	0	288
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	233,709	234	(234)	0	234
Miscellaneous	2003	Voice Messaging - Tariffed Expense	52803130	176,980	177	(177)	0	177
Miscellaneous	2003	Other - Sales/Joint Marketing Service - Affiliate Norecurring	52809712		(301)		(301)	
Subtotal					636	(937)	(301)	918
TOTAL Sections 1 & 2					(12,422)	12,146	(276)	(4,081)
					Input to ACC Staff Schedule C-19 pg.1 Column G Line 1			

NOTE: **FCC Deregulated Account Map to Product:**
 5280.13 - 21110 CDAR (Account Reporting)
 5280.14 - 23400 Voice Messaging
 5280.22 - 13100 Premise Service
 5280.313 - 23400 Voice Messaging
 5280.342 - 35010 National Directory Assistance
 5280.53 - 35010 National Directory Assistance
 5280.9712 - 45020 Joint Marketing

Data Worksheet for Qwest Corrections to ACC Staff Schedules C-19 and C-24:

3) PFN-09 Call Centers Miscellaneous Dereg Revenue (Acct 5280) Adjustments:

Source file -- CallCntrExp.xls;tab:AffilRev-Adj;tab:Summary;Col:G.

YEAR 2003 - Estimated Re-allocation of Affiliate Revenues Booked in 2003

Line	Description	Source	Amount \$ Whole)	Input Correction to ACC Staff Adj C- 19 Revised	PFN-09 Intrastate Adjustment (00's)	Qwest Profoma Relating to FCC Dereg In AZ Price Cap Basket"& VMS	Remainder
1	Total Service Orders Processed for QLDC in Year 2003	Records	2,795,288				
2	Per Service Order Rate Charged to QLDC	Records	\$ 31.51				
3	Amount Paid by QLDC to QC - AC 5280.9712)	L1xL2	\$ 88,079,524.88				
4	Arizona Percent	Records HQ Prorate	16.587%				
5	AZ Revenues HQ Allocated	L3xL4	\$ 14,609,750.79				
6	Actual AZ Affiliate Revenue Booked in Year 2003 for the Service Order Function	Records	\$ 5,142,967.67				
7	Difference	L5-L6	\$ 9,466,783.12				
8	Intrastate Percent	Test Year	80.952%				
9	Difference = Additional Affiliate Revenues	L7xL8	\$ 7,663,512.41	7,664	0	7,664	

Note:

1)Account 5280.9712 is part of the Joint Marketing product group for FCC Deregulated services.

QWEST CORPORATION
 ARIZONA INTRASTATE OPERATIONS
 Test Year Ending December 31, 2003
 (IN THOUSANDS OF DOLLARS)

Date: 1/26/2005
 Time: 4:56 PM

PFN-18

BSI Remote
 Colocation Revenue

Revenues

1	Local Service Revenues	
2	Network Access Service Revenues	
3	Long Distance Network Service Rev.	
4	Miscellaneous	1,169
5	Total Oper. Rev. (L1 thru L4)	<u>1,169</u>

Expenses

6	Maintenance	
7	Engineering Expense	
8	Network Operations	
9	Network Administration	
10	Access Expense	
11	Other	
12	Total Cost of Services & Products(L6 thru L11)	<u>0</u>
13	Customer Operations	
14	Corporate Operations	
15	Property & Other Taxes	
16	Uncollectibles	
17	Tot Selling, General & Admin.(L13 thru L16)	<u>0</u>
18	Other Operating Income & Expense	
19	Depreciation Expense	
20	Universal Service Fund	
21	Link Up America	
22	Total Operating Expense(L12+L17 thru L21)	<u>0</u>
23	Income From Operations (L5-L22)	<u>1,169</u>

Taxes

24	Federal Income Tax (L23-L30) x Eff FIT Rate	383
25	State & Local Income Tax (L23-L30) x Eff SIT Rate	76
26	Net Operating Income (L23-L24-L25)	<u>710</u>

Other

27	Nonoperating Income & Expense	
28	Nonoperating Income Tax	
29	Net Operating Earnings (L26-L27-L28)	<u>710</u>
30	Interest Expense	
31	Juris Diff & Nonreg Net Income	
32	Extraordinary Items	
33	Net Income (L29-L30-L31-L32)	<u>710</u>

Rate Base

34	Telephone Plant In Service	
35	Short-Term Plant Under Construction	
36	Materials and Supplies	
37	Allowance for Cash Working Capital	
38	Accumulated Depreciation & Amortization Reserve	
39	Accumulated Deferred Income Tax	
40	Customer Deposits	
41	Land Development Agreement Deposits	
42	Other Assets & Liabilities	
43	End-of-Period Rate Base	<u>0</u>
	(L34+L35+L36+L37-L38-L39-L40-L41+L42)	

Arizona Corporation Commission
Docket No.

BSI Remote Colocation Revenue

Title:
Time: 458 PM
Date: 1/26/2005
Adj. # PFN-18

Qwest Corporation

Arizona Intrastate Operations

Add 2003 BSI Non-recurring Revenue

Test Year Ending December 31, 2003

\$000)

Operating Revenues	1,169
Operating Expenses	
Total Operating Income Taxes	459
Net Operating Income	710
Rate Base	0
Revenue Requirement	(1,199)

This adjustment adds Non-recurring revenue for shelves added at Physical Remote Collocation sites by BSI in 2003.

BSI PHYSICAL REMOTE COLLOCATION

CONFIDENTIAL

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @ \$668.13	Non-Recurring FDI Terminations per binder group @ \$558.99	Total Non-Recurring Charges	Intrastate Revenues @ .8095
X 5133 N 78 ST	4	4	01/01/03	13,890.08	8,943.84	22,833.92	18,484.06
X 252 N LAKEVIEW BLVD	3	3	01/02/03	10,417.56	6,707.88	17,125.44	13,863.04
X 2270 E PECOS RD	4	4	01/02/03	13,890.08	8,943.84	22,833.92	18,484.06
X 7200 N 43 AV	4	4	01/09/03	13,890.08	8,943.84	22,833.92	18,484.06
X 7639 N 42 LN	4	4	01/09/03	13,890.08	8,943.84	22,833.92	18,484.06
X 8755 N 43 AV	4	4	01/09/03	13,890.08	8,943.84	22,833.92	18,484.06
X 18955 N 67 AV	1	1	01/13/03	3,472.52	2,235.96	5,708.48	4,621.01
X 4801 E ROADRUNNER RD	2	2	01/13/03	6,945.04	4,471.92	11,416.96	9,242.03
X 5841 W DEL LAGO CIR	3	3	01/13/03	10,417.56	6,707.88	17,125.44	13,863.04
X 6749 N 43 AV	3	3	01/13/03	10,417.56	6,707.88	17,125.44	13,863.04
X 1201 E GLENN DR	4	4	01/13/03	13,890.08	8,943.84	22,833.92	18,484.06
X 4104 N 78 ST	4	4	01/13/03	13,890.08	8,943.84	22,833.92	18,484.06
X 6747 W ARROWHEAD LOOP RD	4	4	01/13/03	13,890.08	8,943.84	22,833.92	18,484.06
X 707 E MYRTLE AV	2	2	01/15/03	6,945.04	4,471.92	11,416.96	9,242.03
X 18301 N 9 ST	3	3	01/16/03	10,417.56	6,707.88	17,125.44	13,863.04
I 8401 W MONROE ST	1	0	01/27/03				
X 17824 N 20 ST	4	4	01/30/03	13,890.08	8,943.84	22,833.92	18,484.06
X 35603 N 33 LN	1	1	02/07/03	3,472.52	2,235.96	5,708.48	4,621.01
X 5020 E VILLAGE PKWY	3	3	02/14/03	10,417.56	6,707.88	17,125.44	13,863.04
X 1906 W WAYNE LN	5	5	02/28/03	17,362.60	11,179.80	28,542.40	23,105.07
X 2754 N HIGH NOON WY	4	4	03/03/03	13,890.08	8,943.84	22,833.92	18,484.06
X 43296 N NAVIGATION WY	9	9	03/03/03	31,252.68	20,123.64	51,376.32	41,589.13
X 10352 E WINDGATE PASS DR	1	1	03/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2066 W WOLF RUN DR	4	4	03/04/03	13,890.08	8,943.84	22,833.92	18,484.06
X 2594 W HASTINGS WY	5	5	03/04/03	17,362.60	11,179.80	28,542.40	23,105.07
X 5304 E VILLAGE PKWY	1	1	03/13/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1369 S GARDEN CIR E	1	1	03/21/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1372 S GARDEN CIR E	3	3	03/21/03	10,417.56	6,707.88	17,125.44	13,863.04
X 3655 W ANTHEM WY	1	1	03/26/03	3,472.52	2,235.96	5,708.48	4,621.01
X 9619 E DESERT CAMP DR	1	1	05/28/03	3,472.52	2,235.96	5,708.48	4,621.01
X 10902 E WINDGATE PASS DR	1	1	05/29/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3480 S CALISTOGA DR	2	2	06/23/03	6,945.04	4,471.92	11,416.96	9,242.03
X 3430 E MENLO PARK DR	2	2	06/24/03	6,945.04	4,471.92	11,416.96	9,242.03
X 42022 N GAVILAN PEAK PKWY	3	3	06/24/03	10,417.56	6,707.88	17,125.44	13,863.04
X 2294 W HASTINGS WY	7	7	06/24/03	24,307.64	15,651.72	39,959.36	32,347.10
X 2438 W PECOS RD	1	1	06/27/03	3,472.52	2,235.96	5,708.48	4,621.01
X 10875 N 78 ST	6	6	07/09/03	20,835.12	13,415.76	34,250.88	27,726.09
X 1351 E BUFFALO ST	2	2	07/10/03	6,945.04	4,471.92	11,416.96	9,242.03

1 shelf = SMU 4 FDI 4

CONFIDENTIAL

BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @ \$868.13	Non-Recurring FDI Terminations per binder group @ \$558.99	Total Non-Recurring Charges	Intrastate Revenues @ .8095
X 3395 E PALMER ST	2	2	08/07/03	6,945.04	4,471.92	11,416.96	9,242.03
X 42184 N MANTLE WY	2	2	08/07/03	6,945.04	4,471.92	11,416.96	9,242.03
I 4041 N CENTRAL AV	1	0	08/13/03	-	-	-	-
X I 1121 N 44 ST	10	0	08/29/03	-	-	-	-
X 1850 W WOLF RUN DR	4	4	08/29/03	13,890.08	8,943.84	22,833.92	18,484.06
X 5261 W IRONWOOD DR	4	4	08/29/03	13,890.08	8,943.84	22,833.92	18,484.06
X 112 E CHANDLER BLVD	1	1	09/22/03	3,472.52	2,235.96	5,708.48	4,621.01
X 15433 S 13 DR	1	1	09/22/03	3,472.52	2,235.96	5,708.48	4,621.01
X 590 W CHANDLER BLVD	1	1	09/22/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1502 E LIBERTY LN	1	1	09/24/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2374 W GERMANN RD	1	1	09/25/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2647 W COYOTE CREEK CT	4	4	09/29/03	13,890.08	8,943.84	22,833.92	18,484.06
X 4262 W ORANGEWOOD AV	1	1	09/30/03	3,472.52	2,235.96	5,708.48	4,621.01
X 5350 E DOUBLE TREE RANCH RD	1	1	09/30/03	3,472.52	2,235.96	5,708.48	4,621.01
X 593 E CANYON CREEK RD	1	1	09/30/03	3,472.52	2,235.96	5,708.48	4,621.01
X 130 N COLORADO ST	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 18200 N 9 ST	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 4231 W EVA ST	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 5205 N 78 ST	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 5801 N 78 ST	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 875 N MCQUEEN RD	2	2	09/30/03	6,945.04	4,471.92	11,416.96	9,242.03
X 5550 N 78 ST	3	3	09/30/03	10,417.56	6,707.88	17,125.44	13,863.04
X 700 E BELMONT AV	3	3	09/30/03	10,417.56	6,707.88	17,125.44	13,863.04
X 7708 N 12 ST	3	3	09/30/03	10,417.56	6,707.88	17,125.44	13,863.04
X 17030 N 15 ST	4	4	09/30/03	13,890.08	8,943.84	22,833.92	18,484.06
X 1860 E MICHIGAN AV	4	4	09/30/03	13,890.08	8,943.84	22,833.92	18,484.06
X 27527 N NORTERRA PKWY	4	4	09/30/03	13,890.08	8,943.84	22,833.92	18,484.06
X 7829 E VISTA DR	4	4	09/30/03	13,890.08	8,943.84	22,833.92	18,484.06
X 986 E SPECTRUM WY	1	1	10/01/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3130 E RYAN RD	1	1	10/07/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2604 S HARTFORD ST	1	1	10/10/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1498 E FRYE RD	1	1	10/13/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3493 W PARKSIDE LN	1	1	10/15/03	3,472.52	2,235.96	5,708.48	4,621.01
X 34203 N 24 AV	4	4	10/21/03	13,890.08	8,943.84	22,833.92	18,484.06
X 607 E DERRINGER WAY	1	1	10/24/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3230 W DYNAMITE BLVD	1	1	11/03/03	3,472.52	2,235.96	5,708.48	4,621.01
X 7613 S 20 ST	1	1	11/03/03	3,472.52	2,235.96	5,708.48	4,621.01
I 6683 S CLUBHOUSE DR	1	0	11/10/03	-	-	-	-
X 42337 N 45 DR	1	1	11/11/03	3,472.52	2,235.96	5,708.48	4,621.01

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BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @ \$868.13	Non-Recurring FDI Terminations per binder group @ \$558.99	Total Non-Recurring Charges	Intrastate Revenues @ 8095
X 10265 E ROB'S CAMP RD	1	1	11/15/03	3,472.52	2,235.96	5,708.48	4,621.01
X 25600 N STETSON HILLS LP	1	1	11/15/03	3,472.52	2,235.96	5,708.48	4,621.01
X 7602 S 21 DR	1	1	11/15/03	3,472.52	2,235.96	5,708.48	4,621.01
I 9400-7 W MARYLAND AVE	2	0	11/17/03	-	-	-	-
X 5025 N 36 ST	1	1	11/17/03	3,472.52	2,235.96	5,708.48	4,621.01
X 6258 S BRADSHAW WAY	1	1	11/17/03	3,472.52	2,235.96	5,708.48	4,621.01
X 4088 S POSSE TR	2	2	11/18/03	6,945.04	4,471.92	11,416.96	9,242.03
X 4104 S HIGLEY RD	1	1	11/21/03	3,472.52	2,235.96	5,708.48	4,621.01
I 4369 E VILLAGE PKWY	1	0	11/24/03	-	-	-	-
X 6201 S TURQUOISE DR	1	1	11/24/03	3,472.52	2,235.96	5,708.48	4,621.01
X 12603 E HEMLOCK WAY	2	2	11/24/03	6,945.04	4,471.92	11,416.96	9,242.03
X 13731 E SHANNON ST	1	1	11/25/03	3,472.52	2,235.96	5,708.48	4,621.01
X 24201 N 61 AV	1	1	11/25/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3129 W PINNACLE VISTA DR	1	1	11/25/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3595 S TATUM LN	1	1	11/25/03	3,472.52	2,235.96	5,708.48	4,621.01
I 875 W PECOS RD	1	0	11/26/03	-	-	-	-
X 2082 E WILLIS RD	1	1	11/26/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2897 W SHAUGHNESSEY RD	1	1	11/29/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3619 S CUPERTINO DR	2	2	12/02/03	6,945.04	4,471.92	11,416.96	9,242.03
X 28203 N 31 AV	1	1	12/03/03	3,472.52	2,235.96	5,708.48	4,621.01
X 8559 W BRILES RD	1	1	12/03/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1625 S SANDERS DR	1	1	12/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1708 S SANDERS DR	1	1	12/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 27240 N PLEASANT VALLEY DR	1	1	12/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 330 W GERMANN RD	1	1	12/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3600 E YALE ST	1	1	12/04/03	3,472.52	2,235.96	5,708.48	4,621.01
X 15725 E OCOTILLO RD	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1856 S BLUEJAY DR	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 19638 N 31 AV	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2135 E TAURUS PL	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2841 E AGRITOPIA LP	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2951 S HIGLEY RD	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3145 E WATERVIEW DR	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3720 E RAY RD	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3777 S NAPA LN	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 5300 S RIGGS MEADOWS DR	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 5791 S GILBERT RD	1	1	12/05/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1717 E OCOTILLO RD	1	1	12/08/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1730 E BROOKS FARM RD	1	1	12/08/03	3,472.52	2,235.96	5,708.48	4,621.01

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BSI PHYSICAL REMOTE COLLOCATION

SAI ADDRESS	Total Shelves	12/13/04 Billable Shelves	Initial Cabinet Turn Up Date	Non-Recurring Space per mounting unit @\$868.13	Non-Recurring FDI Terminations per binder group @\$558.99	Total Non-Recurring Charges	Intrastate Revenues @.8095
X 2099 E BLUE RIDGE WAY	1	1	12/08/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2100 W SAINT CHARLES AV	1	1	12/08/03	3,472.52	2,235.96	5,708.48	4,621.01
X 1320 N LAKE PARK DR	1	1	12/09/03	3,472.52	2,235.96	5,708.48	4,621.01
X 6506 S MCQUEEN RD	1	1	12/09/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2802 S LINDSAY RD	1	1	12/11/03	3,472.52	2,235.96	5,708.48	4,621.01
X 6753 S MAREN DR	1	1	12/12/03	3,472.52	2,235.96	5,708.48	4,621.01
X 950 W GERMANN RD	1	1	12/12/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3782 E MANZANITA RD	2	2	12/12/03	6,945.04	4,471.92	11,416.96	9,242.03
X 3321 W VINEYARD RD	1	1	12/16/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3574 S HIGLEY RD	1	1	12/16/03	3,472.52	2,235.96	5,708.48	4,621.01
X 7210 S 31 AV	1	1	12/16/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3869 S LANTANA RANCH BLVD	1	1	12/20/03	3,472.52	2,235.96	5,708.48	4,621.01
X 6029 S SUN GROVES BLVD	1	1	12/20/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2070 S ASHLAND RANCH RD	2	2	12/20/03	6,945.04	4,471.92	11,416.96	9,242.03
X 1310 S ASHLAND RANCH RD	1	1	12/23/03	3,472.52	2,235.96	5,708.48	4,621.01
X 29788 N SCOTTSDALE RD	1	1	12/23/03	3,472.52	2,235.96	5,708.48	4,621.01
X 3680 S GILBERT RD	1	1	12/23/03	3,472.52	2,235.96	5,708.48	4,621.01
X 8621 W VARNEY RD	2	2	12/23/03	6,945.04	4,471.92	11,416.96	9,242.03
X 1352 N PLEASANT DR	1	1	12/24/03	3,472.52	2,235.96	5,708.48	4,621.01
X 6586 W DEER VALLEY RD	1	1	12/25/03	3,472.52	2,235.96	5,708.48	4,621.01
X 2289 E OCOTILLO RD	1	1	12/31/03	3,472.52	2,235.96	5,708.48	4,621.01
Total				878,547.56	565,697.88	1,444,245.44	1,169,116.68

Miscellaneous Revenue
 Account 5240

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QWEST CORPORATION
Arizona Intrastate Operations
Test Year Ending December 31, 2003
ROLLODOWN OF REVENUE REQUIREMENT

	A	B	C	D = A+C
	Revenue Requirement - Rebuttal Exhibit PEG-R1	Revised Qwest or Uncontested ACC Staff Adjustments (Notes 1 & 2)	Change in Revenue Requirement	Revenue Requirement - Rejoinder Exhibit PEG- RJ05
A. Earned Return Per Books	0		0	0
B. Revenue Requirement Authorized	417,448		0	417,448
Accounting Adjustments				
PFA-01 Depreciation	(145,538)		0	(145,538)
PFA-02 Post Employment Benefits Other Than Pensions	40,002		0	40,002
PFA-03 REVISED SOP98 Adoption	19,005		0	19,005
PFA-04 Plant Under Construction	4,087		0	4,087
C. Total Accounting Adjustments	(82,444)	0	0	(82,444)
Normalizing Adjustments				
PFN-01 Out of Period Revenue and Expense	(19,781)	(11,250) #	8,532	(11,250)
PFN-02 In-Test-Year Rate Changes	7,272		0	7,272
PFN-03 Operating Income Annualization	44,706		0	44,706
PFN-04 Post-Test-Year Rate Changes	18,858		0	18,858
PFN-05 Wage and Salary Rates	211		0	211
PFN-06 Headquarters Factors Update	(4,447)		0	(4,447)
PFN-07 Rent Compensation Update	(2,924)		0	(2,924)
PFN-08 Incentive Compensation True-Up	(1,181)		0	(1,181)
PFN-09 Call Centers	(4,669)		0	(4,669)
PFN-10 Property Tax Update	(798)		0	(798)
PFN-11 Depreciation Synchronization	4,616		0	4,616
PFN-12 Planning for Enhanced Services TrueUp	(8,320)		0	(8,320)
PFN-13 Contingency Accruals	(6,011)		0	(6,011)
PFN-14 Separations Factors	(345)		0	(345)
PFN-15 Effective Income Tax Rates	330		0	330
PFN-16 Sponsorships	(493)		0	(493)
PFN-17 Separations Changes	(3,181)		0	(3,181)
PFN-18 BSI Remote Colocation Revenue		(1,199) #	(1,199)	(1,199)
PFN-S1 Remove Voice Messaging		(480) ##	(480)	(480)
PFN-S2 Qwest Wireless Prices (ACC Staff C-10)		(530) ###	(530)	(530)
PFN-S3 Re-Audit, D&O, Sec Litigation Costs (ACC Staff C-12)		(2,034) ##	(2,034)	(2,034)
PFN-S4 PUBLIC AFFAIRS COSTS (Staff ACC C-14)		(389) ##	(389)	(389)
PFN-S5 QSC COST EXCLUSIONS (Staff ACC C-15)		(116) ##	(116)	(116)
D. Total Normalizing Adjustments	23,843	(15,997)	3,784	27,627
Ratemaking Adjustments				
PFR-01 Directory Revenue Imputation	(74,196)		0	(74,196)
PFR-02 Fines and Penalties	(1,405)		0	(1,405)
PFR-03 Interest Synchronization	(19,526)		0	(19,526)
PFR-04 Cash Working Capital	(9,892)		0	(9,892)
PFR-05 Pension Asset	18,462		0	18,462
PFR-06 Remove 1991 Merger Cost	(4)		0	(4)
PFR-07 Charitable Contributions	(1,159)		0	(1,159)
PFR-08 Customer Deposits	130		0	130
E. Total Ratemaking Adjustments	(87,589)	0	0	(87,589)
F. Total Adjustments	(146,190)	(15,997)	3,784	(142,406)
G. Adjusted Revenue Requirement	271,258	(15,997)	3,784	275,042

Notes:

1) Data source:

- Source is a Qwest calculated adjustment.

- Source is an ACC Staff calculated adjustment (Schedule E).

2) Impact of changes in adjustments are assumed here to have a diminimus effect on other, dependent adjustments (i.e. Interest Sync & CWC).

Interest Sync and Cash Working Capital adjustments, while uncontested, are generally standard calculations based on a parties total adjusted Intrastate.

These adjustments will only be determined when the Commission renders a decision or the parties reach a settlement.

REDACTED

REDACTED

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS**

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

Furthermore, it should also be noted that Qwest's offbook accounting records have not complied with PAYGO accounting, as addressed in Decision No. 58927. At pages 69-70, Mr. Carver describes how Qwest has continued to maintain its Arizona intrastate accounting records on an accrual basis, except for the TBO amortization, not on PAYGO basis.

Respondent: Steven Carver

REQUEST: Qwest 10-18

Identify the date and method by which the Arizona Corporation Commission notified Qwest that it was authorized to begin using Statement of Financial Accounting Standards No. 106 (SFAS 106) to account for the cost of other post employment benefits (OPEBs) for ratemaking purposes in Arizona. Please provide copies of any and all documents that support your answer.

RESPONSE:

See the response to Qwest DR 10-17.

10-19 Please identify by citation (including the page and line numbers) the Arizona Corporation Commission decision or order that prescribes for Qwest how it is to amortize the Transition Benefit Obligation for ratemaking purposes.

RESPONSE:

See the responses to Qwest DRs 10-17 and 10-18. In Docket No. T-1051B-99-105, Staff and RUCO concurred with Qwest's proposed TBO amortization for ratemaking purposes. The Company was fully aware of its proposed TBO amortization and the fact that Staff and RUCO were supportive of such accounting for OPEB costs.

Respondent: Steven Carver

REQUEST: Qwest 10-20

Staffs Supplemental Response to Qwest Data Request No. 2-42 includes a document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and showing a due date of March 26, 2004, 3:00 p.m. On the page numbered 16 of that document the third full paragraph reads:

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS**

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

"Accumulated Deferred Income Taxes - Like accumulated depreciation, review of detailed transactions in the accumulated deferred income tax reserve balance generally yields low "payback" results in terms of rate case adjustments. However, any material transactions which impact the level of booked deferred taxes will be reviewed. In addition, component parts of the reserve will be compared to the regulatory treatment of associated balance sheet accounts for consistency between transactions and their related tax effects. For example, given the ACC's historical treatment of FAS 106 costs, deferred taxes associated with this accounting change may be treated as non-jurisdictional." Emphasis added.

- a. Please admit that the assumptions underlying the treatment of deferred taxes associated with this accounting change as non-jurisdictional are as follows:
1. The deferred tax balance arose as a result of timing differences between FAS 106 cash basis cost recognition under federal income tax law and accrual basis cost recognition under FCC rules; and
 2. The deferred taxes are non-jurisdictional in Arizona because unlike the FCC, Arizona employs cash basis cost recognition for Qwest's FAS 106 costs.

_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit, including but not limited to, a detailed explanation of what assumption about the Arizona Corporation Commission's historical treatment of FAS 106 costs UTI made with regard to treating as non-jurisdictional the deferred taxes associated with this accounting change.

RESPONSE:

- a.1. With regard to OPEB costs, accumulated deferred income taxes and the related ADIT reserve balance are associated with the timing difference between the recording of accrual basis costs and allowable IRC deductions for PAYGO, or cash basis, expenditures to or on behalf of eligible retirees.
- a.2. In general terms, the recognition of accumulated deferred income tax (ADIT) reserves in rate base follows ratemaking recognition of the underlying transactions giving rise to those tax/ book timing differences. In ACC Docket No. E-1051-93-183, then U S West proposed adoption of accrual accounting and rate base

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TENTH SET OF DATA REQUESTS**

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

recognition of both an OPEB liability and related debit deferred income tax reserve balance. In that proceeding, Staff proposed and the Commission adopted the continuation of PAYGO accounting in lieu of FAS106 accrual basis recognition. Staff Adjustment B-8 removed the OPEB liability and the debit ADIT reserve balances from rate base, increasing intrastate rate base by about \$5 million. In Docket No. T-1051B-99-105, the pro forma OPEB recommendations sponsored by Company witness Redding, including any embedded rate base and ADIT impacts, were not contested by Staff. In the current proceeding, Mr. Carver sponsors Staff Adjustment B-8, which recognizes a rate base reduction for the excess of cumulative OPEB accruals over PAYGO during the period 1999 through 2003 – net of related debit ADIT reserve impacts – consistent with Staff's adoption of Mr. Redding's OPEB recommendations in Docket No. T-1051B-99-105. The net effect of Staff Adjustment B-8 in the current proceeding increases rate base by about \$78.7 million, as compared to Qwest's proposed treatment.

Respondent: Steven Carver

REQUEST: Qwest 10-21

Staffs Supplemental Response to Qwest Data Request No. 2-42 includes a document entitled "Proposal to the Arizona Corporation Commission Utilities Division, Qwest Corporation Filing of a Renewed Price Cap Plan" prepared by Utilitech, Inc., 740 NW Blue Parkway, Ste. 204, Lee's Summit, MO and showing a due date of March 26, 2004, 3:00 p.m. On the page numbered 19 of that document the second full paragraph reads:

"FAS 106 - The cost of post-retirement benefit (OPEB) programs will be assessed on the basis of past Arizona precedent as well as Company efforts to mitigate cost exposures. The utilization of tax-advantaged funding vehicles and the existence of reasonable actuarial determinations of such costs will also be considered. UTI will work with ACC Staff personnel to formulate the position taken on this issue. The materiality of any amounts Qwest proposes to include in cost of service will be considered in determining the amount of project resources assigned to this area."

- a. Identify with specificity the past Arizona precedent to which the first sentence in the paragraph refers. Please provide a copy of any and all documents that establish the "past Arizona precedent" concerning OPEBs to which the first sentence refers.
- b. Please provide copies of any and all notes, correspondence, and other

COMMISSIONERS
JEFF HATCH-MILLER- Chairman
WILLIAM MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES



BRIAN C. MCNEIL
Executive Secretary

ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission
Qwest Corporation PEG-RJ08
Rejoinder Exhibits of Philip E. Grate
Docket No. T-01051B-03-0454
Page 1 of 25

January 25, 2005

Sent via email and First Class Mail

Timothy Berg
FENNEMORE CRAIG
3003 N. Central Avenue Ste. 2600
Phoenix, Arizona 85012

Norman G. Curtright
QWEST CORPORATION
4041 N. Central Avenue, Ste. 1100
Phoenix, Arizona 85012

Re: Qwest Corporation's Amended Renewed Price Regulation Plan
Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

Dear Messrs. Berg and Curtright:

Enclosed please find Staff's responses to Qwest's Twenty-first, Twenty-second and Twenty-third sets of Data Requests.

Should you have any questions, you may contact me at (602) 542-6022.

Very truly yours,

A handwritten signature in black ink that reads "Maureen Scott". The signature is stylized and written in cursive.

Maureen A. Scott
Attorney, Legal Division

MAS:daa
Enclosure

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TWENTY-FIRST SET OF DATA REQUESTS**

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

January 25, 2005

Arizona Corporation Commission
Qwest Corporation PEG-RJ08
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REQUEST NO.: Qwest 21-1

In answering this request, please refer to the Dunkel Surrebuttal Testimony. Identify and provide an electronic copy of any and all of Mr. Dunkel's workpapers that support his RCND analysis and his development of the conditions percents shown on Schedule WDA-S5.

RESPONSE: 21-1

The workpapers for all of the accounts, including the three addressed in Mr. Dunkel's Surrebuttal testimony may be found on the enclosed disk.

Respondent: William Dunkel

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TWENTY-SECOND SET OF DATA REQUESTS**

Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672

January 25, 2005

Arizona Corporation Commission
Qwest Corporation PEG-RJ08
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REQUEST NO.: Qwest 22-1

In answering this request, please refer to Page 6, Line 8 of the Brosch Surrebuttal Testimony. Is it your position that Arizona regulatory jurisprudence does not presume operating expense items, such as advertising, lobbying, corporate contributions and incentive compensation, to be reasonable? If your response is yes, please identify any and all relevant citations to any Arizona authority that supports your answer.

RESPONSE: 22-1

Mr. Brosch is not an attorney and offers no legal opinion regarding what is permitted under Arizona jurisprudence. Mr. Brosch is advised by Staff Counsel that legal issues associated with Staff's revenue requirement positions will be addressed in Staff's Briefs in this Docket.

Mr. Brosch's Surrebuttal Testimony is responsive to Mr. Grate's inaccurate citation of cost recovery review standards in Arizona, said to be applicable to operating expense items such as advertising, lobbying, corporate contributions and incentive compensation. Upon review of the Commission's rules, Mr. Brosch found no prescribed standards for regulatory review of operating expenses and no presumption that such costs are reasonable, as asserted by Mr. Grate.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-2

In answering this request, please refer to Page 7, Line 17 through Page 8, Line 9 of the Brosch Surrebuttal Testimony. For each of the following, identify and explain how each provides benefits to ratepayers that are both tangible and direct:

- a) Employees' paid vacations and sick leave;
- b) Employees' healthcare benefits;
- c) Employees' retirement savings plan benefits;
- d) Employees' post employment benefits;
- e) Employee training expenses;
- f) Cost of compliance with immigration laws;
- g) Cost of compliance with environmental laws;
- h) Cost of compliance with safety laws;
- i) Cost of compliance with and workers' compensation laws;
- j) Costs of operating Qwest's accounts receivable department;
- k) Costs of operating Qwest's accounts payable department;
- l) Costs of operating Qwest's customer billing department;
- m) Costs of operating Qwest's customer credit department;
- n) Costs of operating Qwest's legal department;

**ARIZONA CORPORATION COMMISSION
STAFF'S RESPONSE TO QWEST CORPORATION'S
TWENTY-SECOND SET OF DATA REQUESTS
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- o) Costs of operating Qwest's tax department;
- p) Costs of operating Qwest's human resources department;
- q) Costs of operating Qwest's risk management department; and
- r) Costs of operating Qwest's real estate department.

RESPONSE: 22-2

Rate recovery of the listed types of costs are not at issue in this Docket and are not the subject of Mr. Brosch's Surrebuttal Testimony. Staff's review of operating expenses in this Docket did not find rate recovery of any of the listed costs (listed items a through r) to be objectionable or to be inconsistent with past Arizona Corporation Commission ratemaking policies. In contrast other expenses, such as corporate image advertising, have been excluded in past Qwest rate cases and remain subject to disallowance. In his Surrebuttal response to Mr. Grate's assertion that virtually all costs are as "discretionary" as corporate image advertising, Mr. Brosch states, "The employee benefits and various department costs listed by Mr. Grate are representative of costs that do provide tangible, direct benefits to the Company and its ratepayers and are not discretionary to the same extent as the corporate image advertising, legislative affairs and incentive compensation costs that are being challenged by Staff."

With respect to employee benefit costs (listed items a through e), it is obvious that Qwest Corporation employees are essential to the provision of services in Arizona and that these elements of their compensation, if reasonable in amount, represent costs associated with human resources that are of direct tangible benefit to Qwest customers. Staff has not asserted that Qwest Corporation employees are not providing direct tangible benefits to customers by responding to their service demands and maintaining the network and support systems required to provide safe and adequate regulated services.

With respect to compliance with laws (listed items f through i), Staff recognizes that public utility operations are subject to tax, labor, environmental and other laws and that compliance activities and reasonable costs incurred with respect to legal compliance are essential and non-discretionary costs of doing business. Costs associated with compliance with such laws provides a direct and tangible benefit to customers by ensuring that Qwest pays only the taxes and fees that it owes while avoiding fines and penalties associated with non-compliance.

Similarly, the "departmental" costs (listed items j through r) represent essential business functions that provide tangible direct benefits to Qwest Corporation and its customers, by allowing the business to comply with laws and regulations, cost-effectively manage its human resources, administer insurance programs and acquire/manage real estate, for which the costs incurred, if reasonable in amount, are generally viewed by regulators as recoverable. All of the listed costs are distinguishable from Qwest's corporate image advertising and

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Response:

Please refer to Mr. Brosch's Direct Testimony at page 8, line 15 through page 10, line 6.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-4

In answering this request, please refer to Page 9, Lines 16-19 of the Brosch Surrebuttal Testimony.

a) Identify any facts, documents, Commission precedent or other evidence upon which you rely for the proposition that your adjustment C-17 regarding incentive compensation expenses is an established Commission regulatory policy.

RESPONSE: 22-4

The reference to Brosch Surrebuttal Testimony Page 9, lines 16-19 is unclear. Please refer to Mr. Carver's Direct Testimony at pages 36 through 45 where he explains the facts, documents and other evidence he (rather than Mr. Brosch) relied upon. See also the response to Qwest Data Request 22-3, above.

b) Identify any facts, documents, Commission precedent or other evidence upon which you rely for the proposition that your proposed adjustment C-9 regarding marketing and advertising costs is an established Commission regulatory policy.

Response:

Please refer to Mr. Brosch's Direct Testimony at page 8, line 15 through page 10, line 6.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-5

In answering this request, please refer to Page 12, Line 17 of the Brosch Surrebuttal Testimony.

Admit that it is your position that Arizona regulatory jurisprudence permits disallowance of image advertising in raternaking unless a utility meets a burden of providing economic justification for it.

_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit, and

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_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion. In particular, identify the expert witness upon whom Staff relies, and identify that witness' qualifications to offer expert testimony that Qwest's image advertising expenditures were commercially unreasonable, wasteful or imprudent.

Response:

Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

f) Admit that Staff has not offered substantial comparative data showing that Qwest's test year image advertising expenditures were commercially unreasonable or wasteful or imprudent or ineffective.

_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

Response:

Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

g) Admit that you have not offered expert opinion showing that compared to commercial standards of conduct, Qwest's test year image advertising expenditures were commercially unreasonable or wasteful or imprudent or in effective.

_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

Response:

Please see Staff's responses to Qwest Data Requests 22-3(a) and 22-5, above.

h) Identify and explain precisely the standard of review that applies to the inclusion of Arizona utility's image advertising in calculating the cost of service for purposes of establishing revenue requirement. Identify by specific citation, including page number, the source of Arizona statute, rule, decision or other precedent that informs or supports your answer to this request.

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Response:

Objection, this question seeks a legal conclusion. Without waiving this objection, Staff is unaware of any Arizona statute or rule that defines a specific standard of review association with rate recovery of an Arizona utility's image advertising in calculating the cost of service to establish revenue requirement. Pages 8 and 9 of Mr. Brosch's Direct Testimony explain ACC precedent regarding the disallowance of Qwest/US West corporate image advertising costs.

i) State and explain precisely what burden of proof you believe Arizona utilities must bear in order to include image advertising costs in the calculation of cost of service for purposes of establishing revenue requirement. Identify by specific citation, including page number, the source of Arizona statute, rule, decision or other precedent that informs or supports your answer to this request.

Response:

Objection, this question seeks a legal conclusion. Without waiving this objection, Staff is unaware of any Arizona statute or rule that defines a specific standard of review association with rate recovery of an Arizona utility's image advertising in calculating the cost of service to establish revenue requirement. Pages 8 and 9 of Mr. Brosch's Direct Testimony explain ACC precedent regarding the disallowance of Qwest/U S West corporate image advertising costs. Qwest's "burden of proof" is to convince the Commission that changed circumstances now warrant revision of past regulatory policy in Arizona that excluded corporate image advertising costs.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-7

In answering this request, please refer to Page 9, Lines 16-19 of the Brosch Surrebuttal Testimony.

a) Identify and explain all reasons why Staff could not "simply append seven prescribed adjustments to Qwest's unadjusted, separated intrastate financial reports" if Qwest were to provide its unadjusted separated results of operations.

RESPONSE: 22-7

Staff assumes the intended reference is to page 21 of Mr. Brosch's Surrebuttal Testimony. The reasons Qwest should be required to "simply append seven prescribed adjustments" include the following:

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- Qwest possesses the accounting data to accurately and more efficiently calculate and include all seven of the adjustments, while Staff would be required to request and interpret accounting data from the Company each year to quantify some of the adjustments.
 - Qwest is more familiar with its accounting data and the extraction of information required to prepare accounting adjustments. Staff consultants who are retained to assist during formal regulatory proceedings are familiar with accounting adjustments, but such consultants are not on retainer to assist between rate proceedings when financial reports are submitted by Qwest.
 - If Staff independently prepared complex adjustment calculations to append to Qwest's annual reports, it is likely that Qwest may dispute how such adjustments were quantified and appended. Admittedly, Staff could independently insert the fixed amounts of directory imputation and cash working capital (Brosch Direct, page 6, line 25 and 28) but the other five adjustments are inherently complex and Staff would need to request and evaluate Qwest's detailed accounting data to calculate such adjustments.
 - A single, integrated filing of the prescribed data by Qwest would contain information regarding ACC-basis Arizona financial performance that more accurately depicts jurisdictional regulatory policies in one document for which Qwest is entirely responsible, rather than introducing multiple calculations of adjusted financial results to be interpreted and weighed by the Commission.
- b) Please identify and explain why it would be an excessive or unreasonable "burden" for Staff to "prepare a few additional prescribed adjustments" to unadjusted separated results of operations supplied by Qwest.

Response:

Please see the response to Part (a), above.

- c) Please identify and explain the importance of the resulting annual reports to Staff and the Commission. In particular explain what decisions Staff and or the Commission would likely make with information gleaned from reports of separated results of operations adjusted for seven items that they could not make with separated results of operations that had no adjustments.

Response:

The resulting annual reports could be employed by Staff and the Commission to monitor Qwest's financial performance on a jurisdictional, adjusted basis and have knowledge of Qwest's overall financial performance and financial condition when other issues are before it, such as tariff submissions, customer complaints, service classification proceedings or service quality disputes. Additionally, in any future review of Qwest's Price Cap Plan or any other, new regulatory framework, a series of financial Annual Reports that are prepared on a consistent ACC basis of

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accounting to show how Qwest's financial results have changed or trended throughout recent history should be useful in determining what specific, more detailed information is required in such future proceedings.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-8.

In answering this request, please refer to Qwest Data Request No. 15-2(e)(2), and Staffs response to that request.

a) Does being subject to cost of service revenue and rate regulation by the Commission afford Qwest protection from market forces in Arizona? If so, please identify and describe the protection so afforded and provide the facts, data or other evidence that supports your identification and description.

RESPONSE: 22-8

No. However, Qwest is the incumbent LEC in Arizona and is the dominant provider in many markets it serves, as explained in the testimony of Staff witness Fimbres. Certain of Qwest's intrastate services are subject to less competition than others, as evidenced by the service basket classifications within the existing Price Cap Plan. In any event, the purpose of late regulation is not to "protect" the utility, but rather to protect the ratepayers, from the monopoly or market power of the utility, while allowing the utility to chase a just and reasonable rate.

b) Please provide any and all facts, data, or other evidence that shows that cost of service revenue and rate regulation by the Commission protects Qwest from market forces in Arizona.

Response:

Please see the response to part (a).

c) Please identify and provide any and all facts, data, or other evidence that shows that Qwest is not subject to market forces in Arizona.

Response:

Please see the response to part (a), as well as the testimony of Staff witness Fimbres.

d) Please state and explain all reasons why you believe Qwest's competitors are not compelled to produce confidential advertising data in discovery propounded by Staff.

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Response:

In its response to Qwest question 15-2(e)(2), Staff stated, "Staff has no reasonable opportunity to derive meaningful Arizona-basis, comparable advertising data for each of Qwest's competitors, given that no public reporting of such data exists. Competitors would undoubtedly view such information to be confidential information they are not compelled to produce in the pending Qwest proceeding." Some of Qwest's competitors are not subject to the jurisdiction of the ACC while others are not parties to Qwest regulatory proceedings. Moreover, there are no prescribed accounting and reporting procedures through which one might reasonably expect non-regulated business that compete with Qwest to have Arizona-basis comparable data that segregates product from corporate-image advertising in the manner required by FCC Part 32 Rules.

e) Please confirm that you believe there is no linkage between incurred costs and pricing for other service providers that compete with the incumbent LEC.

Response:

In its response to Qwest question 15-2(e)(2), Staff stated, "There is no reason to assume any linkage between incurred costs and pricing or revenues for other service providers that compete with the incumbent LEC, because competitors are generally subject to market forces, rather than cost-based pricing." With pricing dictated by market forces, the only linkage to costs in an effectively competitive market would be in deciding whether entry into a market or continuing to offer a given product/service within a competitive market is likely to produce sufficient financial returns.

Respondent: Michael Brosch

REQUEST NO.: Qwest 22-9

In answering this request, please refer to Qwest Data Request No. 15-3 and Staff's response to that request.

a) Do you believe that as long as Qwest remains subject to cost of service revenue and rate regulation by the Commission in Arizona, Qwest faces no competitive pressures in Arizona? If your answer is yes, please state the basis for your explanation.

Response:

No. In its response to Qwest question 15-3, Staff stated, "As long as Qwest remains subject to cost-based regulation of its revenues and rates, competitive pressures must be assumed to be insufficient to justify deregulation. The corollary to this view is that Qwest will be free to seek recovery of all costs (including image advertising) as well as an unlimited profit in Arizona at the time competition is determined to be sufficient to justify deregulation of the Company's services." See the testimony of Staff witness Fimbres regarding the competitive pressures faced by Qwest in Arizona.

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b) Do you believe that until Qwest is no longer subject to cost of service revenue and rate regulation by the Commission in Arizona, that regulation provides Qwest protection from competitive pressures? Please also state the basis of your explanation in your answer.

Response:

Please refer to Staff's response to Part (a), above.

Respondent: Michael Brosch

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REQUEST NO.: Qwest 23-1

In answering this request, please refer to Page 23, Lines 19-22 of the Carver Surrebuttal Testimony.

- a) Please identify the jurisdictions in which you have given cost-of service testimony that require by statute or rule the use of an end of period rate base.
- b) Please identify the jurisdictions in which you have given cost-of service testimony that require by other than statute or rule the use of an end of period rate base.
- c) Please identify the jurisdictions in which you have given cost-of-service testimony that do not require the use of an end of period rate base.

RESPONSE: 23-1

Staff objects to Qwest's discovery request as being overly broad and unduly burdensome. In response to Data Requests UTI 21-8 and UTI 21-9, Qwest objected to providing certain information associated with a discussion of rate base and ratemaking methods appearing at pages 34-35 of Mr. Grate's rebuttal testimony, indicating that:

- o The requested information is not reasonably calculated to lead to the discovery of information relevant to this docket.
 - o The request would require Qwest to research the ratemaking methodologies of 49 states.
 - o This irrelevant information is as readily available to Staff as it is to Qwest.
 - o The question would appear to require Qwest to research the other 13 states where Qwest is the ILEC in order to identify those States that employ an historic vs. future or forecast test year. This irrelevant information is a readily available to Staff as it is to Qwest.
- a) Without waiving this objection, Mr. Carver has not performed exhaustive research into the ratemaking methodologies of the various regulatory jurisdictions in which he has previously filed testimony for purposes of this proceeding. The cited portion of Mr. Carver's surrebuttal testimony was in response to representations of Mr. Grate at page 34 of his rebuttal testimony. Referring to Attachment SCC-2 (Carver direct testimony), Mr. Carver provided a listing of 13 different jurisdictions and 63 dockets in which he has previously filed testimony.

In the early stages of a regulatory engagement, UTI determines the general ratemaking methodologies and approaches acceptable to that regulatory jurisdiction. Such a determination may take various forms, including: discussions with client representatives, review of prior Commission decisions, reviews of prior client sponsored testimonies, review of utility testimonies, review of Commission rules or regulations, etc. However, Utilitech does not maintain a data base containing the information regarding other state statutes and rules which Qwest seeks.

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Moreover, it is the testimony of Qwest witness Grate, not Staff witnesses Carver or Brosch, who has filed extensive testimony seeking to raise and litigate generic ratemaking issues involving the Arizona regulatory process in the pending Price Cap proceeding. We do not have and have not compiled a listing of jurisdictional information responsive to this request. As such, UTI does not possess a summary of the general regulatory approach or methodologies embraced by each jurisdiction (e.g., end-of-period vs. average rate base, historic or forecast test year, etc.). Consequently, the information requested by Qwest is as readily available to Qwest as it is to Staff.

The following information is based upon Mr. Carver's knowledge and belief of the Commission policies in Arizona and other states.

Jurisdiction	Year End	Average	Test Year
Arizona	X		Historic
California		X	Forecast
Florida		X	Forecast
Hawaii		X	Forecast
Indiana	X		Historic
Kansas	X		Historic
Missouri	X		Historic
Nevada	X		Historic
New Mexico		X	Historic
Oklahoma	X		Historic
Pennsylvania	X		Forecast
Utah		X	Historic
Washington		X	Historic

- b) See the response to item (a) above.
- c) See the response to item (a) above.

Respondent: Steven Carver

REQUEST NO. Qwest 23-2.

In answering this request, please refer to Page 42 Line 27 through Page 43, Line 9 of the Carver Surrebuttal Testimony. Please identify and provide a copy of each and every one of the 14 testimonies Mr. Carver has filed concerning incentive benefit plans.

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RESPONSE: 23-2

Staff objects to Qwest's discovery request as being unduly burdensome. Without waiving this objection, Mr. Carver has filed testimony on incentive compensation in the following dockets. Copies are a matter of public record and available at each of the State Commissions. [The "Page # Ref" identifies the starting page of Mr. Carver's direct testimony on this subject.]

Company Name	Docket No.	Year	Page # Ref
US West Communications (AZ)	E-1051-88-146	1989	94
PSI Energy (IN)	40003	Nov 1995	43
GTE Hawaiian Telephone (HI)	94-0298	1996	81
Oklahoma Gas & Electric (OK)	960000116	Oct 1996	68
Arizona Telephone Company (AZ)	U-2063-97-329	Dec 1997	47
US West Communications (UT)	97-049-08	1997	73
Sierra Pacific Power Co. (NV)	98-4062/98-4063	Jan 1999	50
US West Communications (AZ)	T-1051B-99-105	2000	39
US West Communications (NM)	3008	March 2000	78
The Gas Company (HI)	00-0309	2001	65
PSI Energy IN)	42359	Aug 2003	77
Arizona Public Service Co. (AZ)	E-10345A-03-0437	Jan 2004	56
Verizon Northwest (WA)	UT-040788	Nov 2004	26
Qwest Corporation (AZ)	T-01051B-03-0454 T-00000D-00-0672	Nov 2004	36

Respondent: Steven Carver

REQUEST NO. Qwest 23-3

In answering this request, please refer to Qwest Data Request No. 10-20(a)(2) and your response to that request.

- a) Please state whether your response to Qwest Data Request No. 10-20(a)(2) is: (1) an unqualified admission; (2) a qualified admission; or (3) a denial.
- b) If your response to Qwest Data Request No. 10-20(a)(2) was a qualified admission, please identify and explain each such qualification.
- c) If your response to Qwest Data Request No. 10-20(a)(2) was a denial, state in detail and with particularity all of the reasons and factual bases for your denial including but not limited to a detailed explanation of what assumption about the Commission's historical treatment of FAS 106 costs UTI made with regard to treating as non-jurisdictional the deferred taxes associated with this accounting change.

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RESPONSE: 23-3

a) The original question [Qwest Data Request 10-20(a)(2)], as posed, sought a conclusory response to a question that oversimplified the ratemaking treatment of FAS 106 costs and related deferred income tax reserves. In responding to the original question, Mr. Carver attempted to provide a thorough response that is relevant to the current proceeding. In the context of tax/book timing differences associated with transactions that have never been recognized (that is, explicitly disallowed) for ratemaking purposes, Mr. Carver would concur that those deferred income tax reserves are typically considered to be non-jurisdictional for ratemaking purposes. As stated in the response to Qwest Data Request 10-20(a)(2), the recognition of accumulated deferred income tax (ADIT) reserves in rate base follows ratemaking recognition of the underlying transactions giving rise to those tax/book timing differences. However, Staff Adjustment B-8 does not attempt to recognize deferred income tax reserve balances associated with timing differences that have not been considered in the regulatory process or that arose prior to Docket No. T-1051B-99-0105.

b) See the response to item (a) above.

c) See the response to item (a) above and Staff Adjustment B-8. As Qwest is well aware, Mr. Carver and Mr. Grate disagree as to the recognition of accrual basis FAS106 OPEB costs in the Company's last rate case, Docket No. T-1051B-99-0105. In the current proceeding, Staff calculated the ADIT reserve included in rate base as the tax effect of the excess of cumulative OPEB accruals over PAYGO during the period 1999 through 2003. The net effect of Staff Adjustment B-8 in the current proceeding increases rate base by about \$78.7 million, as compared to Qwest's proposed treatment. The Staff's proposed rate base treatment, as computed on Staff Adjustment B-8, does not recognize ADIT impacts associated with the FCC methodology or any OPEB accrual/cash timing differences for any year prior to 1999.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-4

In answering this request, please refer to Qwest Data Request No. 16-5 and your response to that request. Admit that you have no qualifications to evaluate the reasonableness of the performance criteria in Qwest's incentive compensation plans from the perspective held by an employee compensation expert.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

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RESPONSE: 23-4

As stated in response to Qwest Data Requests 16-3 and 16-4 as well as at page 42 of his surrebuttal testimony, Mr. Carver is not and has never claimed to be a "Certified Compensation Professional" or a "Certified Benefits Professional." While Mr. Carver has not claimed to be an employee compensation expert, he has clearly and consistently stated that his expertise is as a regulatory expert, with considerable experience in the evaluation of utility expenses for potential ratemaking cost recovery – including the cost of incentive compensation plans. What Mr. Carver concluded in his testimony is that from the perspective of an expert evaluating costs used for ratemaking purposes in a regulatory proceeding, a ratemaking adjustment is warranted.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-5.

In answering this request, please refer to Qwest Data Request No. 16-6(a) and your response to that request. Please admit that you have no evidence demonstrating that the Federal Communications Commission has ever relied on the proposition that the party who benefits from a particular transaction or activity should bear the related financial burden as justification to disallow incentive compensation costs for ratemaking purposes.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit. In particular, please identify, describe and provide a copy of any evidence supporting that the Federal Communications Commission has ever relied on the proposition that the party who benefits from a particular transaction or activity should bear the related financial burden as justification to disallow incentive compensation costs for ratemaking purposes.

RESPONSE: 23-5

As clearly stated in response to Qwest Data Request 16-6 and at surrebuttal page 46, Mr. Carver's direct testimony (pages 42-43) does not claim that the FCC relies or has relied upon the benefit-burden test as justification to disallow incentive compensation costs for ratemaking purposes. The FCC itself has stated that it has been "guided by two historically applied principles – the 'used and useful' standard and the benefit-burden test." Mr. Carver has not conducted any independent research into the vast archives of past FCC decisions, however, to determine when and how the benefit-burden test might have been specifically applied in the past.

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In fact, Mr. Carver is unaware of any recent FCC rate case proceeding due to the adoption of price cap regulations for ILECS. Instead, Mr. Carver relied on the FCC's recognition that this "historically applied principle" helped guide its decision in the cited docket.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-6.

In answering this request, please refer to Qwest Data Request No. 16-6(b) and your response to that request. Please admit that you have no evidence to show that Qwest's unadjusted revenue requirement based on the 2003 test year would have been greater had the amounts paid under the 2003 Bonus Plan been paid instead as base salary.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-6

As indicated in the response to Qwest Data Request 16-6(b), no "evidence" of the form described was important to the Staff's ratemaking treatment of incentive compensation rate recovery. Mr. Carver evaluated the facts surrounding incentive compensation and has not claimed that unadjusted revenue requirement for the 2003 test year would have been hypothetically larger or smaller if the incentive plan amounts been paid instead as base salary.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-7

In answering this request, please refer to Qwest Data Request No. 16-6(c) and your response to that request. Please admit that you have no evidence to show that the level of Qwest's management compensation, including base salary, incentive compensation and non-cash benefits in the test year, was unreasonable when compared with the levels of compensation paid in the prevailing labor market in the United States.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

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TWENTY-THIRD SET OF DATA REQUESTS
Docket Nos.: T-01051B-03-0454 and T-00000D-00-0672
January 25, 2005**

Arizona Corporation Commission
Qwest Corporation PEG-RJ08
Rejoinder Exhibits of Philip E. Grate
Docket No. T-01051B-03-0454
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RESPONSE: 23-7

As indicated in the response to Qwest Data Request 16-6(c), Mr. Carver has not performed or relied upon any studies purporting to compare Qwest's test year management compensation, including base salary, incentive compensation and non-cash benefits, with the levels of compensation paid in some assumed prevailing labor market in the United States. The proposed ratemaking adjustment sponsored by Mr. Carver is not based upon an excessive overall compensation concern.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-8

In answering this request, please refer to Qwest Data Request No. 16-6(d) and your response to that request. Please admit that Staff and its consultants have no evidence to show that employees' pursuit of 2003 Bonus Plan performance targets caused ratepayers direct tangible harm.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

RESPONSE: 23-8

As indicated in the response to Qwest Data Request 16-6(d), Mr. Carver has not claimed that employee pursuit of the 2003 bonus plan targets has caused direct tangible harm or any direct tangible benefit to ratepayers. Mr. Carver has not conducted any analysis of any such harm.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-9

In answering this request, please refer to Qwest Data Request No. 16-7(a) and your response to that request. Please admit that you have no evidence that in establishing revenue requirement under cost of service ratemaking, the Federal Communications Commission disallows test year costs for the reason that the disallowed costs provide ratepayers no direct tangible benefit.

_____ Admit _____ Deny

If your answer was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit.

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RESPONSE: 23-9

Mr. Carver possesses no such "evidence," as none was required to support Staff's proposed adjustment to incentive compensation expense. As indicated in the response to Qwest Data Request 16-7, Mr. Carver has not claimed that the FCC has disallowed test year costs based solely upon the fact that they provide ratepayers no direct tangible benefit. The FCC order, cited at pages 42-43 of Mr. Carver's direct testimony, did describe the benefit-burden test as one of two "historically applied principles" that helped guide the FCC's proposal regarding the components of rate base and net income for dominant carriers. While Mr. Carver has not conducted research on the extent of the FCC's past reliance on the benefit-burden test to determine cost recovery, the FCC, did describe said method as a "historically applied principle." Also, see the response to Qwest Data Request 23-5.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-10

In answering this request, please refer to Qwest Data Request No. 16-7(b) and your response to that request.

a) Please admit that your opinion is not supported or informed by any source or sources of scholarly or regulatory authority (including but not limited to text book references, treatises, scholarly articles, court opinions, etc.)

_____ Admit _____ Deny

If your answer to this request was anything other than an unqualified admission, state in detail and with particularity all of the reasons and factual bases for your denial or failure to admit and provide all facts and data that form the basis for this assertion.

1. State whether or not you have conducted any research on this subject, and if you have, please identify and describe such research.
 2. Provide pinpoint citation to any source or sources of scholarly or regulatory authority (including but not limited to text book references, treatises, scholarly articles, etc. and/or court opinions, etc.) that support Mr. Carver's assertion: "Generally, costs that are required for 'compliance' with laws or to perform non-discretionary business functions such as billing, accounting, collections, audits and the fixed, known and measurable costs to compensate employees are judged to be recoverable if reasonable in amount and produce tangible direct benefits to the company and its customers."
- b) Provide your definitions of "discretionary business functions" and "non-discretionary business functions."

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c) With regard to Qwest's test year, please identify and quantify those costs that are for discretionary business functions and those costs that are for non-discretionary business functions as you define those terms.

RESPONSE: 23-10

a) Staff objects to this question as it is vague and ambiguous and unduly burdensome. Without waiving that objection, Qwest Data Request 16-7(b) lists 42 different types of costs and asks how ratepayers receive a direct tangible benefit from them. The response provided by Staff indicated that it would be necessary to consider the specific facts associated with the listed cost types to apply any direct tangible benefit or benefit-burden test in connection with rate case cost recovery. However, costs that are required for "compliance" with laws or to perform non-discretionary business functions (such as billing, accounting, collections, audits and the fixed, known and measurable costs to compensate employees) are generally considered to be recoverable – if they are reasonable in amount and satisfy specific business requirements associated with regulated services.

This response was based on Mr. Carver's extensive regulatory experience and the general regulatory experience of Utilitech. It was unnecessary for Mr. Carver to research any published texts or regulatory articles, as those documents generally reflect the opinion of the author. Further, the list of regulatory decisions or court decisions requested by Qwest are as equally available to the Company as they are to Staff.

It has long been held in public utility regulation that ratemaking recovery should only be allowed for costs that are both necessary to the provision of regulated service and reasonable in amount. Mr. Carver is advised by Counsel that the legal foundation associated with Staff's revenue requirement positions will be addressed in Staff's Briefs in this Docket, as necessary.

b) The ordinary dictionary definition of "discretionary" is "left to or regulated by one's own judgment or discretion." In this context, discretionary costs would include those costs that are neither necessary nor essential to the utility's business of providing regulated service. Examples of discretionary costs could include: social or athletic club memberships; charitable dues, donations and contributions; recreational, educational or professional sports sponsorships; certain affiliate transactions; lobbying expenses and political activities; etc. Non-discretionary costs are those which are required to comply with legal or regulatory provisions or to meet the day-to-day requirements of providing regulated service. See item (a) above.

c) Staff objects to Qwest's discovery request as being over broad and unduly burdensome. The identification sought by the request would require an extensive special study that has not been conducted nor determined to be necessary for the current proceeding. To the extent that Staff's evaluation of Qwest's asserted revenue requirement uncovered discretionary costs that should not be included in overall revenue requirement, those costs would have been the subject

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of separate adjustment and addressed in Staff testimony. The absence of such testimony would indicate that no objectionable discretionary costs were identified.

The response to Qwest Data Request 22-2 states, in part: "In his Surrebuttal response to Mr. Grate's assertion that virtually all costs are as 'discretionary' as corporate image advertising, Mr. Brosch states, 'The employee benefits and various department costs listed by Mr. Grate are representative of costs that do provide tangible, direct benefits to the Company and its ratepayers and are not discretionary to the same extent as the corporate image advertising, legislative affairs and incentive compensation costs that are being challenged by Staff.'" Mr. Carver concurs.

Respondent: Steven Carver

REQUEST NO.: Qwest 23-11

In answering this request, please refer to Qwest Data Request No. 16-8(b). Please identify the data request in which you requested the labor contract.

RESPONSE: 23.11

The subject of Qwest's Data Request 16-8 was page 45, line 3, of Mr. Carver's direct testimony and Qwest's response to Data Request UTI 1-31(d). This portion of the Company's discovery response identified "a description of the 2003 Bonus Award plan (a.k.a. Lump Sum Payments) for occupational employees as provided in the CWA Union contract that was effective beginning August 17, 2003" that was appended as Confidential Attachment E thereto. Confidential Attachment E consists of three pages that appear to be copies of the cover page and Addendum 7 (pages 206 and 207) of the cited labor agreement, not a separate summary or description of the occupational bonus plan.

Data Request UTI 1-31 specifically sought copies of all incentive plans in the form approved by senior management and the Board of Directors and in the form presented to employees. Since the response to Data Request UTI 1-31 contained a copy of the portion of the labor contract relevant to the occupational bonus plan, Mr. Carver had no reason to believe that the information supplied was anything but a complete and fully responsive copy of the portion of the labor agreement relevant to the occupational bonus plan. As such, no separate request for the labor agreement was thought necessary.

In response to Qwest Data Request UTI 16-8(b), Mr. Carver explained that, in addition to the cited portion of his confidential direct testimony, the Company did not meet the financial floor that must be met before any lump sum payments are required to eligible employees. In the final paragraph of the response to Qwest Data Request 16-8(b), Mr. Carver stated: "If Mr. Carver has misinterpreted the terms of the labor contract or the discretionary nature of the occupational payments in 2003, Mr. Carver would reconsider the quantification of Staff Adjustment C-17

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based on any revised or updated information Qwest might produce." Thus far, Qwest has provided no additional information for Staff's consideration. In the absence of any additional information, Staff is left to conclude that it has reasonably interpreted Qwest's Confidential Attachment E, which represents a full and complete copy of all provisions of the labor agreement relevant to the occupational bonus plan.

Respondent: Steven Carver

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN MAYES
Commissioner

IN THE MATTER OF QWEST)	
CORPORATION'S FILING AMENDED)	DOCKET NO. T-01051B-03-0454
RENEWED PRICE REGULATION PLAN.)	
-----)	
IN THE MATTER OF THE)	
INVESTIGATION OF THE COST OF)	DOCKET NO. T-00000D-00-0672
TELECOMMUNICATIONS ACCESS.)	
-----)	

REJOINDER TESTIMONY OF

NANCY HELLER HUGHES

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

**TESTIMONY INDEX OF
NANCY HELLER HUGHES**

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SUMMARY OF TESTIMONY

The Reproduction Cost New Less Depreciation (RCNLD) study reflecting Qwest's authorized depreciation lives and survivor curves and the use of the Equal Life Group (ELG) depreciation procedure is presented in Exhibit NHH-1R to my rebuttal testimony.

My rejoinder testimony addresses the following issues raised by Staff witness William Dunkel's surrebuttal testimony concerning the RCNLD value.

1. The data in the RCNLD analysis should not be truncated after the remaining life reaches 0.50 year.
2. Qwest's currently authorized average service lives and survivor curves should be used to calculate the RCNLD value, and not the average service lives and survivor curves recommended by Mr. Dunkel.

I recommend that the Commission approve the RCNLD Study filed in my rebuttal testimony and the resulting values shown below:

Reproduction Cost New	\$8,348,462,715
Reproduction Cost New Less Depreciation	\$3,764,710,307
Condition Percent	45%

1 **IDENTIFICATION OF WITNESS**

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

3 A. My name is Nancy Heller Hughes. I am a Senior Director in the Seattle office of
4 R. W. Beck, Inc. My business address is 1001 Fourth Avenue, Suite 2500, Seattle,
5 Washington 98154-1004.

6 **Q. ARE YOU THE SAME NANCY HELLER HUGHES THAT FILED DIRECT AND**
7 **REBUTTAL TESTIMONY ON BEHALF OF QWEST IN THIS PROCEEDING?**

8 A. Yes, I am.

9 **PURPOSE OF TESTIMONY**

10 **Q. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY?**

11 A. The purpose of my rejoinder testimony is to comment on the surrebuttal testimony of
12 William Dunkel filed on behalf of Staff regarding the Reproduction Cost New Less
13 Depreciation (RCNLD) value of Qwest's plant in service in Arizona as of December 31,
14 2003.

15 **METHODOLOGY**

16 **Q. DID YOU PREPARE THE RCNLD STUDIES PREVIOUSLY FILED BY QWEST IN THIS**
17 **PROCEEDING?**

18 A. Yes. The RCNLD studies were prepared under my direction. The RCNLD study filed in
19 my direct testimony was based on the vintage group depreciation procedure. The

1 RCNLD study filed in my rebuttal testimony reflects the use of the Equal Life Group
2 (ELG) procedure for those accounts and vintages where ELG depreciation is approved.
3 Both studies were developed using Qwest's currently prescribed depreciation lives and
4 survivor curves.

5 **Q. WHAT COMMENTS DOES MR. DUNKEL HAVE REGARDING THE RCNLD STUDY**
6 **FILED WITH YOUR REBUTTAL TESTIMONY?**

7 A. First, Mr. Dunkel continues to recommend that Staff's recommended depreciation lives
8 and survivor curves be used to calculate the RCNLD value and resulting condition
9 percent, instead of the depreciation lives and survivor curves that the Commission
10 prescribed in Qwest's last rate case. Qwest witness Dennis Wu discusses this issue at
11 length in his rebuttal and rejoinder testimony and shows why Qwest's currently
12 prescribed depreciation lives and survivor curves are the appropriate depreciation
13 parameters to use. Second, Mr. Dunkel disagrees with me regarding the issue of
14 truncating the data in the RCNLD analysis after the remaining life reaches 0.5 year, even
15 though there are still surviving vintage plant balances.

16 **Q. PLEASE EXPLAIN YOUR POSITION ON TRUNCATING THE DATA AFTER THE**
17 **REMAINING LIFE REACHES 0.5 YEAR.**

18 A. I recommend that the remaining life for older plant vintages that are nearly fully
19 depreciated be held constant at 0.50 year as long as there is plant surviving for that
20 vintage. Mr. Dunkel would permit the remaining life for older vintage plant to be equal to
21 zero, even though there is still plant surviving for that vintage. As discussed at pages 4
22 and 5 of my rebuttal testimony, the effect of truncating the data after the remaining life

1 reaches 0.50 year is to eliminate the value of this remaining plant from the RCNLD
2 value, thus understating the RCNLD value of Qwest's Arizona plant in service.

3 **Q. WHAT EFFECT DOES TRUNCATING THE DATA HAVE ON THE RCNLD VALUE**
4 **BASED ON QWEST'S DEPRECIATION LIVES AND SURVIVOR CURVES?**

5 A. If the data is truncated after the remaining life equals 0.50 year, the RCNLD value based
6 on Qwest's depreciation lives and survivor curves would be reduced by \$9,386,925.

7 **Q. WHAT REASONS DOES MR. DUNKEL GIVE FOR TRUNCATING THE DATA IN HIS**
8 **ANAYSIS?**

9 A. The only reason Mr. Dunkel gives for truncating the data in his analysis after the
10 remaining life equals 0.5 year is that I did the same thing in the initial RCNLD study
11 presented in my direct testimony and, therefore, Mr. Dunkel claims this is not an issue
12 for rebuttal. (Dunkel Surrebuttal Testimony at Page 13, Line 7.) Mr. Dunkel is correct
13 that I truncated the data after 0.50 year in my initial study. However, in preparing my
14 rebuttal testimony and revising the RCNLD study to reflect ELG depreciation (in
15 response to Mr. Dunkel's direct testimony), I discovered the problem with truncating the
16 data after the remaining life reaches 0.50 year. My recommendation is that the
17 remaining life be held constant at 0.50 year until the plant in a vintage is retired. I
18 believe that this is the correct method to use in the analysis.

1 **CONCLUSION**

2 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS TO THE COMMISSION**
3 **REGARDING THE RCNLD VALUE OF QWEST'S ARIZONA PLANT IN SERVICE AS**
4 **OF DECEMBER 31, 2003.**

5 A. I recommend that the results of my RCNLD study presented in Exhibit NHH-1R be
6 adopted by the Commission. This study is based on 1) Qwest's currently prescribed
7 depreciation lives and survivor curves, 2) the use of the ELG procedure for those
8 accounts and vintages that are depreciated using ELG, and 3) the remaining life for
9 older vintages with surviving plant balances assumed to be equal to 0.50 year (i.e., no
10 truncation of data). The results of my RCNLD study are shown in the table on the
11 following page in the column titled "At Qwest Prescribed Lives."

12 **Replacement Cost New Less Depreciation Value**
13 **as of December 31, 2003**

14

	At Qwest Depreciation Lives	At Staff Depreciation Lives
Reproduction Cost New	\$8,348,462,715	\$8,348,462,715
RCNLD	\$3,764,710,307	\$4,550,943,228
Condition Percent	45%	55%

15 For comparison purposes, the RCNLD value based on 1) Staff's recommended
16 depreciation lives and survivor curves, 2) ELG depreciation and 3) no truncation of data
17 after the remaining life equals 0.50 year, is also shown in the table in the column titled

1 "At Staff Recommended Lives." I recommend that the Commission adopt the results
2 shown in the table above using Qwest's depreciation lives and survivor curves.

3 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A.** Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON)

)

) ss

AFFIDAVIT OF NANCY HELLER HUGHES

COUNTY OF KING)

)

Nancy Heller Hughes, of lawful age being first duly sworn, deposes and states:

1. My name is Nancy Heller Hughes. I am Senior Director of R. W. Beck, Inc., in Seattle, Washington and am appearing on behalf of Qwest Corporation. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Nancy Heller Hughes
Nancy Heller Hughes

SUBSCRIBED AND SWORN to before me this 19 day of January, 2005.

LINDA L. ROSS
STATE OF WASHINGTON
NOTARY ---- PUBLIC
MY COMMISSION EXPIRES 4-05-06
My Commission Expires: 4-5-06

Linda L. Ross
Notary Public

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

**JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES**

**IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN**

) **DOCKET NO. T-01051B-03-0454**
)
)
)

**IN THE MATTER OF THE INVESTIGATION OF
THE COST OF TELECOMMUNICATIONS
ACCESS.**

) **DOCKET NO. T-00000D-00-0672**
)
)
)

REJOINDER TESTIMONY

OF

SCOTT A. MCINTYRE

QWEST CORPORATION

JANUARY 27, 2005

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1

2

I. IDENTIFICATION OF WITNESS

3

4 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND PLACE OF**
5 **EMPLOYMENT.**

6 A. My name is Scott A. McIntyre. I work for Qwest Services Corporation
7 ("Qwest"). My title is Staff Director – Public Policy. My responsibilities
8 include developing marketing and pricing strategies for Qwest and
9 supporting these strategies in the regulatory arena. My business address is
10 1600 7th Avenue, Room 3214, Seattle, Washington 98191.

11

12 **Q. HAVE YOU FILED TESTIMONY PREVIOUSLY IN THIS CASE?**

13 A. Yes, I filed direct testimony on May 5, 2004 and rebuttal testimony on
14 December 20, 2004.

15

16

II. PURPOSE OF TESTIMONY

17

18 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

19 A. The purpose of my testimony is to respond to the surrebuttal testimony of Mr.
20 Thomas Regan filed on behalf of the Arizona Commission Staff on January 12,
21 2005, as it relates to Qwest's intrastate switched access rates. I will also address the

1 surrebuttal testimony of Timothy J. Gates for Time Warner, Don Price for MCI and
2 Del Smith for the Utilities Division.

3

4 **III. TESTIMONY OF MR. THOMAS REGAN**

5

6 **Q. WHAT IN MR. REGAN'S TESTIMONY WOULD YOU LIKE TO**
7 **ADDRESS?**

8 A. On page 34 of his surrebuttal testimony, Mr. Regan states that revenue
9 decreases as a result of reductions in Qwest's switched access rates can
10 be offset with increases in Qwest's Basket 3 services. This is not an offset
11 and will result in an overall loss of revenue. Such a proposal will only
12 exacerbate Qwest's earnings problem in Arizona.

13 **Q. CAN BASKET 3 SERVICE PRICES BE INCREASED TO GENERATE**
14 **ADDITIONAL REVENUE AS MR REGAN SUGGESTS?**

15 A. Only to a limited degree. The services in Basket 3 are competitive services.
16 Increasing their prices will create competitive losses that will offset the price
17 increases. This means that increasing prices for Basket 3 services is not an
18 option for offsetting switched access reductions. If Qwest must reduce
19 switched access rates and revenues more than the \$5 million already
20 proposed by Qwest in this case, the only reasonable offset must be
21 increases in residence basic exchange rates.

1

2

IV. TESTIMONY OF MR. TIMOTHY J. GATES

3

4 **Q. WHAT, IN MR. GATES' TESTIMONY WOULD YOU LIKE TO ADDRESS?**

5 A. I would first like to address how Mr. Gates has changed his position from
6 the direct testimony he filed on November 18, 2004. Once these changes
7 have been identified, Mr. Gates' testimony becomes essentially moot.

8

9 **Q. HAS MR. GATES CHANGED HIS TESTIMONY FROM THE DIRECT**
10 **TESTIMONY HE FILED IN THIS CASE?**

11 A. Yes. In his direct testimony, Mr. Gates claimed on page 11 that Qwest is
12 **"the monopoly provider** of special access services" in Arizona (emphasis
13 added). Again on page 11 he refers to Qwest as **"the sole provider** of these
14 services" (emphasis added). In his latest testimony, he now claims that
15 Qwest "is the only alternative available in **many** locations" (emphasis
16 added). His claim has now diminished to "pockets" of monopoly control.

17 **Q. DOES QWEST HAVE "POCKETS" WHERE QWEST IS THE ONLY**
18 **ALTERNATIVE FOR SOME CUSTOMERS OF SPECIAL ACCESS?**

19 A. While I will still contend there are options to Qwest service in any situation, I
20 will agree that there are locations where these options may be somewhat

1 impractical. "Pockets" where such situations exist however is significantly
2 different than the case Mr. Gates was trying to make in his initial misleading
3 testimony in this case.

4 **Q. WHERE ARE THESE "POCKETS" OF QWEST DOMINANCE**
5 **DESCRIBED BY MR. GATES?**

6 A. Typically, these "pockets" are in low density areas where customers are few
7 and far between and there is insufficient revenue to attract competitive
8 facility investments. These pockets do not exist in metropolitan areas or
9 anywhere there are significant clusters of customers. Competitors are
10 drawn to areas where many customers can be served by relatively few
11 facility routes. Such situations provide the maximum opportunity for good
12 return on network investments.

13 **Q. ON PAGES 4 AND 5 OF HIS TESTIMONY, MR. GATES SUGGESTS**
14 **THAT QWEST'S PRICES DO NOT REFLECT THE MOST COST**
15 **EFFICIENT NETWORK POSSIBLE AND THIS RESULTS IN HIGHER**
16 **PRICES. IS HIS SUGGESTION REASONABLE?**

17 A. No. Mr. Gates has missed the point entirely. In my rebuttal testimony I
18 stated that under certain circumstances, customers may provide their own
19 facilities less expensively than they can purchase them from Qwest.
20 Qwest's rates are based on state-wide averages. These averages include
21 low volume, high cost areas as well as high volume low cost areas. A
22 customer needing service in one of the high volume, low cost areas may
23 very easily be able to provide their own facilities and beat Qwest's state-

1 wide average rates. Such customers may also be able to purchase service
2 from competitors that only serve customers in such high volume, low cost
3 areas.

4 **Q. HAS MR. GATES ALSO CHANGED HIS TESTIMONY ABOUT WHETHER**
5 **TIME WARNER PROVIDES ITS OWN FACILITIES IN SOME**
6 **SITUATIONS?**

7 A. Yes. In his direct testimony, Mr. Gates claimed that Time Warner must
8 purchase special access services "solely from Qwest" (Page 5, line 19). He
9 has now backed away from that position and acknowledges on page 5 of
10 his surrebuttal that Time Warner does use its own facilities if it can. His
11 argument now is that this is not "always" possible.

12 From Gates surrebuttal; Question: **DO YOU DISPUTE MR. MCINTYRE'S**
13 **SUGGESTION THAT TWTA DOES PROVIDE ITS OWN FACILITIES IN**
14 **CERTAIN AREAS? (MCINTYRE AT 14)**

15 Answer. No.

16

17 **Q. ON PAGE 10 OF HIS REBUTTAL, MR. GATES DISCUSSES INCREASES**
18 **IN SPECIAL ACCESS/PRIVATE LINE RATES AT THE FEDERAL LEVEL.**
19 **IS THIS RELEVANT IN THIS CASE?**

20 A. No. While Qwest has made some recent price increases for certain
21 products in the FCC tariff, this does not reflect the fact that Qwest has had
22 some of the lowest rates in the nation for these services for many years. Mr.

1 Gates is referring to rates regulated by the FCC which are not at issue in
2 Arizona. Over 98% of the special access/private line circuits purchased by
3 carriers in Arizona are purchased through the FCC tariff. The rates for these
4 services are regulated by the FCC and the revenues are not included in any
5 analysis of Qwest's financial position represented in this proceeding.

6

7 **Q. HAS QWEST INCREASED RATES IN ARIZONA FOR SPECIAL**
8 **ACCESS/PRIVATE LINE SERVICES USED BY CARRIERS?**

9 A. No. The last increase in Arizona was for low speed voice grade services
10 which are not typically used by carriers for special access. These increases
11 came as a result of the last rate case which resulted in the establishment of
12 competitive Basket 3 services. Qwest was given pricing headroom in Basket
13 3 and had little choice but to raise the prices for some services. The low
14 speed services which were increased in price were among the least utilized
15 of Qwest's private line services. They include alarm circuits, low speed data
16 services and analog voice channels that are not typically purchased by
17 carriers. Services such as DS-1 and DS-3 which are commonly used for
18 special access applications have not increased in price for many years.

19 **Q. SINCE SPECIAL ACCESS/PRIVATE LINE SERVICES IN ARIZONA**
20 **HAVE BEEN CLASSIFIED COMPETITIVE OR FLEXIBLY PRICED AS**
21 **PART OF QWEST'S BASKET 3 SERVICES, HAS ANY PARTY**
22 **CONTESTED THIS CLASSIFICATION?**

1 A. No.

2

V. TESTIMONY OF MR. DON PRICE

3

4 **Q. WHAT TESTIMONY OF MR. DON PRICE FOR MCI WOULD YOU LIKE**
5 **TO ADDRESS?**

6 A. Mr. Price discusses the nature of regulation at some length. He concludes
7 that since rate of return regulation is no longer valid, Qwest should reduce
8 switched access rates with no revenue offset.

9 **Q. DOES MR. PRICE'S ANALYSIS OF RATE OF RETURN REGULATION**
10 **APPLY IN THIS CASE?**

11 A. No. The Commission determined that Qwest's earnings and revenue
12 deficiency was an essential part of the information it needed to evaluate
13 Qwest's price plan proposal. Regardless of which analysis you choose in
14 this case, reductions to switched access without a revenue offset only
15 inflates Qwest's revenue shortfall.

16 **Q. DOES MR. PRICE SUGGEST ANY SOURCE FOR OFFSETTING**
17 **SWITCHED ACCESS REDUCTIONS?**

18 A. Yes. At the end of his testimony, on page 25, he suggests that shifting the
19 recovery of revenue from switched access to Basket 3 services might be
20 allowable.

1 **Q. IS BASKET 3 AN APPROPRIATE SOURCE FOR REVENUES NOW**
2 **RECOVERED THROUGH SWITCHED ACCESS RATES?**

3 A. No. First of all, the current policy for pricing switched access was
4 established to keep basic exchange rates low. If this policy is to be reversed
5 and past support for basic exchange service is to be eliminated, it is exactly
6 those services which must now bear that revenue burden. Making another
7 policy shift which creates another artificial pricing mechanism is
8 inappropriate.

9 Secondly, shifting revenue recovery from switched access to basket 3 is not
10 a revenue "shift" because the revenue cannot be automatically collected
11 through Basket 3 services. Basket 3 services are competitive. Increasing
12 prices for Qwest's most competitive services will only cause a loss of
13 market share. This market share loss offsets any increase in price and no
14 additional revenue is recovered. A shift of revenue recovery from switched
15 access to Basket 3 services will have the same result as merely eliminating
16 this revenue stream and this will make Qwest's revenue shortfall even
17 worse.

18 **Q. AREN'T QWEST'S SWITCHED ACCESS REVENUES ALSO SUBJECT**
19 **TO COMPETITIVE LOSS IF SWITCHED ACCESS RATES REMAIN**
20 **HIGHER THAN FCC RATES?**

21 A. Yes. There are alternatives to Qwest's switched access service and these
22 alternatives threaten this revenue as well. Losing customers to competitive
23 local service providers results in lost switched access minutes and

1 revenues. Bypassing switched access through the use of special access/
2 private line circuits also results in lost minutes and revenues. Customers are
3 also using wireless services for toll calling and this too, results in lost
4 switched access revenues.

5 **Q. THEN WHY IS QWEST PROPOSING LIMITED REDUCTIONS IN**
6 **SWITCHED ACCESS RATES IN THIS PROCEEDING?**

7 A. There are no longer any safe mechanisms for recovering this revenue.
8 Local service competition is increasing, wireless competition is eroding toll
9 and switched access revenues and bypass remains a cost effective solution
10 for many customers. While all revenues are now at risk, the most reliable
11 source of revenue at this time is basic exchange service. Since low basic
12 exchange rates were the original goal of high switched access pricing, basic
13 exchange is the proper place to recover this revenue requirement. Qwest
14 believes that a policy where the Arizona Commission shifts the recovery of
15 access revenues back to basic exchange services should be established,
16 but until then, the current policy should be maintained and the revenue
17 recovery mechanism should continue to be switched access. While there is
18 a risk to Qwest in maintaining this rate structure, it is the most reasonable
19 risk to take at this time in Arizona's circumstance.

20 In addition, there are many local service providers that charge for switched
21 access service for calls completed to or originating from their customers.
22 These competitors may also use switched access revenues to help support
23 low local service rates. In fact, there are many CLEC switched access rates

1 that meet or exceed Qwest's rates¹. If the Commission were to investigate
2 switched access with an intent to reform the current artificial pricing
3 structure, Qwest would support such a proceeding. In absence of such an
4 industry-wide investigation, there is no reason to single out Qwest for
5 extreme rate rebalancing.

6

7

VI. TESTIMONY OF MR. DEL SMITH

8

9 **Q. IS MR. SMITH NOW CLAIMING THAT HE HAS NOT PROPOSED**
10 **CHANGES TO QWEST'S PERFORMANCE OBJECTIVES FOR ACCESS**
11 **TO QWEST'S CALL CENTERS?**

12 **A. Yes. On page 1 of his Surrebuttal Testimony he asks the question "Was a**
13 **change to the performance objective for the residence, business and**
14 **repair centers proposed in Staff's testimony as suggested by Mr.**
15 **McIntyre's rebuttal restimony (sic)? Answer : "No".**

16 **Q. HAS HE, IN FACT, PROPOSED CHANGES TO THESE OBJECTIVES?**

17 **A. Yes.**

¹ **Qwest** Switched Access Rates: Originating Local Switching: \$0.0173, Terminating Local Switching: \$0.0173, Originating CCL: \$0.006244, Terminating CCL: \$0.014153 **Allegiance** Local Switching (O & T): \$0.0173, CCL (O) \$0.0100, (T): \$0.0242; **Level 3** Local Switching (O & T): \$0.0173, CCL (O & T): \$0.0242 **Eschelon** Local Switching (O): \$0.03856, (T): \$0.0681369 **AT&T** Local Switching (O): \$0.0273, (T): \$0.0415 **Cox** Local Switching (O & T): \$0.041588 **MCI** Local Switching (O): \$0.050274, (T): \$0.071148 **Xo** Local Switching (O): \$0.027402, (T): \$0.041602

All rates above are charged on a per minute basis

1 **Q. CAN YOU PROVIDE A SIMPLE EXAMPLE OF INCREASED PENALTIES**
2 **UNDER MR. SMITH'S PROPOSAL?**

3 A. Yes. Currently if Qwest performs at a 70.01 to 75% performance level, there
4 are no penalties. Under Mr. Smith's proposal this same performance level
5 will result in \$1000 per day in penalties. This is clearly an increase in
6 penalties.

7 **Q. DID YOU PROPOSE ANY CHANGES TO THE SERVICE QUALITY**
8 **STANDARDS IN YOUR INITIAL TESTIMONY IN THIS PROCEEDING?**

9 A. No. Mr. Smith brought up this issue and proposed increasing the penalties.

10 **Q. WHY DID YOU INTRODUCE THE CONCEPT OF AVERAGE WAIT TIME**
11 **AS A BETTER MEASUREMENT OF SERVICE QUALITY IN YOUR**
12 **REBUTTAL TESTIMONY?**

13 A. Since Mr. Smith brought up the subject of call center performance, I felt
14 obligated to inform the Commission that a better measurement mechanism
15 exists and has been advocated by Qwest for quite some time.

16
17 **Q. WHO PROVIDED THE INITIAL MEASUREMENT SCHEME OF 80% OF**
18 **CALLS ANSWERED IN 20 SECONDS?**

19 A. Qwest did, many years ago. This was a measurement scheme used by
20 Qwest internally and this internal measurement plan was extrapolated to the
21 regulatory world.

22 **Q. IS AVERAGE WAIT TIME A BETTER MEASUREMENT SCHEME?**

1 A. Yes, as I explained in my rebuttal testimony.

2 **Q. WHY DOES MR. SMITH RESIST A CHANGE TO A BETTER**
3 **MEASUREMENT STANDARD?**

4 A. He has seen no "proof" that it is a better standard, relies on the fact that
5 Qwest can produce both measurements and relies on the fact that other
6 states in Qwest territory require a similar measurement scheme.

7 **Q. WHAT IS YOUR PROOF THAT AVERAGE WAIT TIME IS A "BETTER"**
8 **STANDARD?**

9 A. The proof is rather simple. Qwest believes it is a better measurement tool
10 and prefers to use it for internal measurements. Qwest has expert
11 personnel managing call centers and this expertise should be relied upon
12 for such judgment. The average wait time measurement is more direct and
13 provides better information to Qwest managers about how they are
14 performing. Qwest initially proposed the current measurement scheme and
15 it was accepted by regulators in all states. Qwest's proposal for new
16 measurements should also be accepted. Although it is not "intuitively" a
17 better scheme to Mr. Smith, (Smith surrebuttal, page 3, line 10), it seems
18 obvious that measuring the hold times for ALL calls is a better standard than
19 measuring and reporting on only 80% of the calls.

20 **Q. ARE AVERAGE HOLD TIME PERFORMANCE STANDARDS THE**
21 **REGULATORY STANDARD IN OTHER QWEST STATES?**

1 A. Yes. Utah, Washington and New Mexico have converted to this new
2 standard.

3 **Q. CAN QWEST PRODUCE BOTH MEASUREMENTS AS MR. SMITH**
4 **CLAIMS?**

5 A. Yes, but why should Qwest have to produce both measurements? This is
6 wasteful. Qwest is only producing results in the 80% measurement scheme
7 because regulators are resistant to change. Qwest should not have to
8 produce archaic measurements simply to satisfy this resistance.

9 **Q. MR. SMITH LOOKS TO THE IDAHO STAFF FOR SUPPORT FOR HIS**
10 **CONCLUSION THAT AN AVERAGE WAIT TIME IS NOT APPROPRIATE.**
11 **IS THIS APPROACH VALID?**

12 A. No. First of all, Qwest is not required to file this information with the Idaho
13 Commission. Qwest's provision of this data is completely voluntary. Second,
14 there is no mathematical calculation that can compare one measurement to
15 the other. This is because the 80/20 standard only measures 80% of the
16 calls while the average wait time measurement measures all of the calls.
17 The fact that there is no an algorithm to convert from one measurement to
18 the other is further proof that duplicate reporting is inappropriate.

1 problems that he now acknowledges do not exist is amazing. Over 98% of
2 the special access/ private line circuits purchased by carriers are purchased
3 out of the FCC tariff and are not at issue in this case. This proceeding is
4 large enough and complicated enough without diverting effort to non-
5 existent problems or issues beyond the scope of this Commission.

6

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

8 **A.** Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON)

COUNTY OF KING)

ss

AFFIDAVIT OF SCOTT A. MCINTYRE

Scott A. McIntyre, of lawful age being first duly sworn, deposes and states:

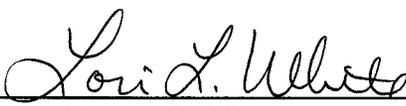
1. My name is Scott A. McIntyre. I am Staff Director – Public Policy for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.


 Scott A. McIntyre

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.




 Lori L. White
 Notary Public

My Commission Expires: 7/10/07

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S)
FILING OF RENEWED PRICE REGULATION)
PLAN)
-----)
IN THE MATTER OF THE INVESTIGATION OF)
THE COST OF TELECOMMUNICATIONS)
ACCESS.)
-----)

DOCKET NO. T-01051B-03-0454

DOCKET NO. T-00000D-00-0672

REJOINDER TESTIMONY

OF

TERESA K. MILLION

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY INDEX

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EXECUTIVE SUMMARY

Current Responsibilities:

My title is Staff Director - Service Cost. My responsibilities include preparing expert testimony and testifying about the cost of service for all products and services that Qwest offers, including its traditional retail services and more contemporary wholesale services.

Purpose of Testimony:

My testimony rebuts the testimony of Mr. Thomas Regan and Mr. F. Wayne Lafferty regarding Qwest's proposal for the Arizona Universal Service Fund (AUSF). In addition, my testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors based on Qwest's TSLRIC studies.

Summary of Testimony:

My testimony further explains why Mr. Regan's interpretation of the AUSF rules, which assumes that no loop or port cost should be included in calculating the funding need, does not make sense and is inconsistent with the universal service fund determinations of other states in Qwest's region.

My testimony addresses Mr. Lafferty's continuing concerns regarding the appropriate calculation of Qwest's retail price floors using TSLRIC. In addition, I address Mr. Lafferty's apparent recommendation against awarding AUSF funding to Qwest despite his calculation of a \$24.5 million shortfall in Zones 2 and 3.

1

IDENTIFICATION OF WITNESS

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

3 A. My name is Teresa K. (Terri) Million. My business address is 1801 California
4 Street, Room 2050, Denver, Colorado 80202. I am employed by Qwest Services
5 Corporation as a Staff Director, Service Costs, in the Public Policy Department. In
6 this position, I am responsible for preparing testimony and testifying about Qwest's
7 cost studies in a variety of regulatory proceedings.

8 **Q. ARE YOU THE SAME TERESA MILLION WHO FILED DIRECT TESTIMONY IN**
9 **THIS PROCEEDING?**

10 A. Yes.

11

PURPOSE OF TESTIMONY

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

13 A. My testimony rebuts the direct testimonies of Thomas Regan on behalf of the Staff
14 of the Arizona Corporation Commission (ACC) and F. Wayne Lafferty on behalf of
15 Cox Arizona Telcom regarding Qwest's proposal for the AUSF. In addition, my
16 testimony rebuts Mr. Lafferty's testimony regarding the calculation of price floors
17 based on Qwest's TSLRIC studies.

1 Testimony of Mr. Thomas Regan

2 **Q. MR. REGAN CLAIMS QWEST'S RESPONSES TO HIS DATA REQUEST [WDA**
3 **19-13 (A & B)] CONTRADICT YOUR TESTIMONY THAT QWEST'S DECISION**
4 **TO INVEST IN ADDITIONAL LOOP AND PORT FACILITIES IS BASED ON THE**
5 **PROVISIONING OF LOCAL DIAL TONE TO CONSUMERS. PLEASE**
6 **COMMENT.**

7 A. It is true that whenever Qwest provides its basic local exchange service to a
8 customer, it hopes to garner revenues from other sources (such as vertical
9 services, switched access and toll). In some instances, those revenues are
10 considered in Qwest's decision whether to provide service to a particular customer.
11 Indeed, for its unregulated services, Qwest commonly performs the type of
12 business case analysis that Mr. Regan suggests. However, such an analysis does
13 not drive Qwest's decision to invest in additional loop and port facilities in the
14 majority of its network. The reason for this is simple. In those areas where Qwest
15 has an existing customer base within its authorized service territory, Qwest has an
16 obligation to serve all of the customers in that area. One need only look at the
17 penalties the ACC imposes on Qwest for orders that are considered "held" (i.e.,
18 orders that cannot be completed in a timely manner due to lack of facilities) to
19 understand that Qwest is required to invest in and provide facilities in those areas
20 whether customers ever intend to purchase more than basic dial tone or not.
21 Under these circumstances, Qwest does not have the luxury of determining the
22 revenue potential of its basic exchange customers in considering whether to invest
23 in loop and port facilities, unless it is willing to face the imposition of significant
24 regulatory penalties by the State. The most revenue that Qwest can count on from

1 its customers is basic local exchange revenue. In some cases, as substitution
2 from wireless services increases, Qwest cannot count on receiving even basic
3 local exchange revenues from all potential customers in spite of its obligation to
4 invest in facilities in order to have them ready and available for those customers
5 who may want service. Therefore, except in cases where Qwest is considering
6 serving a single customer in a remote location or determining whether to expand
7 into previously unserved areas, Qwest only hopes that it will have an opportunity to
8 earn additional revenues from vertical services, switched access and toll, in order
9 to cover the cost of its facilities. It does not, however, depend on them in its
10 decision to invest.

11 **Q. WHAT DO YOU CONCLUDE FROM YOUR DISCUSSION ABOVE?**

12 A. I can only conclude that Mr. Regan's suggestion that the appropriate way to
13 calculate Qwest's TSLRIC cost for basic exchange service is to exclude the cost of
14 the loop and port. This suggestion entirely ignores the regulatory environment in
15 which Qwest operates. Until the ACC is willing to eliminate the penalties that
16 Qwest pays for held orders and acknowledges that in the face of competition
17 Qwest no longer has an obligation to serve all of the customers in its local calling
18 areas, Qwest does not have the luxury of analyzing revenues when determining
19 when and where to place facilities to make dial tone available to its potential
20 customers. Therefore, under the current regulatory environment which continues
21 to reflect a historical mindset that requires telephone service to be available

1 ubiquitously as if it were an inalienable right of all citizens, it is inconceivable that
2 the TSLRIC cost of basic local exchange service would not include the cost of the
3 loop and port.

4 **Q. DO YOU DISPUTE MR. REGAN'S ASSERTION THAT AS LONG AS A**
5 **SERVICE IS PRICED EQUAL TO OR ABOVE ITS TSLRIC, THE SERVICE IS**
6 **NOT RECEIVING A SUBSIDY?**

7 **A.** No. However, I do take issue with Mr. Regan's exclusion of loop and port costs
8 from the TSLRIC of basic local exchange service. Further, I would clarify that
9 where I have referred to the "implicit subsidies" inherent in Qwest's current pricing
10 scheme, I am not describing economic subsidies in the strictest sense. Rather, I
11 am referring to the contributions necessary from all products and services in order
12 to cover all of Qwest's costs, including its common costs. It is important to keep in
13 mind that merely covering the TSLRIC of a service does not provide for
14 contribution toward the recovery of the common costs or overheads of a company.
15 In the long run, just as with any other company, if Qwest is unable to recover all of
16 its costs of doing business, eventually it will be unable to remain in business.
17 Thus, to the extent that Qwest's price for basic local exchange service in high-cost
18 zones either covers the TSLRIC of the service (including the loop and port costs)
19 or does not cover the TSLRIC, the only way to recover Qwest's overall costs is
20 through contributions from other services. And, as pointed out in Mr. Teitzel's
21 testimony, in the face of increasing competition the sources of other revenues
22 Qwest has to draw on for contribution to those common costs continues to

1 dwindle. Therefore, if it is truly the intent of the Commission to keep the price of
2 basic exchange service affordable for all of Arizona's citizens, then in light of such
3 growing competition the best way for the Commission to ensure its goal continues
4 to be met is to allow Qwest and its qualified competitors to receive AUSF funding
5 in the high-cost zones.

6 **Q. ON PAGE 29 OF HIS REBUTTAL TESTIMONY MR. REGAN DISTINGUISHES**
7 **THE COMMISSION'S DECISION IN THE MIDVALE AUSF WAIVER REQUEST**
8 **FROM QWEST'S AUSF FUNDING REQUEST BY POINTING OUT THAT**
9 **MIDVALE WAS SEEKING FUNDS TO PROVIDE NEW SERVICES IN**
10 **UNSERVED AREAS. DOES THAT DISTINCTION MATTER?**

11 A. No. Mr. Regan's rebuttal misses the point of Mr. Teitzel's and my discussion about
12 the Midvale waiver. Our point was that there is precedent established by this
13 Commission that allows for waiver of the specific requirements for AUSF funding in
14 circumstances where the Commission finds it in the public interest to do so. In the
15 case of Midvale the scope was admittedly smaller and the purpose for the
16 requested waiver was different. Nevertheless, the Commission determined that in
17 order to bring service to previously unserved areas it was willing to overlook the
18 specific rules and allow Midvale to obtain AUSF funding.

19 In Qwest's case the request for AUSF funding is related to its high-cost of
20 continuing to serve rural customers in Zones 2 and 3, as well as encouraging
21 competition in high-cost areas. No party in this case disputes the fact that Qwest's
22 costs to serve rural customers are high. Further, in the face of increasing

1 competition in Phoenix and Tucson as described by Mr. Teitzel, it becomes
2 increasingly difficult for Qwest to find contribution margins from other products that
3 enable it to continue to serve those rural customers at its current retail prices.
4 Thus, Qwest is merely pointing out that in analyzing the AUSF funding issue and
5 deciding how to properly calculate Qwest's funding requirement, the Midvale case
6 provides precedent that allows the Commission to consider the public interest in
7 maintaining low rates while encouraging competition as it makes its determination.

8 **Q. MR. REGAN PURPORTS TO EXPLAIN WHY HIS USE OF THE UNE LOOP AND**
9 **PORT RATES IN HIS OVERALL ANALYSIS ARE CORRECT. PLEASE**
10 **COMMENT.**

11 A. Mr. Regan simply confuses the issue with his discussion about the fact that as
12 UNEs, the loop and port are not retail services. Clearly, the loop and port are not
13 in themselves retail services; however, just as clearly, they are part of the facilities
14 that make up the retail service known as basic local exchange. If the purpose of
15 Mr. Regan's analysis is to compare the revenues for retail basic local exchange
16 services to the overall costs for those services, then those revenues and costs
17 should match up. In other words, the revenues for retail services should be
18 matched against the costs for the organizations and activities that support those
19 revenues. For example, by using the UNE loop and port rates in his analysis, Mr.
20 Regan avoids recognizing the cost to Qwest of advertising its retail products. This
21 is because, as wholesale products, the UNE loop and port receive no loading for
22 advertising in their rates as the Commission has previously determined in other

1 cost proceedings that there are no advertising costs associated with the sale of
2 UNEs. Yet there can be no doubt that Qwest incurs advertising costs in order to
3 sell its retail products. Thus, because the loop and port make up the majority of
4 the overall cost of a 1FR, and there are no advertising costs included in the UNE
5 rates for the loop and port, by using the UNE rates Mr. Regan is able to avoid
6 including those costs in his analysis. In addition, the factors used to load
7 expenses for categories such as product management, uncollectibles and
8 customer operations are based on the expenses Qwest incurs to support its
9 wholesale business, and have no relationship to the organizations, experience and
10 activities that are the result of supporting its retail business. Furthermore, the
11 expense loadings that are included in the UNE rates for loop and port that Mr.
12 Regan uses have purposely excluded any expenses that are associated with
13 Qwest's retail operations according to the HAI documentation filed in the wholesale
14 cost docket. Therefore, a large portion of the expense loadings included in the
15 costs that Mr. Regan uses to offset the retail revenues in his analysis have nothing
16 to do with the retail products he purports to analyze.

17 **Q. DID THE ADJUSTMENT THAT YOU PROVIDED TO MR. REGAN'S ANALYSIS**
18 **CORRECT THIS MISMATCHING OF EXPENSES AND REVENUES?**

19 **A.** Yes. By using fully allocated costs from the retail cost studies for the basic local
20 exchange services, my adjustment eliminates the wholesale expenses from the
21 calculation and substitutes the retail expenses into the comparison. It also still
22 effectively imputes the ACC-determined cost of a loop into the comparison

1 because, as I stated in my rebuttal testimony, the only real difference between a
2 retail and wholesale cost study are the expense loadings applied to the underlying
3 investment. The investment used in determining the fully allocated costs of the
4 retail basic local exchange services is the same investment determined by the
5 ACC for the loop and port in the wholesale cost docket. The way Mr. Regan
6 calculates the intrastate costs, i.e., using UNE rates for the loop and port instead of
7 calculating retail costs based on the underlying investment determined by the
8 ACC, results in some retail expenses and a majority of wholesale expenses being
9 compared to retail revenues.

10 **Q. IS THERE ANY SIGNIFICANCE TO MR. REGAN'S CONCERN THAT QWEST'S**
11 **RETAIL FACTORS HAVE NOT BEEN APPROVED BY THE ACC?**

12 A. No. Mr. Regan's comment about Qwest's retail factors not receiving ACC approval
13 is again an attempt to confuse the issue. If anything, Qwest's retail factors (as
14 calculated in a forward-looking cost study) are understated when compared to the
15 actual expenses Qwest incurs in support of its retail operations. This is because
16 the retail factors are often applied against an investment amount that is less than
17 the embedded investment used to generate the actual expenses associated with
18 the revenues analyzed by Mr. Regan. In addition, productivity and inflation factors
19 are applied to Qwest's actual expenses in order to estimate those expenses on a
20 forward-looking basis. This too results in retail factors that typically reflect less
21 expense than Qwest's actual incurred retail expenses. Of course by using the
22 UNE rates, based on wholesale expenses, Mr. Regan's analysis produces a lower

1 cost that when compared to revenues, does not result in an AUSF funding
2 requirement. In contrast, when retail revenues are properly matched with retail
3 expenses by using the fully allocated basic local exchange costs from the TSLRIC
4 study a shortfall continues to exist that justifies AUSF funding for Qwest.

5 **Q. DOES MR. REGAN'S OVERALL ANALYSIS PROPERLY MATCH "TOTAL**
6 **INTRASTATE REVENUES TO TOTAL INTRASTATE COSTS" AS HE CLAIMS**
7 **ON PAGE 25 OF HIS REBUTTAL TESTIMONY?**

8 A. No. As I have discussed above, Mr. Regan's analysis results in a mismatch of
9 revenues and costs because he improperly compares intrastate retail revenues
10 with costs that include the expenses associated with Qwest's wholesale operations
11 and exclude expenses associated with its retail operations.

12 **Q. MR. REGAN POINTS OUT THAT QWEST DOES NOT RECEIVE FEDERAL**
13 **UNIVERSAL SERVICE FUNDING AND THEREFORE SHOULD NOT BE**
14 **ENTITLED TO AUSF FUNDING UNDER A.A.C. R14-2-1202.A. DO YOU**
15 **AGREE?**

16 A. No. Although the rule cited by Mr. Regan requires AUSF funding to be provided
17 "net of any universal service support from federal sources," it does not say that a
18 carrier must receive support from federal sources before being eligible for AUSF
19 funding. If this result was what the ACC intended, it could have written the rules to
20 require a carrier to actually obtain federal funding before becoming eligible to
21 receive AUSF funds. Instead, the rules provide that "federal funding should be
22 pursued...." The fact is Qwest should not be penalized in its efforts to obtain
23 support for its high-cost zones simply because the method of distributing federal

1 universal service funds is flawed. Indeed, Congress is considering legislation to
2 correct the problems with the way the federal fund currently works. Under the
3 existing method, only a few states (mostly located in the southern part of the
4 United States) receive federal funds for non-rural carriers. This result is unfair and
5 discriminatory. The greatest expanses of rural territory in the United States are
6 located in the West and are primarily in Qwest's service area, including Arizona.
7 There is no dispute over the fact that Qwest serves a significant number of high-
8 cost rural customers in Arizona. According to Mr. Regan's own analysis, nearly
9 38% of Qwest's intrastate revenues are derived from its high-cost rural customers
10 in Zones 2 and 3. Clearly, Qwest's rural customers in Arizona are no different than
11 the rural customers served by independent carriers. Yet under the flawed federal
12 system, Qwest receives no support for its Arizona services while independent
13 carriers are award significant federal USF funds for this State. It would be patently
14 unjust to Qwest in the current competitive environment for the AUSF system to be
15 applied in the same discriminatory manner.

16 **Q. MR. REGAN QUOTES DR. JOHNSON AS SAYING "THERE IS NO LOGICAL**
17 **REASON TO IMPOSE THE ENTIRETY OF THESE [LOOP] COSTS ONTO JUST**
18 **ONE OF THE SERVICES BENEFITING FROM THEM." IS IT ANY MORE**
19 **LOGICAL TO ENTIRELY EXCLUDE THE LOOP COSTS FROM THE BASIC**
20 **LOCAL EXCHANGE SERVICES AS MR. REGAN HAS?**

21 **A.** No. Yet Mr. Regan's "Code Analysis" does just that by assuming that *none* of the
22 cost of the loop and port should be included, while *all* of the revenues from basic
23 local exchange service are included. In addition, *all* of the interstate EUCL is

1 included, despite the fact that on Page 21 of his rebuttal testimony, Mr. Regan
2 argues that the "USF being addressed in this proceeding is an intrastate USF." At
3 least my proposal to include 100% of the cost of the retail basic local exchange
4 service in his "Overall Analysis" is consistent with my proposal to also include the
5 interstate EUCL in the revenues being analyzed.

6 **Q. DO OTHER STATES IN QWEST'S REGION INCLUDE THE COST OF THE**
7 **LOOP AND PORT IN THEIR CALCULATION OF USF FUNDING**
8 **REQUIREMENTS?**

9 A. Yes. For example, Colorado, Oregon, Nebraska and Wyoming (the only other
10 states in Qwest's region to provide intrastate USF funds) all include the cost of the
11 loop and port in their calculations of USF funding requirements. Those states
12 recognize, as discussed in my rebuttal testimony, that USF funds should address
13 the high cost of providing service in sparsely populated rural areas, as compared
14 to the cost of the loops in dense, urban areas. In those states, Qwest receives
15 USF funding to recover the high cost of the loop in rural areas.

16 **Testimony of Mr. F. Wayne Lafferty**

17 **Q. MR. LAFFERTY STATES THAT HE DOES NOT PROPOSE THE ACC**
18 **AUTHORIZE AUSF FUNDS FOR QWEST IN SPITE OF HIS CALCULATION OF**
19 **A \$24.5 MILLION SHORTFALL IN ZONES 2 AND 3. PLEASE COMMENT.**

20 A. It is surprising that Mr. Lafferty so readily dismisses the idea of Qwest drawing
21 funds from the AUSF in light of the fact that Qwest's proposal includes a provision
22 for making the funds portable to all qualified carriers serving customers in high-

1 cost zones. On the other hand, his position is not surprising when one considers
2 that as a competitive carrier Cox (like other competitive carriers) has no obligation
3 to serve customers in high-cost areas. Thus, unlike Qwest, Mr. Lafferty's employer
4 can choose not to serve high-cost customers wishing to purchase only basic
5 exchange services and is therefore free to focus its marketing efforts on only those
6 customers whom it may serve profitably without the need for AUSF funding.

7 Nevertheless, as the representative of a competitive carrier, Mr. Lafferty appears
8 to recognize that in calculating the proper AUSF funding amount using TSLRIC, it
9 is appropriate to include the loop and port in the cost. Presumably this is because
10 Mr. Lafferty recognizes, as does Qwest, that despite differing economic theories,
11 practically speaking it only makes sense for a carrier to include its loop and port
12 costs in its calculation of an AUSF funding requirement because those costs are
13 legitimately a part of any carrier's cost to provide service to its customers.

14 **Q. MR. LAFFERTY CONTINUES TO EXPRESS CONCERNS IN HIS REBUTTAL**
15 **TESTIMONY WITH QWEST'S USE OF TSLRIC STUDIES TO DETERMINE ITS**
16 **PRICE FLOOR. ARE HIS CONCERNS JUSTIFIED?**

17 **A.** No. As I described in my direct and rebuttal testimonies, Qwest has made a
18 proper imputation of the UNE elements into its TSLRIC costs for the studies that it
19 has filed. Any method in which the entire UNE cost is imputed into the cost results
20 in a mismatch of wholesale expenses with the retail product represented by the
21 TSLRIC study, as discussed in my response above to Mr. Regan's rebuttal
22 testimony. In addition, the rule in Arizona for pricing of competitive

1 telecommunications services states specifically that a telecommunications
2 company "may price a competitive telecommunications service at any level at or
3 below the maximum rate stated in the company's tariff on file with the Commission,
4 provided that the price for the service is not less than the company's *total service*
5 *long-run incremental cost* of providing the service."¹

6 As Mr. Lafferty points out in his discussion of my calculation of Qwest's AUSF
7 funding requirement, the TSLRIC of a product is not the same as the fully allocated
8 cost of a product. The TSLRIC represents the direct and directly attributable costs
9 of a product, while the fully allocated cost includes the common overhead costs of
10 the firm that must be recovered in order for the firm to remain in business over the
11 long run. The TELRIC calculation for an unbundled element also results in the
12 common overhead costs for the *wholesale* portion of the firm being included in the
13 UNE rate. Therefore, Mr. Lafferty's suggestion that the proper calculation of the
14 price floor for *retail services* is the "sum of the prices of the unbundled network
15 elements that are utilized to provision the service..." is incorrect. In fact, the
16 section of the rules that refers to the imputation of prices in the price floor does so
17 in reference to the calculation of the "*retail price* of each telecommunications
18 service...."² Thus, by definition, Qwest's method of imputing UNE investments into
19 TSLRIC studies that utilize retail expense loadings and produce the *retail price* of

¹ A.A.C. R14-2-1109. Pricing of Competitive Telecommunications Services. Emphasis added.

² A.A.C. R14-2-1310 C. Pricing Imputation. Emphasis added.

1 each service is more correct than Mr. Lafferty's method, which produces a price
2 that includes Qwest's wholesale expense loadings and common overheads.

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

4 A. Yes

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S
FILING OF RENEWED PRICE REGULATION
PLAN.

)
) DOCKET NO. T-01051B-03-0454
)
)

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF TELECOMMUNICATIONS
ACCESS.

)
) DOCKET NO. T-00000D-00-0672
)
)

REJOINDER TESTIMONY

OF

DENNIS PAPPAS

QWEST CORPORATION

JANUARY 28, 2004

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Dennis Pappas. My business address is 700 Mineral Ave., Room MN H 20.13 in Littleton, CO 80120.

Q. WHAT IS YOUR CURRENT POSITION?

A. I am a Director in Qwest's Public Policy organization representing Local Network Operations.

Q. ARE YOU THE SAME DENNIS PAPPAS THAT PRESENTED REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. I am.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My rejoinder testimony addresses the requests of Staff witness Mr. Del Smith to leave the Service Quality rules in Arizona in effect - for perpetuity apparently. As demonstrated in my rebuttal testimony, the need for rules in the areas of held orders, out-of-service measurements and trouble report rates have run their course and Qwest is performing well within the thresholds that have been set in the Service Quality rules. While Mr. Smith proposes to keep these rules in place just to make sure Qwest does not back-step, Qwest asserts that the competitive market in Arizona is an effective "hammer," which is now in place to assure service quality and can be relied upon by this Commission instead of rules.

1 services – many customers now finding wireless as a total substitution for wireline
2 service. My point is that with competition being so prevalent in Arizona, any back
3 sliding by Qwest in performance (measured or not) can and will result in an end
4 user seeking other alternatives from among the many available. Qwest's witness
5 Mr. Dave Teitzel goes into much greater detail on the level of competition that
6 currently exists in the state.

7 **Q. WHAT EFFECT DOES THE EXISTENCE OF LOCAL COMPETITION HAVE ON**
8 **THE ROLE OF SERVICE QUALITY REGULATION?**

9 In both his Rebuttal and Surrebuttal testimony, Mr. Smith has repeatedly agreed
10 with Qwest's position that Qwest's service not only has improved but has been
11 maintained at levels higher than required by the Service Quality Plan Tariff. The
12 fact that Qwest is providing higher quality of service levels than are required by
13 the plan indicates that other forces are motivating Qwest's behavior - such as the
14 forces of market competition. For example, if Qwest does not install an order for a
15 landline service on the date requested, both recurring charges and potential
16 access charge revenues are at risk. If the delay is extended beyond customer
17 expectations, the customer will simply choose to order service from a competitor
18 or completely bypass landline service altogether in favor of a wireless solution.
19 Moreover, the impacts go far beyond just losing the local service to a competitor.
20 Customers that are not happy with Qwest's local service are also not likely to
21 choose Qwest's long distance service. Competition already exists in many forms,
22 and Qwest is committed to providing high quality service without the need for
23 government-imposed service quality incentive programs. These facts support the

1 removal of regulatory standards and penalties, as they are no longer needed to
2 protect the public interest since Qwest is already providing a higher level of
3 protection on its own accord.
4

5 **Q. IN TURN, WHAT EFFECT DOES THE KIND OF SERVICE QUALITY**
6 **REGULATION MR. SMITH ADVOCATES CONTINUING HAVE ON THE**
7 **INDUSTRY?**

8 Mr. Smith continues to promote an outdated and outmoded regulatory model of
9 standards and penalties designed to provide an ongoing incentive to maintain
10 service quality performance. Retaining the penalty provisions of the Service
11 Quality Plan Tariff sends the wrong message and incentive. If the penalty aspects
12 are not eliminated, despite Qwest's excellent quality above required levels, the
13 message to Qwest is that it is unwise to improve its level of service, since the
14 regulatory response in the future will likely be to raise standards and penalties to
15 reflect the improved performance, thus imposing upon Qwest a heightened level
16 of risk, fines for violations, and removing any competitive advantage Qwest may
17 have gained in the marketplace by improving their service quality above that of
18 their competitors.

19 **Q. PLEASE RESPOND TO MR. SMITH'S REFERENCE TO THE TESTIMONY OF**
20 **STAFF WITNESS FIMBRES, ATTEMPTING TO EXPLAIN AWAY THE**
21 **EXISTENCE OF COMPETITIVE ALTERNATIVES.**

22 Merely stating that Qwest remains the primary provider of wireline service in its
23 service territory is like saying that England still controls 100% of the British

1 Empire. It was once said that the sun never set on the British Empire, so large
2 was its breadth and scope. While England may still control 100% of that empire
3 today, the fact is that the British Empire is a small shadow of its former greatness.
4 Statements such as witness Fimbres' ignore the erosion of Qwest's wireline
5 services caused by competitive alternatives provided by CLECs, cable
6 companies, wireless companies and VoIP service providers. In light of
7 burgeoning competition, Qwest believes that customer demand, choice, and
8 expectations – not regulation – should decide the nature and degree of service
9 quality that is necessary.

10 **Q. IN YOUR OPINION, HAS THE CONCEPT OF SERVICE QUALITY TAKEN A**
11 **BACK SEAT TO THE COST OF SERVICES?**

12 A. I continue to be amazed at the tolerance subscribers have for relatively poor
13 levels of cell phone service quality over the years. If the PSTN were to drop as
14 many calls as the wireless network, this Commission would be flooded with
15 complaints. Yet, the convenience of talking on the go outweighs having to redial a
16 telephone number and apologize to the person on the other end for the
17 inadequacies of the cell phone company. Early on, VoIP technology experienced
18 similar issues and many brought into question the quality of VoIP calls and
19 asserted that call quality remained below that provided on traditional wireline
20 phones. At that time, market analysts had readily admitted that the sound quality
21 of VoIP calls are "awfully close" to that of a wireless call. No one will dispute that
22 the sound quality of wireless calls is far less than that provided by wireline
23 carriers, such as Qwest, yet customers have flocked by the millions to wireless

1 service and increasingly to the newer service known as VoIP. Exhibit DP-1 is an
2 article written by Urvaksh Karkaria on the Fort Wayne Indiana home page
3 discussing Vonage, an IP telephony company, and their current foot-hold in the
4 VoIP market. It is projected that between 2003 and 2008, the number of VoIP
5 residential VoIP subscriptions to grow from nearly 1 million by the end of 2005 to
6 an estimated 11.7 million by 2008. These estimates were based on research
7 conducted by Analysys – the consulting firm. Clearly, customers are willing to
8 accept and try newer, different quality services in exchange for some other
9 benefit, such as price or convenience. The point is that consumers have
10 increasingly become more price sensitive than performance sensitive because
11 they have become accustomed to lesser service quality due to inter-modal
12 competition such as wireless. Often time wireless performance is less than
13 satisfactory but the convenience of being able to make the call at that moment
14 takes the sting away of having the call dropped numerous times. For this
15 Commission to continue with measurements that, first, Qwest has seldom had to
16 worry about, and second, are not even important to many subscribers, seems
17 ludicrous in light of the market conditions and trends.

18 It also seems odd for anyone to suggest that the Commission might even consider
19 retaining outdated service quality standards, conceivably set to reflect minimum
20 performance levels that currently exceed the minimum performance that
21 customers evidently increasingly accept. Imposing regulatory hoops in areas that
22 are not presently a concern of our customers provides no benefits to those

1 customers and only adds operational, administrative and economic burdens on
2 Qwest.

3
4 **Q. MR. SMITH STATES ON PAGE 4 OF HIS SURREBUTTAL THAT THE**
5 **SERVICE QUALITY PLAN AND ITS ASSOCIATED PENALTIES WERE**
6 **ESTABLISHED TO ADDRESS QWEST'S PAST PERFORMANCE. PLEASE**
7 **ELOBORATE ON QWEST'S PAST PERFORMANCE.**

8 A. Over that past 18 months, Qwest has reported held orders numbers in the single
9 digits or low teens across the state. Exhibit DP-2 illustrates the general trend in
10 held orders since October of 2000. Based on this "past performance," it appears
11 that the service quality plan has served its purpose. Confidential Exhibit DP-3
12 illustrates those held orders which have gone for longer than 30 days and, once
13 again, it is easy to see that Qwest's "past performance" is not an issue – in fact, in
14 the past 24 months, Qwest has only had one order held for a period of 30 days or
15 longer.

16 Exhibit DP-4 provides a snap shot of Qwest's out-of-service measurements and
17 as the chart demonstrates, Qwest's "past performance" has exceeded the
18 standard in 9 of the last 12 months and has not dropped below the standard in
19 any two consecutive months during that period. In fact, since December 2000,
20 Qwest has NEVER had two consecutive months below the standard. Once again,
21 past performance does not appear to be an issue for this measurement either.
22 Confidential Exhibit DP-5 demonstrates, again, that Qwest has remained well
23 below the trouble report rate of 8 reports per 100 across the State since this

1 measurement was put in place. If one believes what Mr. Smith is saying about
2 the penalties addressing past performance, indeed, Qwest's past performance
3 has been very good, in fact two aspects of these rules have NEVER been
4 triggered. For that reason, the service quality measurements for held order, out-
5 of-service and trouble report rates should be abandoned.

6

7

III. CONCLUSION

8

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

10 **A. Yes, it does.**

BEFORE THE ARIZONA CORPORATION COMMISSION

JEFF HATCH-MILLER
Chairman
WILLIAM A. MUNDELL
Commissioner
MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

IN THE MATTER OF QWEST CORPORATION'S) FILING OF RENEWED PRICE REGULATION) PLAN.)	DOCKET NO. T-01051B-03-0454
<hr/>	
IN THE MATTER OF THE INVESTIGATION) OF THE COST OF TELECOMMUNICATIONS) ACCESS.)	DOCKET NO. T-00000D-00-0672

REJOINDER EXHIBITS

OF

DENNIS PAPPAS

QWEST CORPORATION

JANUARY 28, 2004

Arizona Corporation Commission
 Docket No. T-01051B-03-0454
 Docket No. T-00000D-00-0672
 Qwest Corporation - DP-1
 Rejoinder Exhibits of Dennis Pappas
 January 27, 2005

VONAGE

THE BROADBAND PHONE COMPANY™

Internet Phone Service Race
Date: Saturday, July 03 @ 00:00:00 EDT
Topic: Vonage News



Rivals Line Up For Internet Phone Service Race

July 12, 2004

By Urvaksh Karkaria

As Gulliver stirs, the Lilliputians in the nascent Internet phone service business are bracing for a not-so-even showdown.

Verizon Communications plans to invest about \$3 billion over the next two years to beef up its broadband service, which will include launching nationwide phone service using Voice over Internet Protocol, or VoIP. New York-based Verizon could be viewed as the powerful sea captain from the novel "Gulliver's Travels" as the company lumbers into the high-speed Internet phone business, attempting to fend off the cable competitors and Lilliputian startups snipping at its market share.

"We're in the final stages of testing this," Verizon spokeswoman Bobbi Henson said.

A national rollout of the service is expected to begin later this summer, but Henson remained mum on which cities might get the service first or when it would trickle down to the northeast Indiana market.

This is Verizon's "competitive counterpunch," said Richard Heidemann Jr., telecommunications analyst with National City's Private Client Group in Cleveland.

By offering Internet phone service, Heidemann said, Verizon will be able to hold onto some customers who might ditch their conventional telephone connection for the more hip technology.

VoIP player Vonage, which claims to have 55 percent market share, is putting on a brave face and adopting a bring-it-on attitude.

Internet phone service is the latest way in which technology is changing the way people communicate. And judging from Verizon, it's changing the way companies that keep us in touch operate.

While conventional calls are transmitted through a labyrinth of high-maintenance cables, switches and copper wires, VoIP uses technology that packages voice calls as data and sends them over a broadband connection such as cable modems or DSL.

The technique is less expensive because it avoids some access charges inherent in the traditional phone network. And it opens up new features, such as Web-based management of voice mail.

The standard price for VoIP packages from AT&T Corp. and Cablevision Systems Corp. is \$34.99 a month for unlimited local and long-distance calling, voice mail and call forwarding - but that doesn't include a broadband connection, which typically costs at least \$30 a month.

Verizon's local and long-distance packages for traditional calling range from \$49.95 to \$64.95 a month.

The Web interface offers additional features and gives users more control over how they make calls and receive messages, said Michael Kende, principal consultant at Analysys, a U.K.-based telecommunications strategy consulting company.

"It's much more interactive," Kende said from Analysys' Washington, D.C., office.

The market for high-speed Internet phone service, so far, has been dominated by startups such as Vonage. The Edison, N.J.-based company, which launched VoIP service in the Fort Wayne area in July

2003, has about 200,000 customers nationwide including nearly 1,000 in Indiana. At least half of Vonage customers have cut the cord to their landlines, the company said.

So far, Vonage's market infiltration is likely not forcing Verizon chief Ivan Seidenberg to reach for the aspirin. With annual sales of \$67.8 billion, Verizon is unarguably the 800-pound gorilla in the telecommunications business.

But Vonage could be just the tip of a slippery slope. Better-financed and recognized rivals in the cable and telecommunications worlds are also stepping in to wrestle customers away.

VoIP technology "lowers the barrier to competition" in the local telephone business, Analysys' Kende said.

Until now, offering local phone service was cost-prohibitive because it required expensive cables and copper wire infrastructure, he said. But by using VoIP, new entrants in the market can bypass the expensive infrastructure and offer local telephone service through broadband connections.

Using VoIP, cable companies such as Comcast Corp. can also offer "what's called a triple play of voice video and data" on their cable infrastructure, which will increase their competitiveness, Kende said.

Comcast, whose cable infrastructure passes through more than 153,000 homes in the Fort Wayne area, hopes to squeeze more revenue from its customers. Comcast anticipates offering Internet phone service to all its customers by the end of 2006.

And long distance-carrier AT&T says it expects to have 1 million VoIP customers by the end of next year.

Henson said competitive threats are a reason Verizon is going down the VoIP road.

"Certainly it will help us retain customers (who) are looking for this kind of service," she said. "And more and more customers are looking for this service."

Verizon is also betting that Internet phone service will entice more people to sign up for its DSL connections.

"This is actually a part of our broadband strategy as much as it is part of our voice strategy," Henson said. "Voice is becoming more and more of an application."

Improvements in call quality and blistering demand for broadband connections have piqued Verizon's interest, too.

"This is a technology that's come into its own," Henson said. "Now the technology and the market have intersected."

Until recently, calling over the Internet - while easy on the wallet - was hard on the nerves. Callers had to deal with dropped connections, echoes and static.

But new compression technology and faster connection speeds have reduced the hassle factor.

Today the sound quality of VoIP calls are "awfully close" to that of a wireless call, National City's Heidemann said.

The market for Internet-based calling has also expanded as more American households upgrade to fast broadband Internet connections.

At the end of 2003, about 24 million U.S. homes had broadband connections, Heidemann said. That number is forecast to climb to about 65 million in 2008. VoIP adoption is expected to reach 17 percent of broadband-enabled U.S. households in 2008 - growing from fewer than 1 million at the end of this year to 11.7 million in 2008, according to Analysys, the consulting firm.

The Internet phone service is expected to be adopted by 23 percent of broadband-enabled small businesses - increasing from fewer than 100,000 this year to 800,000 in 2008.

Together, consumers and small businesses are expected to provide almost 13 million VoIP subscriptions and \$5.7 billion in annual revenues in 2008, Analysys said.

But even as Verizon trains its guns on the VoIP business, Vonage is not flinching.

Vonage will continue to compete on price and offer innovative products, Louis Holder, executive vice

president of product development, said.

While the average household spends about \$75 a month on conventional phone service, "with (Vonage's VoIP service) you can get a plan as low as \$15 a month or as high as \$30 a month," Holder said.

Rather than cower before the much bigger competitors, Holder welcomes it. Verizon's entry into the VoIP business, he said, will bring brand-name cache to the fledgling technology.

The bundles of dollars Verizon will throw at marketing its service will help create awareness and benefit all service providers, Holder said.

Vonage also has a 2 1/2 -year headstart in the business.

"We've ironed out a lot of the bugs," Holder said, adding the new entrants will have to play catch-up.

And Vonage's Lilliputian size allows it to react more quickly to competitive threats and stay on top of the competition, Holder said.

The battle for this latest frontier in the telecommunication's business will pitch the financial muscle of Gulliver against the strategic nimbleness of the Lilliputians. The bugle call, marking the start of that battle, has only just been sounded.

This article comes from Vonage VoIP Forum
<http://www.vonage-forum.com>

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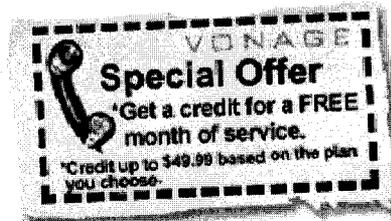


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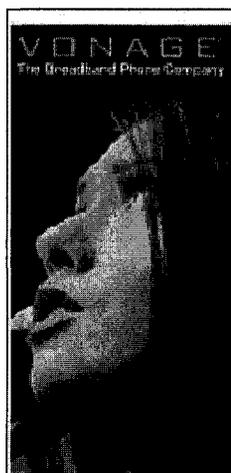


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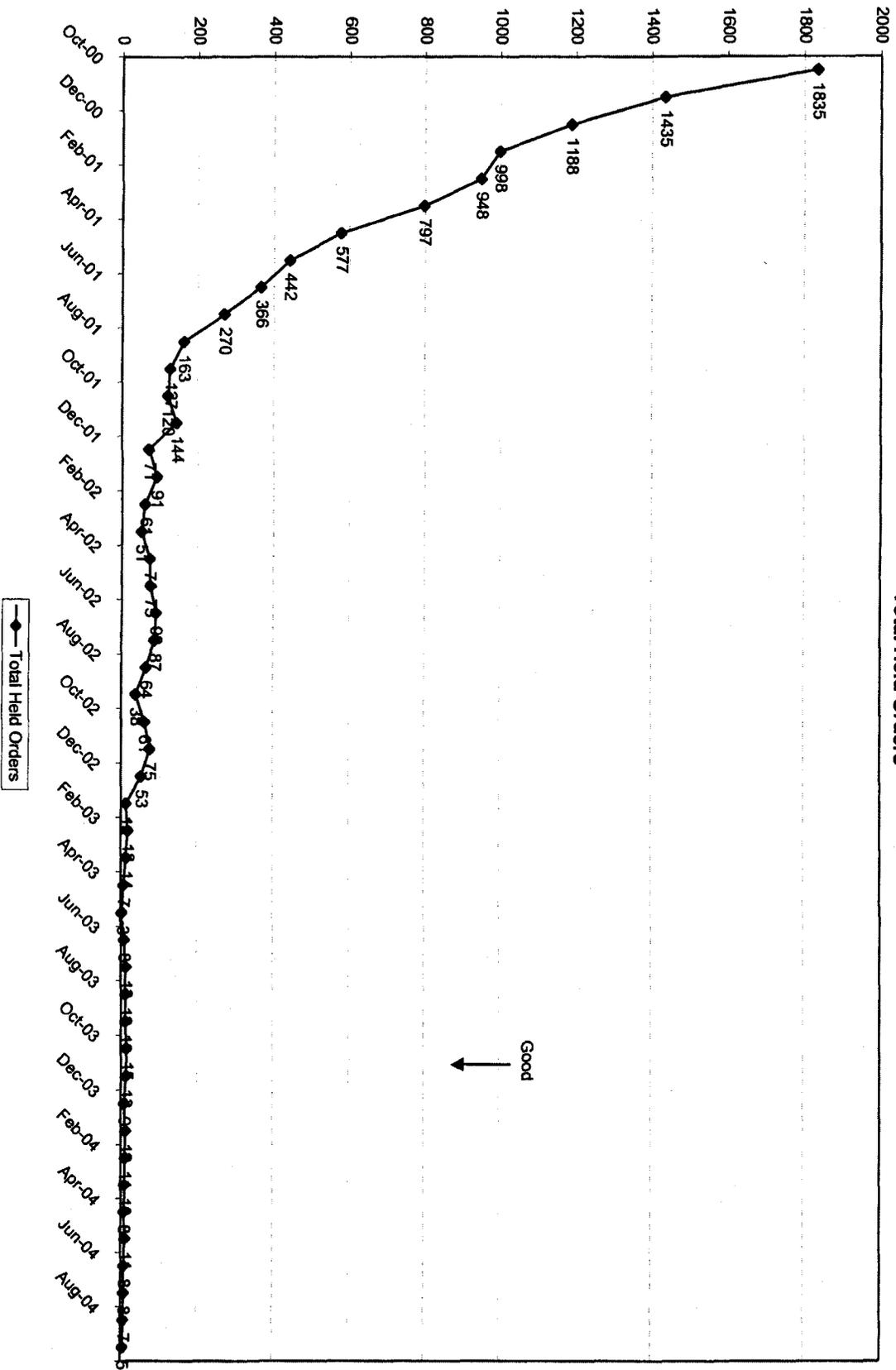
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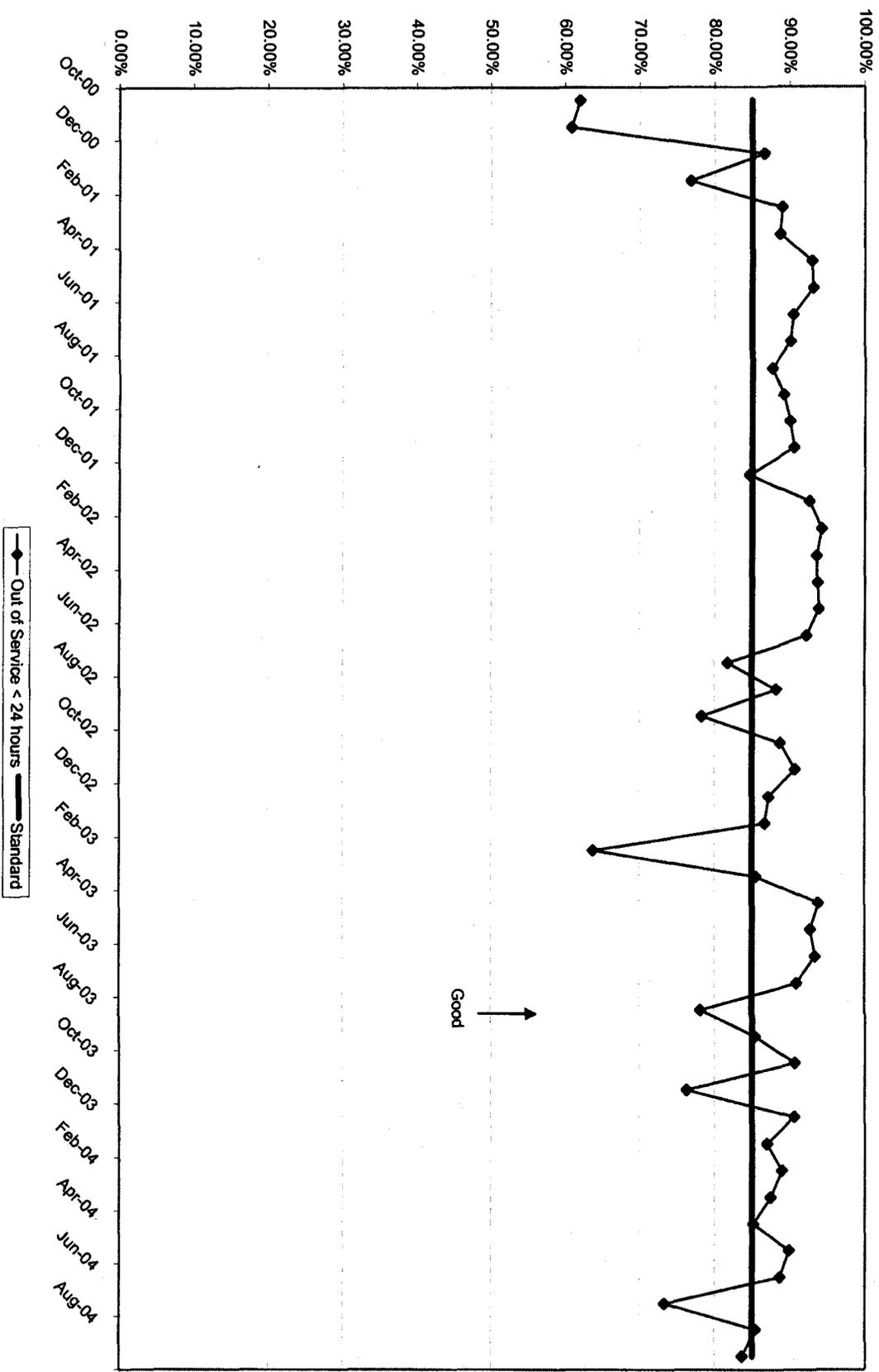


Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation – Confidential Exhibit DP-3
Rejoinder Exhibits of Dennis Pappas
January 27, 2005

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Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation - DP-4
Rejoinder Exhibits of Dennis Pappas
January 27, 2005



Arizona Corporation Commission
Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672
Qwest Corporation – Confidential Exhibit DP-5
Rejoinder Exhibits of Dennis Pappas
January 27, 2005

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1 **I. IDENTIFICATION OF WITNESS.**

2

3 **Q1. ARE YOU THE SAME HARRY M. SHOOSHAN III WHO PROVIDED**
4 **DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?**

5 **A1.** Yes.

6

7 **II. PURPOSE AND SUMMARY OF REJOINDER TESTIMONY.**

8

9 **Q2. WHAT IS THE PURPOSE OF YOUR REJOINDER TESTIMONY IN THIS**
10 **PROCEEDING?**

11 **A2.** The purpose of my rejoinder testimony is to respond to the positions taken
12 by Matthew Rowell on behalf of Staff and Ben Johnson on behalf of
13 RUCO regarding competition in Arizona and construct of the price cap
14 plan.

15

16 **Q3. WHAT SPECIFIC ISSUES RAISED BY THOSE WITNESSES DO YOU**
17 **ADDRESS IN YOUR REJOINDER TESTIMONY?**

18 **A3.** In this rejoinder testimony, I reiterate my objections to Staff's and RUCO's
19 proposals to treat any of Qwest's Basket 3 services differently than the
20 comparable offerings of competitors. I also reiterate my concerns about
21 RUCO's complex and radical restructuring of baskets which would be a

1 giant step backwards for this Commission at a time when we need to take
2 the evolutionary "next step" that is reflected in Qwest's proposal. I also
3 continue to oppose Dr. Johnson's recommendation to retain an inflation-
4 minus-productivity mechanism. Dr. Johnson has largely failed even to
5 respond to my criticisms of his approach. I believe that the same
6 objectives—reasonable constraints on the price of basic service and
7 incentives for increased productivity—can be achieved without penalizing
8 the Company. Finally, I respond to Dr. Johnson and Mr. Rowell regarding
9 the issue of elasticity of supply, which I raised in response to their efforts
10 to define "effective competition" in terms of market share statistics and
11 concentration ratios.

12
13 **III. RESPONSE TO RUCO WITNESS JOHNSON**

14
15 **Q4. DR. JOHNSON CONTINUES TO CLAIM THAT THE HHI IS THE**
16 **CORRECT FACTOR TO CONSIDER IN DETERMINING WHETHER THE**
17 **MARKET IS COMPETITIVE. JOHNSON AT 3-6. HOW DO YOU**
18 **RESPOND?**

19 **A4.** I continue to point out that static measures tend to belie the reality of the
20 situation. Such market concentration or market share information does
21 not consider the fact that many competitors (as described in Mr. Teitzel's

1 testimony) are present and have access to either Qwest facilities or their
2 own facilities in order to serve customers in the market. As I have noted,
3 effectiveness of competition really turns on elasticity of supply and basic
4 entry conditions—not what actually results market-share wise at a given
5 moment in time, which is, in part, simply a matter of chance and historical
6 circumstance.

7

8 **Q5. DR. JOHNSON ASSERTS THAT YOU BELIEVE THAT MARKET**
9 **SHARE MEASURES SHOULD BE BASED ON MINUTES OF USE**
10 **RATHER THAN LINES. JOHNSON AT 7.¹ IS THIS YOUR POSITION?**

11 **A5.** No. Dr. Johnson misunderstands my testimony. I am, in general, not in
12 favor of basing determinations of competition on market share statistics,
13 whether the unit of measure is lines or usage. In my rebuttal testimony, I
14 pointed out that Dr. Johnson's reliance upon lines also misses the
15 movement of actual usage and traffic to other networks from Qwest's.
16 The simple point is that a firm could lose "only" 20 percent of its lines but,
17 say, 80 percent of the total usage if, as can be expected, that 20 percent
18 represents primarily the high-volume users. I reiterate that many factors
19 must be considered regarding productive capacity when considering the

¹ Staff witness Fimbres makes a similar statement. Fimbres Surrebuttal at 2.

1 extent of competition in a market. Simply looking at market share
2 however it is measured misses much of the picture.

3

4 **Q6. WHAT OTHER LIABILITIES ARE THERE IS PLACING TOO MUCH**
5 **WEIGHT ON MARKET SHARE STATISTICS?**

6 **A6.** Consider the following. Suppose regulation keeps the market price below
7 the efficient competitive level. Now observed competitor market shares
8 (say, those of CLECs) will understate how much share competitors would
9 take at (higher) competitive prices. It is only at the competitive equilibrium
10 price that the observed market shares will be unbiased in this sense.
11 Viewed from this perspective, market shares in local telephony
12 significantly understate the actual degree of competitiveness. A regulatory
13 regime that seeks to keep local rates below the competitively efficient
14 level, while at the same time supplying strong, but indiscriminate,
15 incentives for entry, distorts the market and renders practically irrelevant
16 any observation of market share. An appropriate economic interpretation
17 of conditions in local telephony imply that it is *more* competitive than might
18 be implied by a simple reading of share information, particularly, shares of
19 lines served as opposed to actual or potential productive capabilities.

20

1 Q7. DR. JOHNSON CLAIMS THAT, IN SPITE OF THE PRESENCE OF
2 COMPETITORS' FACILITIES, THERE WOULD STILL BE BARRIERS
3 TO ENTRY. JOHNSON AT 7. HOW DO YOU RESPOND?

4 A7. The Commission's responsibilities are to remove legal and regulatory
5 barriers to entry and allow the market forces to play out; that is, allow the
6 various competitors and platforms to compete for the business of the
7 consumer. However, the freedom to enter does not mean that entry is
8 costless. Even when nothing prevents a firm from entering a market, it still
9 has to produce a product and cover all of the costs of doing business.
10 Regulators should not attempt to repeal the fundamental laws of
11 economics. Where demand is low or costs are high, entry will be limited.
12 This is not a competitive failure.
13 Moreover, with the current asymmetric regulation of Qwest, competitive
14 forces are not able to play out fully in Arizona. The current competition is
15 one-sided in that competitors can respond to Qwest's tariffed rates, but
16 Qwest's ability to respond as quickly and as freely as its competitors is
17 lacking under current regulations. When Qwest is granted the same
18 pricing freedom for its competitive services that its competitors have, the
19 Commission can expect even more vigorous competition, including more
20 price competition, in what has historically been Qwest's service area in
21 Arizona.

22

1 Q8. DR. JOHNSON "STRONGLY DISPUTE[S]" YOUR ASSERTION THAT
2 THE RUCO PRICE CAP PLAN IS "MUCH MORE COMPLEX."
3 JOHNSON AT 12-14, 25. WHY HAVE YOU SAID THAT DR.
4 JOHNSON'S PROPOSED PLAN IS "MUCH MORE COMPLEX" THAN
5 THE CURRENT PLAN OR QWEST'S PROPOSAL IN THIS
6 PROCEEDING?

7 A8. I have said that Dr. Johnson's proposed plan is "much more complex" than
8 the current plan or Qwest's proposal because it seeks to reassign from
9 scratch the distribution of Qwest services among the baskets; it adds
10 additional baskets; it potentially may re-regulate Qwest services that have
11 already been assigned to Basket 3; and it would mix retail and wholesale
12 services in the same basket, unlike the current plan.²

13 Dr. Johnson's proposal is indeed far more complex than the current plan
14 which has one basket for basic/noncompetitive services, a second basket
15 for wholesale services, and a third basket for competitive/flexibly-priced
16 services. What purpose do these greater complexities really serve? What
17 benefit do they really provide? In my opinion, no discernable benefit is
18 gained by designing such a detailed and intricate classification plan. I
19 continue to believe Dr. Johnson's recommended approach is an effort on

² In response to this last concern, Dr. Johnson says he would be willing to create even more baskets (at 13).

1 the part of RUCO to throw sand into the wheels of price cap regulation it
2 did not support in the first place.

3

4 **Q9. DR. JOHNSON CLAIMS THAT HIS PROPOSAL DOES NOT GO**
5 **AGAINST THE "SPIRIT" OF PRICE CAP REGULATION BECAUSE IT**
6 **DOES BREAK THE LINK BETWEEN COST AND PRICES. JOHNSON**
7 **AT 13-14. DO YOU AGREE?**

8 **A9.** No. Price cap regulation, besides moving to break the cost-price link, is
9 intended be more efficient and less costly to administer than traditional
10 rate of return regulation.³ Dr. Johnson's proposal for detailed criteria and
11 multiple baskets to reflect multiple degrees of "competitiveness" hardly
12 meets this criterion. His proposal is regressive and draconian.

13

14 **Q10. HOW DOES DR. JOHNSON'S PROPOSED ARRAY OF BASKETS AND**
15 **COMPETITIVE CRITERIA COMPARE WITH THE REGULATION OF**
16 **SERVICES OF QWEST'S COMPETITORS?**

17 **A10.** As I described in my Rebuttal Testimony (at 4), this proposal perpetuates,
18 and may indeed exacerbate, the asymmetric regulation of Qwest.
19 Contrary to Dr. Johnson's representations, his proposal would leave
20 Qwest with even less pricing freedom than its competitors for the same or

³ James C. Bonbright, Albert L. Danielsen, and David R. Kamerschen, *Principles of Public Utility Rates: Second Edition* (1988, Public Utilities Reports, Inc.; Arlington, VA) at 587-588.

1 similar set of services. There is no rationale for continuing this
2 asymmetric regulation.

3

4 **Q11. DR. JOHNSON CONTINUES TO ADVOCATE THE INCLUSION OF A**
5 **PRODUCTIVITY OFFSET IN THE PRICE CAP PLAN. JOHNSON AT**
6 **29. HOW DO YOU RESPOND?**

7 **A11.** I continue to recommend that the Commission eliminate the productivity
8 offset in the price cap plan. First, it is important to consider the price cap
9 plan as a whole, taking into account elements such as basket structure
10 and the various price control mechanisms that might be used (i.e., caps on
11 basket revenues). The efficiency gains we hope to achieve—for both the
12 company and for regulators—are a product of the plan as a whole. Dr.
13 Johnson wants to make the basket structure much more complex, *while at*
14 *the same time retaining the productivity offset*. This is a prescription for
15 undermining, not enhancing efficiency.

16 We also know much more about price cap regulation than we did a
17 decade ago. We do not need to tie up scarce regulatory resources
18 debating the calculations and components of a productivity offset, the
19 effects of which can be obtained much more simply and directly. This is
20 why the elimination of the inflation-minus-productivity mechanism is a step

1 forward in price regulation methods in Arizona—and consistent with the
2 trend in the U.S. in general.

3

4 **Q12. HOW WILL THE REVENUE CAP ON BASKET 1 SERVICES ACHIEVE**
5 **THE COMMISSION'S DESIRED GOALS?**

6 **A12.** As I described at length in my Direct Testimony in this proceeding (at 7-
7 11), I believe that Qwest's proposal contains adequate incentives for
8 achieving *reasonable* productivity gains while still providing adequate
9 protection for ratepayers. While Basket 1 services are capped, the
10 nominal prices of Qwest's services will remain constant while their real
11 prices will decrease as Qwest faces inflation (just like the rest of the
12 economy). Unlike unregulated firms, Qwest will not be able to raise
13 nominal prices for the services in Basket 1 to compensate for inflation.
14 It is but another step backward to continue to impose an inflation-minus-
15 productivity mechanism, which typically has the primary objective of
16 forcing prices downward, both nominally and in real terms. This is
17 precisely the wrong direction to be going at this time in Arizona.

18

19 **Q13. IS DR. JOHNSON CORRECT THAT A PRODUCTIVITY MEASURE**
20 **SHOULD REFLECT THE TELECOMMUNICATIONS INDUSTRY AS A**
21 **WHOLE? JOHNSON AT 29-30.**

1 **A13.** No, he is not. In my Rebuttal Testimony, I discussed a number of reasons
2 why a nationwide measure of productivity may not appropriately capture
3 the trends in Arizona. Shooshan Rebuttal at 11-13. Further, I know of no
4 definitive agreement among economists or regulatory experts as to what
5 would be the "correct" method of arriving at a measure of productivity as a
6 component of a price cap plan. Indeed, if every one agreed, few
7 resources would have to be wasted on such a debate. In fact, Dr.
8 Johnson's concern that a company-specific productivity offset may re-
9 establish ties between the company's cost and prices, and is thus contrary
10 to the spirit of price cap regulation, is misplaced. Indeed, the linkage is
11 broken by the capping of revenues in Basket 1. As I am sure Dr. Johnson
12 would agree, inflation is an exogenous factor over which Qwest has no
13 control. Qwest will have to adjust its prices to remain within the revenue
14 cap regardless of its costs.

15

16 **IV. RESPONSE TO STAFF WITNESS ROWELL.**

17

18 **Q14. STAFF WITNESS ROWELL CLAIMS THAT STAFF IS NOT CHANGING**
19 **THE TREATMENT OF BASKET 3 SERVICES IN A WAY THAT RUNS**
20 **COUNTER TO THE COMMISSION'S INTENT. ROWELL AT 6. DO YOU**
21 **AGREE?**

1 A14. No. I continue to disagree. As I stated in my Rebuttal Testimony (at 3),:
2 "[I]t is contrary to the original intent of Basket 3 which was to give Qwest
3 flexibility in pricing services and packages of services which had either
4 been found to be competitive or which are discretionary in nature." The
5 inclusion of services that have heretofore resided in Basket 1 in no way
6 changes that reasoning, as Mr. Rowell claims. If a service or package of
7 services is placed in Basket 3 because it has been found to be
8 competitive, then Qwest should have the same ability as its competitors to
9 set the prices for that service or package of services. To constrain Qwest
10 in ways its competitors (e.g., Cox) are not in pricing its services to market
11 is unwise and goes against the spirit underlying the existing price cap
12 plan. Further, as I discussed in my Rebuttal Testimony (at 3-4), with
13 regard to packages in Basket 3, consumers are protected by the
14 continued availability of the basic/noncompetitive product on a standalone
15 basis in Basket 1.

16

17 **Q15. MR. ROWELL COMPLAINS [AT 7] THAT YOU DID NOT PROVIDE ANY**
18 **QUANTIFICATION OF THE ELASTICITY OF SUPPLY AND THAT YOU**
19 **ARE SIMPLY PLAYING A GAME OF SEMANTICS. WHY HAVE YOU**
20 **NOT PRESENTED SUCH EVIDENCE IN THIS PROCEEDING?**

21 A15. I have not presented evidence regarding the elasticity of supply because
22 that is not the reclassification standard that Qwest is proposing in this

1 proceeding. Further, my point regarding the relevance of elasticity of
2 supply as an indicator of the competitiveness of a market was made in
3 response to Dr. Johnson's urging the Commission to rely on a variety of
4 static measures (i.e., market share data and concentration ratios) in order
5 to reclassify a Qwest service from Basket 1 to Basket 3. Finally, as I
6 stated in Qwest response to Staff Data Request STF 37-1, the elasticity of
7 supply "is primarily approached as a qualitative assessment of a market,"
8 rather than strictly a mathematical exercise. Nonetheless, in this
9 proceeding, Mr. Teitzel has provided substantial data on the presence of
10 competitors in Qwest's service area, including those that have deployed
11 their own facilities. Competitors are able to lease from Qwest certain
12 parts of its network or resell Qwest services at a discount in order to
13 extend their reach to serve new customers. While I have not offered a
14 formal analysis of the elasticity of supply in this case, I do believe that
15 these facts are indicators that there is a high degree of elasticity of supply
16 in Qwest's service area in Arizona.

1

2 **V. SUMMARY AND CONCLUSION.**

3

4 **Q16. PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY.**

5 **A16.** The Commission should approve the price cap plan proposed by Qwest
6 in this proceeding. The Commission should discontinue the cap on
7 revenues of Basket 3 services so that Qwest competitive services may be
8 treated in the same manner as its competitors' services. The creation of
9 additional sub-constraints in the baskets undermines the incentives for
10 achieving greater economic efficiency which an appropriate price-
11 regulation plan can provide. The renewed plan need not include a
12 productivity-inflation adjustment mechanism. Finally, the Commission
13 should resist suggestions that it rely on static measures of competition,
14 especially since such measures—when applied in this context—are likely
15 to understate significantly the competitive effectiveness of the local
16 market.

17

18 **Q17. DOES THAT CONCLUDE YOUR REJOINDER TESTIMONY?**

19 **A17.** Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF NEW HAMPSHIRE)

) ss

AFFIDAVIT OF HARRY M. SHOOSHAN

COUNTY OF HILLSBOROUGH)

Harry M. Shooshan, of lawful age being first duly sworn, deposes and states:

1. My name is Harry M. Shooshan. I am a principal in Strategic Policy Research, Inc. located in Bethesda, Maryland and am appearing on behalf of Qwest Corporation. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.



Harry M. Shooshan

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.



Notary Public

PATRICIA A. LETOURNEAU
NOTARY PUBLIC
STATE OF NEW HAMPSHIRE
My commission expires Jan. 21, 2009

My Commission Expires:

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN MAYES

IN THE MATTER OF QWEST CORPORATION'S FILING OF RENEWED PRICE REGULATION PLAN))))	DOCKET NO. T-01051B-03-0454
----- IN THE MATTER OF THE INVESTIGATION OF THE COST OF TELECOMMUNICATIONS ACCESS. -----))))	DOCKET NO. T-00000D-00-0672

REJOINDER TESTIMONY

OF

DAVID L. TEITZEL

QWEST CORPORATION

JANUARY 27, 2005

TESTIMONY INDEX

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EXECUTIVE SUMMARY

My rejoinder testimony focuses on issues raised in this docket in the testimonies of Staff, RUCO, Department of Defense ("DOD"), MCI, Time Warner and Cox Communications regarding issues discussed in my direct and rebuttal testimony. While witnesses for these parties raise a number of issues that are addressed in detail in the body of my rejoinder testimony that follows, there are three primary themes that recur in the intervenors' testimonies regarding Qwest's advocacy that require clarification to ensure the Commission is not left with a misunderstanding. The three primary intervenor themes are: 1) forms of competition other than full bypass competition can be largely disregarded, 2) intermodal competition (e.g., wireless and Voice over Internet Protocol) is not significant and should be disregarded and 3) Qwest does not need Arizona Universal Service Fund ("AUSF") support to defray the cost of serving customers in high cost areas. The following summarizes and clarifies Qwest's advocacy on each point:

CLEC Competition

Qwest has lost in excess of 25% of the Arizona local exchange market to various forms of competition, including competition from CLECs utilizing their own facilities, CLECs utilizing unbundled network elements and CLECs utilizing resale. In each instance, the competitive loss for Qwest is real and causes Qwest to lose the retail relationship with the end user and

eliminates Qwest's opportunity to maintain and grow the revenue stream associated with that relationship. While Qwest receives a fraction of the prior retail revenue when losing a customer to a CLEC using UNEs or resale, these losses essentially eliminate the margin used to recover costs Qwest incurs to serve high cost areas that CLECs choose not to serve. Further, it is very important for the Commission to recognize that these forms of competition are not, in effect, being "legislated out of existence" by the FCC in its Triennial Review Order ("TRO"). To the extent that local switching is not available after a defined point in the future, that is because the FCC has determined that CLECs have either switches of their own they can use to serve customers or that they can obtain that technology as easily as Qwest. In addition, numerous CLECs have taken advantage of an alternative commercially-available product entitled Qwest Platform Plus ("QPP") for those CLECs who wish to continue to use Qwest's loops and switching on a wholesale basis to serve their customer base. There is no reason to believe that CLEC competition will decline, as has been implied by the parties, and every reason to believe that it will continue to grow.

Intermodal Competition

In its Competitive Zones proposal in this docket, Qwest is not relying on intermodal competition as a "competitive trigger" to classify a particular wire center as a competitive zone. However, the Arizona competitive market is very dynamic and the mix of competitive alternatives has changed substantially even since this docket was initiated. Wireless

customers are relying on their wireless services to an ever greater degree and VoIP service is now widely available from multiple providers to any Arizona customer with a broadband internet connection. As customer perception of these services as viable alternatives to traditional telephone service continues to expand, these intermodal services represent an ever-increasing form of price constraining competition to Qwest. To the extent the Commission, after reviewing the evidence in this docket, determines that sufficient CLEC competition exists in a particular wire center to warrant designation of that wire center as a competitive zone, the reality of intermodal competition should give the Commission additional comfort that competitive forces will properly regulate Qwest's rate levels there.

AUSF Support

Qwest's costs to provide service to customers in high cost wire centers are indisputably higher than Qwest's costs to provide service in low cost (primarily urban) wire centers. Rather than supporting Qwest's proposal to utilize AUSF funding to defray the cost of serving customers in high cost areas, Qwest's opponents suggest that Qwest should use margins from profitable services (such as optional calling features, intraLATA toll, switched access and business local exchange services) to defray the cost of serving those customers. Absent competitive realities, the intervenors' model might be viable (and actually closely aligns with the manner in which prices were set prior to the Telecommunications Act of 1996). However, in reality, the "margin" associated with profitable products is being quickly eroded by competition. Significant local and long

distance usage is being shifted from Qwest's network to wireless networks, eroding Qwest's toll and switched access revenue base. CLECs are successfully winning high value business customers from Qwest, especially in urban areas of Arizona. CLECs, such as Cox and MCI, are successfully winning residential optional feature revenue from Qwest by offering attractive local service and feature packages, again, largely in urban and suburban areas of the state. The Commission no longer has the "monopoly" era luxury of using margins from high value services to underwrite the provision of local exchange service in high cost areas. This model fails in the face of competition.

An important feature of Qwest's AUSF proposal is that funding is "competitively portable," meaning that it is available to Qwest's competitors who choose to compete with Qwest to win customers in high cost areas. This allows Qwest's competitors to expect to earn a reasonable return on such customers and encourages the growth of competition in areas where competition has been slow to emerge. Rejection of Qwest's AUSF proposal means that customers in high cost areas are not likely to soon enjoy the fruits of competition.

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is David L. Teitzel. I am employed by Qwest Corporation ("Qwest") as Staff Director-Public Policy. My business address is 1600 7th Avenue, Room 3214, Seattle, WA, 98191.

Q. DID YOU SUBMIT DIRECT AND REBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this docket on May 20, 2004 and rebuttal testimony on December 20, 2004.

II. STRUCTURE OF REJOINDER TESTIMONY

Q. HOW IS YOUR REJOINDER TESTIMONY STRUCTURED?

A. My rejoinder testimony is generally organized by intervening party and witness representing that party. In most instances, only one witness is associated with an intervening party. However, my testimony responds to three Staff witnesses: Matt Rowell, Tom Regan and Armando Fimbres.

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III. STAFF

a. Tom Regan

Q. AT PAGE 5, MR. REGAN POINTS OUT THAT QWEST RECEIVES REVENUES FROM A RANGE OF SERVICES THAT "CONTRIBUTE TO THE TOTAL COST OF SERVING ITS CUSTOMERS." WOULD YOU COMMENT?

A. In any business, a firm's total revenues received from its customers should exceed the firm's total costs if the firm expects to remain solvent. However, Mr. Regan suggests that certain Qwest costs should be recovered from services that historically have had high margins, such as optional calling features, long distance, switched access and business services. The fatal flaw in his logic is that he ignores the effects of competition: the relatively high margins in certain services are being "competed away" as Qwest's competitors focus on those services. As competitors continue to win an increasing proportion of the high margin services from Qwest, the margin available to recover costs as Mr. Regan defines them is being substantially reduced.

Another problem with Mr. Regan's logic is that it is focused only on his view of how Qwest should recover its costs. In suggesting that Qwest price its services in a certain fashion, especially local exchange services in high cost areas, he is

1 apparently suggesting that Qwest's competitors should also view cost recovery in
2 the same manner. Mr. Regan's logic would suggest that CLECs should be eager
3 to provide local exchange services to customers located in high cost areas, since
4 they are equally able as Qwest to use margins from high-margin services to
5 defray the cost of providing local service in these areas. Unfortunately, Mr.
6 Regan's logic does not comport with reality. CLECs choose to focus on
7 geographic areas where the greatest margin is available.

8
9 **Q. DOES QWEST'S AUSF PROPOSAL ADDRESS THE FLAWS IN MR.**
10 **REGAN'S LOGIC?**

11 **A.** Yes. Qwest's AUSF proposal provides a source of sustainable funding targeted
12 specifically to the provision of local exchange service to customers in high cost
13 areas. Qwest's proposal is also "competitively portable" and provides a source
14 of funding to Qwest's competitors considering whether provision of local
15 exchange service to high cost areas is economically viable.

16
17 **Q. AT PAGE 12, MR. REGAN ALLEGES THAT HE OVERLOOKED THE**
18 **EFFECTS OF DIRECTORY REVENUE IMPUTATION IN HIS ANALYSIS OF**
19 **REVENUES AND COSTS OF PROVIDING QWEST LOCAL EXCHANGE**
20 **SERVICE IN THE THREE UNBUNDLED NETWORK ELEMENT (UNE) LOOP**

1 **ZONES, AND THAT HIS ORIGINAL ANALYSIS IN HIS SCHEDULE TMR-3 "IS**
2 **NO LONGER A VALID SCHEDULE." WOULD YOU COMMENT?**

3 A. Yes. In his "corrected analysis" in Schedule TMR-S1, Mr. Regan adds \$72m of
4 directory revenue, which he asserts Qwest agreed to impute to its intrastate
5 Arizona operations in the Qwest Dex sale settlement, into his "margin calculation"
6 for local exchange service in each of the three UNE zones. However, as
7 discussed in the direct and rebuttal testimony of Qwest witness Phil Grate, Qwest
8 has a revenue requirement of over \$400m in Arizona (on a fair value rate base),
9 excluding effects of directory imputation. Even after deducting \$72m of imputed
10 directory revenue from this figure, a very significant positive revenue requirement
11 remains. Mr. Regan assumes that the Commission will agree with Staff's
12 revenue requirement adjustments in his margin analysis, thereby choosing to
13 ignore the revenue requirement discussed by Mr. Grate. Instead, he simply uses
14 the directory imputation value, in isolation, as a "lever" to bring the average local
15 exchange customer revenue in high cost zones above "cost" as defined by Mr.
16 Regan. In fact, should the Commission determine that Qwest indeed has a
17 significant positive revenue requirement, even after accounting for the \$72m of
18 directory imputation discussed by Mr. Regan, that finding generally means that
19 Qwest's overall revenues in Arizona are insufficient to cover its costs. The
20 relationship of Qwest's rates for local exchange service in high cost areas as
21 compared to its costs of providing service in those areas is contributing to this

1 shortfall. Since Mr. Regan simply assumes that Staff's revenue requirement will
2 be adopted by the Commission, he ignores the overall revenue requirement
3 issue entirely.

4
5 **Q. AT PAGE 26, MR. REGAN STATES "IT IS NOT CLEAR HOW OR WHY**
6 **QWEST'S COMPETITORS COSTS WOULD BE USED TO CALCULATE AUSF**
7 **SUPPORT NEEDS FOR QWEST." HAS QWEST USED ITS COMPETITORS'**
8 **COSTS TO ESTIMATE ITS AUSF FUNDING REQUIREMENT?**

9 **A.** No. In fact, Mr. Regan misses my point entirely, which is that Qwest's AUSF
10 proposal is competitively portable. From a policy perspective, the Commission
11 should be allowed to consider the consumer benefit of Qwest's AUSF proposal to
12 encourage competition in rural areas of Arizona. In fact the Commission's rules
13 contemplate precisely that circumstance in Rule 14-2-1206(E), as follows:

14 R14-2-1206 E. If the Commission approves AUSF support to a
15 provider of telecommunications service for a defined area, such
16 AUSF support shall also be available to competitive providers of
17 basic local exchange service in the same defined area that are
18 contributing to the AUSF, and that are willing to provide service
19 to all customers in the specific AUSF support area as defined by
20 the Commission. The AUSF support to which the competitive
21 provider is eligible shall be calculated on a per-customer basis,
22 at the same level at which the incumbent provider of
23 telecommunications service receives AUSF support, and shall
24 not result in an increase in the total AUSF support available for
25 the specific census block groups or study area.

26
27 Should Qwest be allowed to receive AUSF in its highest cost service areas,
28 CLECs considering serving customers in those areas would include the effects of

1 AUSF support in calculating whether serving such customers is economically
2 feasible.

3

4 **Q. AT PAGE 34, MR. REGAN SUPPORTS STAFF'S PROPOSAL "TO INCREASE**
5 **THE REVENUE CAP ON BASKET 3 TO ACCOUNT FOR STAFF'S**
6 **PROPOSED SWITCHED ACCESS REDUCTION." IS THIS USEFUL?**

7 A. No. In fact, Mr. Regan's position in this instance is emblematic of the overall
8 problem with his advocacy: he would have Qwest attempt to recover additional
9 revenues to address Qwest's costs and overall revenue requirement from
10 services that are highly competitive. His proposal is tantamount to having Qwest
11 and its shareholders essentially "eat" the revenue loss and make the loss up in
12 margins from services that are already being competed away. The logic simply
13 does not work in a competitive market where demand is elastic.

14

15 **Q. AT PAGE 40, MR. REGAN ARGUES THAT THE EXISTING DIRECTORY**
16 **ASSISTANCE (D.A.) RATES ARE ABOVE COST. IS HE CORRECT?**

17 A. No. In fact, Qwest has continued to provide the first D.A. call by a customer each
18 month without charge. Since that call is "free," it is certainly below cost. At a
19 minimum, customers making two or more D.A. calls per month are underwriting
20 the cost of the customer who makes only one D.A. call. The existing "free" call
21 allowance is simply a vestige of the monopoly era, when customers were not

1 addition, Qwest does not possess highly proprietary access line information at
2 the wire center level for competitors, such as Cox, not utilizing Qwest's network
3 on a wholesale basis to serve customers, and Qwest's competitive data is
4 therefore understated.

5
6 While Qwest disagrees that any specific "market share" test is reasonable in
7 defining the competitiveness of a market, since it is the fact that competitors are
8 present and actively and successfully competing that should define market
9 "openness," it is noteworthy that Staff witness Armando Fimbres and RUCO
10 witness Ben Johnson both maintain that Qwest's competitive zones proposal
11 should not be granted in any particular wire center until Qwest has lost far in
12 excess of 15% of the local exchange market there.

13
14 **Q. AT PAGE 4, MR. ROWELL STATES "IN RESPONSE TO STAFF 35-003,**
15 **QWEST INDICATED THAT THEY HAVE NOT QUANTIFIED THE COST OF**
16 **BASING COMPETITIVE ZONES ON ZIP CODES." DOES MR. ROWELL**
17 **CAPTURE THE FULL CONTEXT OF QWEST'S RESPONSE?**

18 **A.** No. In fact, this is a mischaracterization of Qwest's full response to Staff 36-003,
19 which was as follows:

¹ For example, Confidential Exhibit DLT-17 shows the effects of local exchange competition for each Qwest wire center in the Phoenix and Tucson markets.

1 "Qwest disagrees that the zip code based Competitive Zone
2 structure in Arizona is appropriate and has therefore not
3 commissioned a special study to quantify the implementation cost
4 of such a structure. However, Staff's proposed structure would
5 require an extensive reprogramming of Qwest's retail billing system,
6 since this structure would be unique in Qwest's 14 state Region."
7

8 As stated in this response, a special study would be required, involving a large
9 number of man hours, to quantify the overall cost of implementing such a change
10 to Qwest's regional billing systems. A unique structure such as that proposed by
11 Staff would be extraordinarily cumbersome and costly to implement. Since
12 Qwest has no intention of implementing such a structure, investment in the
13 special study is not warranted.
14

15 **Q. AT PAGE 6, MR. ROWELL ARGUES THAT YOU WERE INCORRECT IN**
16 **STATING THAT THE STAFF'S RECOMMENDED APPROACH TO**
17 **COMPETITIVE ANALYSIS IS IMPRACTICAL. WOULD YOU CLARIFY YOUR**
18 **POSITION?**

19 **A.** Yes. My concern is largely one of process. For example, if Qwest, as the
20 petitioning party, bears the burden of proof to show that particular wire centers
21 are sufficiently competitive to warrant reclassification as competitive zones,
22 Qwest will simply not be able to provide the range and depth of information
23 suggested by Staff. In fact, much of this data is highly confidential and
24 proprietary customer in-service data held only by the CLECs. Staff's proposal
25 would require competitive in-service data for each specific service in a defined

1 geographic area from each competitor offering such services. Only then would
2 Staff have the information it maintains is necessary for its analysis. Not only is
3 this process hugely resource intensive and time consuming, it is doubtful non-
4 parties to such a docket would be willing to provide the information to Staff (let
5 alone to Qwest, a significant competitor). If my concerns are valid, the result of
6 such a complex process would be that a finding on Qwest's petition for
7 competitive zones would be significantly delayed pending pursuit of an extensive
8 analysis that ultimately will likely be incomplete, hindering Qwest's ability to
9 compete in an increasingly competitive market.

10
11 **c. Armando Fimbres**

12
13 **Q. IN HIS EXECUTIVE SUMMARY, MR. FIMBRES QUANTIFIES THE SCOPE OF**
14 **HIS ANALYSIS OF QWEST'S RETAIL SERVICE PROPOSALS AS**
15 **ENCOMPASSING 2,020 PAGES AND SUGGESTS THAT QWEST MAY NOT**
16 **HAVE FULLY REVIEWED HIS ANALYSIS. IS HE CORRECT?**

17 **A.** Qwest does not quarrel with the Staff regarding the fact that its analysis was
18 extensive and appreciates Staff's efforts to assess the competitive Arizona
19 market. In fact, much of the data included in the analysis Mr. Fimbres references
20 was developed and supplied by Qwest, and in most instances, by myself in
21 response to the approximately 250 Staff data requests (excluding sub parts) to

1 Qwest in this proceeding. Contrary to Mr. Fimbres' contention, I did, in fact,
2 review each piece of data and associated analysis provided by Staff to Qwest
3 relevant to the proposals outlined in my direct and rebuttal testimony in this
4 docket.

5
6 Qwest's concerns with Mr. Fimbres' analysis lie not in the quality and extent of the
7 analyses, but in the assumptions on which the analyses are based. For example,
8 Mr. Fimbres relies heavily on the use of white pages directory listings as a basis
9 for estimating the size of the customer bases of Qwest and its competitors, and
10 emphasizes that the white pages data is "highly accurate." He is correct that,
11 since the white pages data for Qwest and CLECs is fed directly by listings
12 information fed into the Qwest white pages database by service order activity and
13 is updated daily, the database accurately reflects what is input to it. However, he
14 neglects to recognize that many CLEC customers with multiple lines elect to list
15 only the first line. For example, a business customer with 10 lines will typically
16 elect to have only the first line in the system appear in the white pages listings. In
17 this instance, a CLEC serving such a customer will likely issue an order to Qwest
18 for a listings appearance for the first line only. There is no obligation on the part
19 of the CLEC to communicate to Qwest that the remaining nine lines are non-
20 listed. This is a major problem with the use of white pages listings as a

1 determinant of relative market sizes of Qwest and its competitors: it understates
2 the relative market size of CLECs as compared to Qwest.

3

4 **Q. ALSO IN HIS EXECUTIVE SUMMARY, MR. FIMBRES COMPLAINS THAT IT IS**
5 **NOT CLEAR WHY WIRELESS AND VOIP COMPETITION IN ARIZONA IS**
6 **EMPHASIZED IN MY REBUTTAL TESTIMONY. WOULD YOU COMMENT?**

7 A. Yes. As stated in my executive summary, I want to be very clear: Qwest is not
8 relying on the presence of wireless and VoIP competition as competitive triggers
9 in its competitive zones proposal. Rather, Qwest is relying on the competitive
10 data presented in my direct and rebuttal testimonies regarding the scope of CLEC
11 competition in the Phoenix and Tucson markets as evidence that competition for
12 Qwest's retail services in these markets is robust and that Qwest's proposal is
13 appropriate.

14

15 The competitive telecom market in Arizona is very dynamic and is continuing to
16 quickly evolve, even as this docket progresses. New communications options are
17 regularly coming on line and are growing quickly in significance. For example,
18 Vonage, one of the most visible and aggressive independent VoIP providers in the
19 nation, announced:

20 Vonage, the leading broadband telephony provider, today announced it
21 has exceeded 400,000 total lines on its network, doubling its subscriber
22 base in less than six months since reaching the 200,000 line mark. The

1 company ended 2004 with more than 390,000 lines in service having
2 added 115,000 lines in Q4 2004 alone.²
3

4 As discussed at page 10 of my rebuttal testimony, the FCC has found that the
5 percentage of customers now relying solely on wireless service for their
6 telecommunications needs is at least 6%, and related research by the Yankee
7 Group in 2004 shows that 40% of U.S. households with both wireless and
8 landline phones expect their wireless phones to completely replace their landline
9 phones. Other new forms of telecommunications competition are either in the
10 market now in Arizona or are currently being trialed. WiFi broadband "hotspots"
11 are now common in such locations as coffee shops and public libraries and a
12 broadband over power lines ("BPL") trial is currently underway in Cottonwood,
13 Arizona.³
14

15 As discussed in my executive summary, the key point is that, as intermodal
16 competition becomes increasingly entrenched, it represents a real form of price
17 constraining competition in the Arizona market. To the extent the Commission,
18 after reviewing Qwest's competitive evidence in this docket, determines that
19 sufficient competition exists that certain wire centers should be classified as
20 competitive zones, the existence of intermodal competition should give the

² Vonage press release, January 5, 2005.

³ A technical trial of BPL is being conducted by the Arizona Public Service power utility. Source: United Power Line Council presentation, December 16, 2004 (entitled "BPL Ready for Prime Time").

1 Commission additional comfort that market forces, not artificial regulatory
2 constraints, will properly govern Qwest's rate levels.

3

4 **Q. AT PAGE 2, MR. FIMBRES STATES "THE EVIDENCE TO SUPPORT**
5 **SUBSTANTIAL AND SUSTAINABLE CLEC COMPETITION HAS DECLINED."**
6 **WOULD YOU COMMENT?**

7 A. I disagree. There is no evidence in the record in this docket that suggests that
8 CLEC competition in Arizona is in decline. Mr. Fimbres may be referring to FCC
9 data showing the rate of CLEC access line growth as of June 2004 reflected a
10 lower percentage growth than was reflected in the December 2003 data.
11 However, the FCC's report shows that CLEC access lines in Arizona increased
12 by over 106,000 in the six months between December 2003 and June 2004 and
13 now number over 814,000. This data does not suggest a market in decline: it
14 suggests the opposite.

15

16 **Q. ALSO AT PAGE 2, MR. FIMBRES IMPLIES THAT QWEST WAS LESS THAN**
17 **FORTHCOMING IN ITS DATA REQUEST RESPONSES, AND STATES**
18 **"QWEST DID NOT PROVIDE RESPONSES TO STAFF'S DATA REQUESTS**
19 **3.18 AND 6.2 THAT REQUESTED MOU INFORMATION." WOULD YOU**
20 **COMMENT?**

1 A. Yes. Staff data request STF 3.18 asked Qwest to supply usage information
2 unavailable to Qwest regarding local usage for CLECs and wireless providers
3 that is tracked and retained only by the CLECs and wireless providers in their
4 local switches. Qwest was fully forthcoming in its responses, and supplied data
5 available to it and in its possession.

6

7 **Q. AT PAGE 4, MR. FIMBRES ATTEMPTS TO BOLSTER HIS STATEMENT**
8 **THAT "COMPETITIVE GAINS IN THE NEARLY 9 YEAR WINDOW SINCE THE**
9 **96 TELECOM ACT WAS PASSED HIGHLIGHT SLOW PROGRESS WITH**
10 **LITTLE TO SUPPORT THAT ACCELERATION IS IMMINENT" BY**
11 **NARROWING HIS FOCUS TO AN EXAMINATION OF MARKET**
12 **PENETRATION OF FULL FACILITIES-BASED CLECS. WOULD YOU**
13 **COMMENT?**

14 A. Yes. At page 17 of his surrebuttal testimony, Mr. Fimbres acknowledges that the
15 FCC reported that, as of June 2004 (over six months ago), CLECs have captured
16 over 25% of the local exchange market in Arizona. This is very significant by any
17 measure. In fact, this percentage understates the level of competition in certain
18 areas of the state, such as Phoenix and Tucson, since it is a statewide average
19 that encompasses rural Qwest territory as well as Independent service areas with
20 little CLEC presence. Mr. Fimbres also fails to acknowledge the actual presence
21 of intermodal competition as a serious competitive factor, even in the face of

1 market deployments of VoIP telephony services by major CLECs such as MCI
2 and AT&T which are now available to any customer with a broadband internet
3 connection in Arizona and of the ever-increasing utility of wireless service as a
4 viable replacement for Qwest wireline services.

5
6 By his statements in testimony, it appears that Mr. Fimbres would have the
7 Commission find a geographic area to be competitive only when multiple
8 facilities-based CLECs have each installed overlaying networks to serve
9 customers. That is an extremely high competitive standard, is not required in any
10 Arizona statute or rule relevant to this docket and ignores the full range of
11 competitive communications alternatives now available in Arizona.

12

13 **Q. AT PAGE 6, MR. FIMBRES STATES: "MR. TEITZEL REMINDS PARTIES BY**
14 **HIS REBUTTAL TESTIMONY THAT ARIZONA HAS A MORE ROBUST**
15 **COMPETITIVE ENVIRONMENT THAN IDAHO, IOWA, MONTANA, NEW**
16 **MEXICO, NORTH DAKOTA, SOUTH DAKOTA AND WYOMING." WOULD**
17 **YOU COMMENT?**

18 **A.** Yes. Since I did not outline share comparisons between Arizona and other
19 Qwest states in my rebuttal, this is an inaccurate characterization of the record.
20 In fact, as is reinforced by Table 1 of Dr. Johnson's surrebuttal testimony, at
21 25.2%, Arizona has easily the highest CLEC share in any of the Qwest in-Region

1 states, and is significantly higher than the national CLEC share average of
2 17.8%. Mr. Fimbres' attempt to minimize the extent of the competitive
3 environment in Arizona should be dismissed.
4

5 **Q. AT PAGE 10, MR. FIMBRES STATES: "I NOTE THAT THE LISTINGS**
6 **INFORMATION UPDATES REQUESTED IN AUGUST 2004 WERE NOT MADE**
7 **AVAILABLE TO STAFF, WHILE QWEST WAS ABLE TO PROVIDE**
8 **SEPTEMBER 2004 LISTINGS INFORMATION FOR ITS OWN USE." IS HIS**
9 **CONCERN FOUNDED IN FACT?**

10 **A.** No. In fact, Mr. Fimbres is referencing Qwest's response to Staff data request
11 STF 18-1, served on Qwest on August 12, 2004, in which Staff requested a
12 report of white pages listings data for August 2004. Qwest's standard tracking
13 reports are typically not available until approximately the 15th of the month
14 following month end. As stated in Qwest's response to STF 18.1, the data was
15 not available for August when Staff requested it, since the month had not yet
16 closed. In contrast, the Arizona statewide September 2004 white pages listings
17 counts were filed in my rebuttal testimony on December 20, 2004, nearly three
18 months after September 2004 month end. This is another instance in which Mr.
19 Fimbres attempts to portray Qwest as less than forthcoming, when in fact, the
20 opposite is the case.

1 **Q. DO YOU HAVE OTHER CONCERNS REGARDING THE ACCURACY OF**
2 **STATEMENTS IN MR. FIMBRES' SURREBUTTAL TESTIMONY?**

3 A. Yes. For example, at Page 16, he states: "what is very clear is that AT&T and
4 MCI have expressed intentions not to actively market to new residential
5 customers." This statement is plainly incorrect. In fact, MCI has signed a "QPP"
6 agreement with Qwest as a replacement for its current UNE-P service
7 arrangement as well as an agreement with McLeod to use McLeod's network to
8 serve residential customers,⁴ and continues to market its residential packaged
9 service entitled "The Neighborhood" in Arizona and other states.⁵ In addition,
10 both MCI and AT&T have embraced VoIP as a strategy to continue to serve
11 mass market customers. In its 3rd Qtr 2004 earnings statement, MCI CEO
12 Michael Capellas said: "Going forward, our focus will be on delivering next-
13 generation IP-based products and services, providing industry-leading service
14 quality and further improving our cost structure." On May 17, 2004, AT&T
15 announced its CallVantage VoIP service deployment in four western states,
16 including Arizona. AT&T Senior Vice President Cathy Martine stated "AT&T
17 already provides traditional residential local service to more than 4 million
18 households nationwide, but AT&T CallVantage Service marks the beginning of
19 an exciting new era in voice communications that gives customers another

⁴ "McLeod reached a three year renewable wholesale agreement with MCI whereby McLeod will enable MCI to provide local residential services to its residential customers using McLeodUSA facilities"
(http://biz.yahoo.com/bw/041216/165795_1.html)

⁵ http://consumer.mci.com/TheNeighborhood/res_local_service

1 competitive choice."⁶ AT&T has also formed partnerships with Best Buy, Circuit
2 City and Staples to market its CallVantage service to residential customers.⁷

3
4 It is clear that both MCI and AT&T are implementing new market strategies to
5 serve residential customers and that both are, in fact, actively marketing
6 telecommunications services to new residential customers as well as continuing
7 to service their existing customer bases.

8
9 **Q. AT PAGE 17, MR. FIMBRES POINTS OUT THAT STAFF IDENTIFIED MORE**
10 **COMPETITIVE LOCAL SWITCHES IN PLACE IN ARIZONA THAN WERE**
11 **IDENTIFIED BY QWEST. IS HE CORRECT?**

12 A. I do not dispute Mr. Fimbres' findings that the Local Exchange Routing Guide
13 ("LERG") shows a significant number of competitive local switches in place in
14 Arizona. This shows that there is additional competitive switching capacity in the
15 state to support even more CLEC access line growth. However, I did not rely on
16 LERG data as a "trigger" for classification of a particular wire center as a
17 competitive zone in the Phoenix and Tucson areas. Rather, the evidence I relied
18 on, as presented in my direct testimony and associated exhibits, was on wire
19 center-level data showing that CLECs are actually serving customers in those
20 wire centers.

⁶ Yahoo! Finance, May 17, 2004.

1

2 **Q. AT PAGE 20, MR. FIMBRES STATES THAT WIRELESS SERVICE IS SIMPLY**
3 **NOT A SUBSTITUTE FOR LOCAL EXCHANGE SERVICE BECAUSE IT**
4 **TAKES LONGER FOR A WIRELESS CUSTOMER TO PLACE AN E911 CALL**
5 **THAN IT DOES A LANDLINE CUSTOMER. IS THIS A PROPER CRITERION**
6 **BY WHICH TO JUDGE WHETHER WIRELESS SERVICE IS A SUBSTITUTE**
7 **FOR LANDLINE SERVICE?**

8 A. Clearly not. In fact, this is nonsense, especially for those customers who have
9 already "cut the cord," which the FCC has determined to be at least 6% of the
10 wireless subscribers. These customers have already made the decision, after
11 considering the functional differences, that wireless service is a completely
12 acceptable substitute for landline service. In another perspective on Mr. Fimbres
13 discussion about placing a call to E911, consider this: for the elderly person who
14 is concerned about falling and not being able to reach the landline telephone
15 mounted on the wall to call for help, the small cell phones available today can
16 easily be carried in the pocket and are an additional safety measure for the
17 elderly who may, for example, fall and break a hip and be unable to reach the
18 standard telephone to call 911.

19

⁷ PR Newswire, January 6, 2005, Telogical Residential Alert, September 29, 2004.

1 Importantly, neither Qwest, nor any other entity of which Qwest is aware, has
2 maintained that wireless service is considered to be a substitute for landline
3 service by 100% of the customers in any state. However, to the extent wireless
4 service is considered to be a substitute by a significant subset of the customer
5 base, it clearly represents an additional form of price constraining competition in
6 the market.

7
8 **Q. AT PAGE 25, MR. FIMBRES COMPLAINS THAT QWEST HAS NOT**
9 **PROVIDED ESTIMATES OF THE COST TO MODIFY QWEST'S REGIONAL**
10 **BILLING SYSTEMS TO ACCOMMODATE STAFF'S PROPOSED**
11 **COMPETITIVE ZONES STRUCTURE AS DEFINED BY ZIP CODES. WOULD**
12 **YOU COMMENT?**

13 **A.** Yes. As addressed earlier in my rejoinder testimony regarding Qwest's response
14 to Staff data request STF 35-3, Qwest clearly informed Staff that modification of
15 Qwest's regional billing systems to accommodate a complex pricing structure that
16 is unique to a single state would be extremely costly, and that expending
17 programming resources to assess the required changes would involve a labor-
18 intensive and costly special project. Since Qwest does not intend to implement a
19 "zip code" competitive zones structure, expenditure of these resources is simply
20 not warranted.

1 Given Mr. Fimbres' previous work history in the telecommunications industry, we
2 believe he is well aware that implementation of the massive changes he
3 proposes to Qwest's regional CRIS system, for a lone state, would be unduly
4 costly.

5
6 **IV. Department of Defense ("DOD")**

7
8 **Q. AT PAGE 2, DEPARTMENT OF DEFENSE WITNESS RICHARD LEE**
9 **DISAGREES WITH YOUR STATEMENT AT PAGE 47 THAT QWEST IS NOT**
10 **PROPOSING PRICING FLEXIBILITY FOR BASKET 1 SERVICES. WOULD**
11 **YOU COMMENT?**

12 **A.** Yes. Mr. Lee takes my testimony out of context. The full cite from page 47 of my
13 rebuttal testimony is as follows:

14 "Qwest is not proposing additional pricing flexibility for Basket 1
15 services in this docket. Rather, Qwest is proposing that specific wire
16 centers that are now subject to robust competition be classified as
17 Competitive Zones, within which Qwest's retail services would be
18 afforded Basket 3 pricing flexibility. In those areas, competition rather
19 than regulation will govern the appropriate market price of the
20 competitive services. With respect to services remaining in Basket 1,
21 Mr. Lee's recommendation to limit price increases to 10% is not
22 necessary."
23

24 In other words, my testimony focused on the additional pricing flexibility
25 associated services afforded "Basket 3" competitive pricing flexibility in Qwest's
26 proposal as geographic areas are reclassified to reflect the high degree of

1 competition in the Phoenix and Tucson areas. Services in Basket 1 will remain
2 under Commission jurisdiction, and the Commission will retain authority to
3 regulate Qwest's rate levels for services in that basket.

4
5 **Q. AT PAGE 6, MR. LEE STATES: "BOTH WIRELESS AND VOIP SERVICES**
6 **IMPACT (OR MAY IMPACT) THE MARKET FOR BASIC LOCAL SERVICES,**
7 **BUT NEITHER SHOULD BE THE BASIS FOR COMPETITIVE ZONE**
8 **DETERMINATION." DO YOU AGREE?**

9 **A.** Yes. As stated earlier in my rejoinder, Qwest is not relying on either wireless or
10 VoIP service as a "trigger" in determining whether a particular wire center should
11 be reclassified as a competitive zone. However, the existence of these
12 competitive alternatives is real and should give the Commission additional
13 comfort that price constraining competition, beyond that represented by CLECs,
14 is present in areas designated as competitive zones.

1

2

V. COX COMMUNICATIONS

3

4 **Q. AT PAGE 1 OF HIS SURREBUTTAL TESTIMONY, COX WITNESS WAYNE**
5 **LAFFERTY STATES THAT COX IS A "FACILITIES-BASED PROVIDER OF**
6 **LOCAL TELECOMMUNICATIONS SERVICES IN ARIZONA." WHY IS THIS**
7 **IMPORTANT?**

8 **A.** Cox is a very significant local exchange competitor in Qwest's service territory in
9 the Phoenix and Tucson areas, and serves its customers primarily via switches
10 and network facilities owned by Cox. As such, Cox is not reliant on UNEs
11 purchased from Qwest to serve its residential and business customers. Yet, a
12 great deal of Mr. Lafferty's surrebuttal testimony focuses on what the
13 Commission should do in considering Qwest's proposals and how UNE-based
14 competition should factor into the Commission's decisions in this regard. It is not
15 clear from his testimony what is driving Mr. Lafferty's passion to advance the
16 cause of UNE-based competition, when it would seem that position is not
17 relevant to the efforts of his client to increase the size of its customer base in
18 Arizona.

19

20 **Q. AT PAGE 2, MR. LAFFERTY STATES THAT CLECS USING UNE-P (AND THE**
21 **REPLACEMENT QPP PRODUCT) WILL NO LONGER BE ABLE TO**

1 **PROFITABLY COMPETE IN THE ARIZONA LOCAL EXCHANGE MARKET.**

2 **WOULD YOU COMMENT?**

3 A. Mr. Lafferty is incorrect. For example, consider MCI's "The Neighborhood
4 Complete" residential local exchange package service, which is currently offered
5 at a recurring price of \$49.99 in Arizona. At pages 7 and 8 of his surrebuttal
6 testimony, Mr. Lafferty lists the QPP rates for Zones 1, 2 and 3 that will be
7 available to CLECs in 2005 and 2007. If one accepts Mr. Lafferty's summary as
8 accurate,⁸ the following tables show MCI's margin opportunity in 2005 and 2007
9 (assuming no price increase to the MCI Neighborhood package price):

10

11

2005

	Zone 1	Zone 2	Zone 3
QPP Rate	\$14.51	\$20.30	\$41.90
15% cost additive (marketing, billing and collections)	X 1.15	X 1.15	X 1.15
QPP rate plus 15%	\$16.99	\$23.35	\$48.19
The Neighborhood recurring price	\$49.99	\$49.99	\$49.99
Gross Margin	\$33.30	\$26.64	\$1.80

12

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2007

	Zone 1	Zone 2	Zone 3
QPP Rate	\$15.25	\$21.14	\$42.74
15% cost additive (marketing, billing and collections)	X 1.15	X 1.15	X 1.15
QPP rate plus 15%	\$17.54	\$24.31	\$49.15
The Neighborhood recurring price	\$49.99	\$49.99	\$49.99
Gross Margin	\$32.45	\$25.68	\$0.84

Clearly, in Zones 1 and 2, where the preponderance of the residential customers are located in Qwest's Arizona service territory, there is a significant margin opportunity for MCI through the use of the QPP product in the residential market. Although the margins shown in Zone 3 are slimmer by comparison, there is even a positive margin available in that zone. While one can argue with the 15% cost additive estimate used for the above comparisons, even if that estimate is doubled, there is still a very significant margin opportunity for MCI in Zones 1 and 2.

⁸ Mr. Lafferty appears to have listed a 2007 local port rate of \$4.84, which is inaccurate. The correct 2007 port rate

1 **Q. AT PAGE 2, MR. LAFFERTY OPINES THAT WIRELESS SERVICE IS NOT**
2 **COMPARABLE TO LANDLINE SERVICE AND IS THEREFORE NOT A**
3 **VIABLE SUBSTITUTE. WOULD YOU COMMENT?**

4 A. Yes. As I discussed in my earlier rejoinder regarding Staff's position on this
5 issue, for those customers who have already substituted (and those stating they
6 are likely to substitute in the near future, Mr. Lafferty's opinion is simply wrong.
7 In fact, Cox itself has acknowledged that it has lost residential access lines to
8 wireless substitution. Without revealing confidential Cox information, in response
9 to Qwest data request 6.4, Cox answered "yes" to the following question:

10 "Have Cox customers ever indicated that they were terminating Cox
11 service in favor of wireless service?"
12

13 Again, without revealing confidential information supplied by Cox in its response
14 to this question, Cox reported that a significant number of Cox local exchange
15 telephone numbers had been ported to wireless carriers in Arizona.
16

17 **Q. AT PAGE 5, MR. LAFFERTY STATES: "THE GROWTH IN THE COMPETITIVE**
18 **LEC MARKET SHARE ALSO DECREASED BY OVER 50% FROM THE PRIOR**
19 **YEAR." WOULD YOU COMMENT?**

20 A. Mr. Lafferty's statement is very misleading. Read another way, his statement is
21 confirming that the number of CLEC access lines in Arizona actually continues to

1 increase at a significant pace. The problem with Mr. Lafferty's implication is that
2 it leads the reader to conclude that competition is waning, when his percentage
3 calculation is simply a mathematical artifact. For example, assume that the
4 number of competitive lines in Arizona grows in a year from 1 line to 2 lines. In
5 that instance, the rate of growth, as expressed as a percentage, is 100%.
6 Assume that, in the following year, the number of competitive access lines in
7 Arizona increased from 2 to 3. In that instance, the rate of growth, as expressed
8 as a percentage, is 50%. Although the absolute growth in competitive lines in
9 this example is constant, the percentage growth of 100% in the first year and
10 50% in the second would make it appear as if the in-service base grew at a
11 significantly lesser rate year over year. Additionally, Mr. Lafferty has chosen to
12 ignore entirely dynamics in the competitive market whereby alternatives other
13 than CLEC services are available to customers and are representing a portion of
14 the growth in competitive lines in service.

15
16 **Q. AT PAGE 7, MR. LAFFERTY STATES: "BASED ON INFORMATION IN THE**
17 **FCC'S DECEMBER 15, 2004 PUBLIC NOTICE, IN CERTAIN MARKETS HIGH**
18 **CAPACITY UNBUNDLED LOOPS (DS1 AND DS3 LEVELS) WILL NO**
19 **LONGER BE AVAILABLE AT TELRIC RATES." IS HE CORRECT?**

20 **A.** Again, Mr. Lafferty's statement is misleading and is made without accompanying
21 factual support. In fact, the FCC's notice regarding DS1 and DS3 loops states

1 that DS1 UNE loops will continue to be available at TELRIC rates in wire centers
2 with fewer than 60,000 business access lines *and* fewer than four fiber-based
3 collocators, and DS3 UNE loops will continue to be available at TELRIC rates in
4 wire centers with fewer than 38,000 business access lines *and* fewer than 3 fiber-
5 based collocators. These are very high thresholds, and assuming they remain
6 unchanged when the FCC releases its actual TRO order, will affect very few
7 Qwest wire centers.

8
9 **Q. AT PAGE 7, MR. LAFFERTY ARGUES THAT QWEST DOES NOT OFFER AN**
10 **ALTERNATIVE TO UNE-P. IS HE CORRECT?**

11 A. No. In fact, Mr. Lafferty discusses the Qwest Platform Plus ("QPP") product at
12 some length at pages 7 and 8 of his surrebuttal testimony. This product is clearly
13 an alternative to UNE-P that is available to any CLEC that chooses to avail itself
14 of this service.

15
16 **Q. AT PAGE 9, MR. LAFFERTY STRONGLY STATES THAT "IN ALL CASES,**
17 **QPP RATES WILL BE HIGHER THAN QWEST'S \$13.18 1FR RATE." WOULD**
18 **YOU COMMENT?**

19 A. His statement is misleading. By his statement, he chooses to ignore other
20 charges that are assessed to customers in addition to the monthly 1FR rate. For
21 example, all 1FR customers pay a \$6.30 End User Common Line ("EUCL")

1 monthly charge, and customers in Zones 1 or 2 are assessed "zone increment"
2 charges of \$1 or \$3 in addition to the EUCL charge. He also ignores in his
3 statement that a wide range of optional calling features are provided at no
4 additional charge in the QPP service, while 1FR customers must pay for these
5 services on either an ala carte basis or as part of a calling package. Finally, Mr.
6 Lafferty ignores the fact that CLECs utilizing UNE-P or QPP receive any switched
7 access revenue associated with their customers' long distance calls. His
8 comparison of "stand-alone" 1FR prices to QPP rates is badly flawed and
9 misleading.

10
11 **Q. AT PAGE 10, MR. LAFFERTY STATES: "MR TEITZEL SUGGESTS THE**
12 **FCC'S DETERMINATION THAT COMPETITORS ARE NOT IMPAIRED**
13 **WITHOUT ACCESS TO INCUMBENT LEC UNBUNDLED SWITCHING IS A**
14 **CONCLUSION THAT COMPETITION IS FLOURISHING." WOULD YOU**
15 **COMMENT?**

16 **A.** Mr. Lafferty mischaracterizes my rebuttal testimony at page 52. My actual
17 rebuttal testimony at page 52, which Mr. Lafferty chose to paraphrase, is as
18 follows:

19 "In fact, any final decisions to withdraw the requirement for
20 BOCs to provide any given unbundled network element can
21 only be based on a finding that the element no longer meets
22 the FCC's competitive impairment test."
23

1 Neither the FCC nor I used phrases such as "flourishing," and I simply noted in
2 the above passage of my rebuttal testimony that the FCC will consider the
3 evidence available to it and determine whether CLECs are impaired without
4 access to a given unbundled network element.

5

6 **Q. AT PAGE 13, MR. LAFFERTY OPINES THAT VOIP SERVICE IS MORE**
7 **EXPENSIVE THAN QWEST WIRELINE SERVICE AND SHOULD THEREFORE**
8 **BE DISMISSED AS A VIABLE ALTERNATIVE. IS HE CORRECT?**

9 A. No. For example, a relatively recent entry into the VoIP market in Arizona is
10 SunRocket, which currently serves the Phoenix market and offers an "all
11 inclusive" VoIP telecommunications service for \$24.95 per month.⁹ SunRocket
12 promotes this price point as being the only price their customers must pay
13 (includes all fees and applicable taxes), and their service includes unlimited
14 calling anywhere within the U.S., ten free calling features, up to 100 minutes of
15 international calling per month and two free directory assistance calls per month.
16 A comparable Qwest service, Qwest Choice Home, is \$32.99 (including the End
17 User Common Line charge), plus long distance charges, taxes and fees (which
18 can total \$15.00 or more). For the residential customer that already has a
19 broadband internet connection (in which case the incremental charge for the
20 connection is a "sunk" cost for the customer and can be excluded from such a

⁹ www.sunrocket.com

1 pricing comparison), this VoIP price point is clearly lower than what a Qwest
2 customer would pay for comparable service.

3

4 **Q. AT PAGE 16, MR. LAFFERTY SUGGESTS THAT COMPETITIVE ZONES**
5 **COULD BE DEFINED AS "CITIES OR TOWNS" RATHER THAN WIRE**
6 **CENTERS OR ZIP CODES, AS ADVOCATED RESPECTIVELY BY QWEST**
7 **AND STAFF. WOULD YOU COMMENT?**

8 A. Mr. Lafferty's suggested competitive zones geographic definition is certainly
9 broader than Staff's granular zip code approach. However, it would constrain
10 Qwest in its ability to fairly compete. For example, it is possible that a particular
11 competitor may choose to enter only a portion of the Phoenix market with a
12 competitive service priced to undercut Qwest's rates in Phoenix. Under Mr.
13 Lafferty's proposal, Qwest would be forced to respond to such competition with a
14 price cut across its entire Phoenix service area, while a more targeted
15 competitive response is appropriate. Qwest's competitive zones proposal would
16 enable Qwest to implement a more targeted response in a manner that can be
17 accommodated by its billing systems.

18

19 **Q. AT PAGE 24, MR. LAFFERTY SUGGESTS THAT, AS LONG AS THE**
20 **COMMISSION DETERMINES QWEST'S RATES MUST BE ARTIFICIALLY**

1 **CONSTRAINED, THE MARKET CAN NOT REALLY BE COMPETITIVE AND**
2 **THERE WOULD BE NO REASON TO DECLARE IT SO BY DESIGNATING AN**
3 **AREA AS A "COMPETITIVE ZONE." DO YOU AGREE?**

4 A. Yes. If the Commission finds that competition exists at a level sufficient to
5 classify a certain geographic area as a "competitive zone," that designation
6 means that price-constraining competition exists. In this instance, the market
7 rather than regulation will determine the appropriate price levels for Qwest's
8 services.

9

10

VI. TIME WARNER

11

12 **Q. AT PAGE 7, TIME WARNER'S WITNESS, TIM GATES, SUGGESTS THAT**
13 **THE COMMISSION SHOULD CONSIDER ONLY FULL FACILITIES-BASED**
14 **CLEC COMPETITION IN DETERMINING WHETHER COMPETITIVE ZONE**
15 **DESIGNATION IS APPROPRIATE IN A PARTICULAR WIRE CENTER. IS HE**
16 **CORRECT?**

17 A. No. As stated in my rejoinder regarding Staff's positions, Qwest loses the retail
18 relationship with any customer choosing to leave Qwest for a CLEC, regardless
19 of the means by which the CLEC chooses to provide the competitive service. In
20 this instance, Qwest no longer has the ability to offer packages and bundles of
21 services, including DSL, satellite television, long distance calling, etc. that it can

1 offer to its local exchange customers. There can be no dispute that customers
2 are demanding the ability to purchase packages and see high value in receiving
3 such packages from a single provider on a single bill. Competitive losses by
4 Qwest to intramodal CLEC providers (regardless of the manner in which the
5 CLECs serve their market) and intermodal competition are all real losses to
6 Qwest and harm Qwest's ability to execute its business plan in Arizona.

7
8 **Q. AT PAGE 8, MR. GATES OFFERS HIS OPINION THAT CLEC SERVICES**
9 **PROVIDED VIA UNE-P OR RESALE ARE NOT "FUNCTIONALLY**
10 **EQUIVALENT AND SUBSTITUTABLE" AS COMPARED TO QWEST RETAIL**
11 **SERVICES. WOULD YOU COMMENT?**

12 **A.** Mr. Gates' opinion is misguided. In fact, CLEC services based on resale of
13 Qwest's retail services or on a UNE-P platform are certainly "functionally
14 equivalent and substitutable" for Qwest services, as they are precisely the same
15 (in the case of resale) or very similar (in the case of UNE-P) as Qwest's retail
16 services. From the retail customer's perspective, the CLEC services and Qwest
17 services are very "functionally equivalent and substitutable."

18
19 **Q. AT PAGE 12, MR. GATES APPEALS TO THE COMMISSION FOR A**
20 **REDUCTION IN QWEST'S SPECIAL ACCESS RATES AND SUGGEST THAT**

1 **QWEST SHOULD SIMPLY "EAT" THE ASSOCIATED REVENUE**
2 **REDUCTIONS. WOULD YOU COMMENT?**

3 A. I can certainly understand Time Warner's perspective on this point: it would
4 directly benefit Time Warner and harm Qwest. Mr. Gates ignores the fact that, in
5 this docket, the Commission has required Qwest to file information regarding its
6 significant intrastate revenue requirement, meaning, very simply, that Qwest's
7 overall revenues in Arizona are insufficient to recover its overall costs in the
8 state. Qwest's intrastate Special Access services contribute to Qwest's overall
9 revenue stream in Arizona. To the extent rates for these services are reduced,
10 as advocated by Time Warner, Qwest's cost-recovery problem is exacerbated.

11
12 **Q. AT PAGE 19, MR. GATES CRITICIZES YOUR CONTENTION THAT**
13 **COMMISSION RULES WILL PROTECT COMPETITORS FROM**
14 **INAPPROPRIATE PRICING BY QWEST. WOULD YOU COMMENT?**

15 A. The Commission has established specific rules (after carefully considering their
16 obligations to protect fair competition) governing pricing of telecommunications
17 services such as those offered by Qwest, such as the imputation guidelines
18 established in R14-2-1310C. Those are the "rules of the game" set in place by
19 the Commission and Qwest is bound to abide by those rules until they are
20 changed. If Mr. Gates disagrees with the current rules and feels that they should
21 be changed, he is free to bring forward such a request for a rulemaking

1 proceeding. However, his arguments are not appropriate or relevant in this
2 docket.

3
4 **VII. RUCO**

5
6 **Q. AT PAGE 3, RUCO WITNESS DR. BEN JOHNSON STATES THAT MAJOR**
7 **TELECOMMUNICATIONS CARRIERS HAVE "ABANDONED" THE MARKET.**
8 **IS HE CORRECT?**

9 A. With respect to major carriers such as AT&T and MCI, he is plainly incorrect. As
10 discussed earlier in my rejoinder regarding Staff testimony, I provided clear
11 evidence that both of these major carriers continue to serve the mass market,
12 and that they are now proceeding with implementation of strategies to serve the
13 market in additional ways by deploying VoIP services.

14
15 **Q. AT PAGE 10, MR. JOHNSON ECHOES STAFF'S COMMENT THAT**
16 **"WIRELESS IS PRIMARILY A COMPLEMENT" TO LOCAL EXCHANGE**
17 **SERVICE. IS HE CORRECT?**

18 A. For those customers who have already made the decision to substitute wireless
19 for landline service, he is incorrect, since they have already weighed the
20 attributes of each service and concluded that one is a full substitute for the other.
21 Like Staff, it would appear that Dr. Johnson would have the Commission ignore

1 wireless service as a competitive factor until all landline customers conclude that
2 wireless service is a complete substitute for landline service. This position
3 ignores market realities, and is tantamount to saying that, since a hamburger isn't
4 the same thing as a hot dog, they should not be considered substitutes when one
5 is hungry. In this example, all hungry people will not view hamburgers and hot
6 dogs as acceptable substitutes, but they are clearly considered to be acceptable
7 substitutes by a large number of hungry people. If the price of hamburgers were
8 to suddenly double in a market, it is highly likely that the demand for hot dogs in
9 that same market would rise.

10

11 **Q. AT PAGES 14, 26 AND 27, DR. JOHNSON ADVOCATES FOR AN**
12 **ASSESSMENT OF SPECIFIC SERVICES IN INDIVIDUAL WIRE CENTERS IN**
13 **DETERMINING WHETHER THOSE SERVICES SHOULD BE PLACED IN**
14 **"MODERATE," HIGH" OR "TOTAL" PRICING FLEXIBILITY BASKETS.**
15 **WOULD YOU COMMENT?**

16 **A.** Yes. Essentially, Dr. Johnson splits the existing Basket 3 into two categories
17 (high pricing flexibility and total pricing flexibility) and argues that services in each
18 wire center at issue should be assigned to these categories based on a
19 combination of Herfindahl-Hirschmann Index ("HHI") values and market share for
20 each service in each wire center. In fact, he argues that for a Qwest service to
21 qualify for "total pricing flexibility," it should have a "market share of less than

1 33%, a 4-firm concentration ratio of less than 75% and an HHI of less than
2 1,800." His recommendation ignores market realities and focuses on a very
3 narrow definition of the "market" (e.g., Qwest vs. CLECs) and represents an
4 extremely complex and granular evidentiary process. His recommendation also
5 ignores the unique characteristics of the Arizona market, where, in many wire
6 centers, Qwest has lost a very significant share of the market to a single
7 competitor. If, for example, Cox and Qwest were the only competitors providing
8 residential service in a wire center and if Cox had captured 50% of that market,
9 Dr. Johnson's criteria would preclude residential service in that wire center from
10 being classified as fully competitive since Qwest's share exceeds 33%, fewer
11 than four firms are actively competing, and the HHI would be higher than 1,800.
12 Dr. Johnson's suggestions represent an extremely high competitive threshold
13 that Qwest would be required to meet and are simply not reasonable.

14
15 **Q. AT PAGE 33, DR. JOHNSON STATES: "MR. TEITZEL CONTENDS THAT THE**
16 **MONOPOLY ERA SYSTEM OF IMPLICIT SUBSIDIES SHOULD BE**
17 **CONTINUED IN PERPETUITY IN ARIZONA." IS THIS CITE TO YOUR**
18 **REBUTTAL TESTIMONY CORRECT?**

19 **A.** No. The correct cite at page 67 of my rebuttal testimony is as follows:

20 "Essentially, Dr. Johnson is suggesting that the monopoly era
21 system of implicit subsidies should be continued in perpetuity in
22 Arizona."
23

1 This statement in my rebuttal testimony addressed Dr. Johnson's Table 2, in
2 which he displayed an analysis he created purportedly showing, based on his
3 assumptions, that Qwest's residential services are profitable in the net, after
4 including revenues from services such as features and long distance.

5
6 **Q. AT PAGE 36, DR. JOHNSON OFFERS AN OPINION THAT THERE SHOULD**
7 **BE NO REVENUE CAP ON "BASKET 3" SERVICES. DO YOU AGREE?**

8 A. Yes. If the Commission finds that sufficient competition exists that a particular
9 wire center should be classified as a competitive zone (which places all retail
10 services in that zone into Basket 3), or that sufficient competition exists for a
11 particular service statewide that the service should be moved in to Basket 3,
12 market forces instead of regulation will drive Qwest's prices for Basket 3 services
13 to the appropriate level.

14
15 **Q. AT PAGE 38, DR. JOHNSON ESSENTIALLY AGREES WITH QWEST THAT**
16 **WIRE CENTERS ARE THE APPROPRIATE GEOGRAPHIC DEFINITION OF**
17 **COMPETITIVE ZONES. WOULD YOU COMMENT?**

18 A. After considering the possible alternatives, Dr. Johnson states: "it is exactly this
19 granular, wire center-based line data that I recommend using to identify markets
20 where increased pricing flexibility can appropriately, and safely, be granted,"¹⁰

¹⁰ Surrebuttal testimony of Dr. Ben Johnson, January 12, 2005, P. 38

1 and "Qwest wire centers are relevant to all competing carriers, including those
2 who primarily rely on their own facilities."¹¹ Qwest agrees with Dr. Johnson's
3 conclusions in this regard and shares Dr. Johnson's concern that the logistics
4 associated with collection and analysis of data at the sub-wire center level for all
5 services offered by all telecommunications competitors in Qwest's service
6 territory in Arizona represents a monumental task and one that is not warranted.

7
8 **VIII. MCI**

9
10 **Q. AT PAGE 2, MCI WITNESS DON PRICE STATES: "THE TRENDS LEADING**
11 **TO CONVERGENCE CLEARLY INDICATE THAT TELECOMMUNICATIONS**
12 **CAN NO LONGER BE THOUGHT OF AS A TRADITIONAL UTILITY SERVICE**
13 **THAT SHOULD BE SUBJECT TO STATE REGULATION." WOULD YOU**
14 **COMMENT?**

15 **A.** Yes. Qwest's proposals in this case, such as its Competitive Zones proposal,
16 recognize that Arizona market is dynamic and that the trend toward
17 "convergence" is continuing to accelerate. In a "converged" market, television
18 services, wireless services, internet service and telephone services are offered
19 by multiple providers and can each be used to serve market needs that
20 previously were served by these services in isolation. Additional service

¹¹ Surrebuttal testimony of Dr. Ben Johnson, January 12, 2005, P. 39.

1 alternatives, such as wireless broadband and broadband over power lines (BPL)
2 are early in their respective life cycles but will likely contribute to the continuing
3 trend toward convergence. Traditional utility regulation simply does not work in a
4 converged market. Qwest agrees with MCI on this point and asks the
5 Commission to implement pricing flexibility where competition is demonstrated to
6 exist in an Arizona market continuing to move toward convergence.

7
8 **Q. AT PAGE 8, MR. PRICE SUGGESTS THAT THE COMPETITIVE RETAIL**
9 **TELECOMMUNICATIONS COMPETITIVE ENVIRONMENT IS CHANGING SO**
10 **QUICKLY THAT "THE COMMISSION SHOULD REFRAIN FROM FURTHER**
11 **RETAIL REGULATION AND INSTEAD SIMPLY MONITOR RETAIL**
12 **PRACTICES TO ASSURE THAT QWEST (OR OTHER PROVIDERS WITH**
13 **MARKET POWER) DO NOT TAKE ADVANTAGE OF THEIR REMAINING**
14 **MARKET POWER BY IMPROPERLY RAISING RATES OR RESTRICTING**
15 **OUTPUT." DO YOU AGREE?**

16 **A.** Yes. As discussed in my direct and rebuttal testimonies, the Phoenix and
17 Tucson markets are particularly competitive and customers now have choices of
18 alternative carriers there. In those markets, Basket 3 pricing flexibility for Qwest's
19 services is appropriate. As suggested by Mr. Price, the Commission has a
20 continuing role in protecting the public interest in such markets, and should the
21 Commission find that market conditions change or that Qwest has unreasonably

1 "raised rates or restricted output," it retains the authority to reinstitute Basket 1
2 classification for those services and/or areas.

3

4 **Q. AT PAGE 25, MR. PRICE STATES THAT QWEST'S LOCAL RATES**
5 **RECOVER 100% OF THE LOOP AND PORT COSTS AS WELL AS OTHER**
6 **DIRECT COSTS "ON A STATEWIDE AVERAGED BASIS." WHAT IS THE**
7 **PROBLEM WITH HIS STATEMENT?**

8 A. The problem with his statement is that, like similar statements of other intervenor
9 witnesses in this docket, it is an indication that Mr. Price still yearns for the
10 monopoly-era system of establishing rates and ignores the effects of competition.
11 Mr. Price fails to recognize that the Commission required an analysis of Qwest's
12 revenue requirement in this proceeding. After losing its argument that such an
13 analysis was not necessary, Qwest complied with the Commission directive and
14 has identified a very significant revenue requirement in this docket. If the
15 Commission agrees that such a revenue requirement exists, that means that
16 Qwest has a need for additional revenue opportunity to recover its Arizona costs.
17 As Qwest continues to face competitive losses, especially in services such as
18 features, toll and business local exchange services, this shortfall is exacerbated.

19

20 **Q. AT PAGE 25, MR. PRICE SUGGESTS THAT HIS RECOMMENDED**
21 **SWITCHED ACCESS RATE REDUCTIONS SHOULD BE OFFSET BY**

1 **ALLOWING QWEST TO RECOVER FOREGONE REVENUE FROM**
2 **INCREASES TO PRICES OF SERVICES IN BASKET 3. WOULD YOU**
3 **COMMENT?**

4 A. MCI's recommendations in this regard are completely self-serving. Mr. Price
5 recommends that revenue decreases in switched access can be replaced by
6 revenue associated with price increases in Qwest's most competitive services
7 and the outcome will have no financial effect on Qwest. In reality, the effect of
8 Mr. Prices's recommendation will likely be a significant financial gain for MCI from
9 potentially lower costs of service and less revenue for Qwest.

10

11 Services have been placed in Basket 3 because they have long been found to be
12 competitive and discretionary, and competitive forces will truncate Qwest's ability
13 to recover revenue losses. Significant increases in Basket 3 service rates will
14 likely result in one of two outcomes: customers will shift to alternative services of
15 Qwest's competitors (including MCI) or will discontinue using the service. In this
16 case, MCI's agenda is to force one of its primary competitors (Qwest) into losing
17 significant revenue while it simultaneously increases its own profitability.

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IX. CONCLUSION

Q. PLEASE SUMMARIZE YOUR REJOINDER TESTIMONY.

A. In my rejoinder testimony, I addressed issues raised by Staff, RUCO, DOD, Time Warner, Cox Communications and MCI in their rebuttal testimonies in this proceeding. As discussed in my direct, rebuttal and rejoinder testimony, the Arizona telecommunications market is now subject to significant intramodal and intermodal competition and the Phoenix and Tucson markets are particularly competitive. However, intervening parties in this docket would have the Commission believe that competition is not yet sufficient to warrant additional pricing flexibility for Qwest. In fact, the parties would essentially have the Commission ignore any competition except that represented by facilities-based CLECs. To the contrary, Arizona is one of Qwest's most competitive states, and Qwest has already lost in excess of 25% of its access line base in Arizona to CLECs of all types (a percentage that is understated since it does not account for the effects of intermodal competition nor new customers who initially establish service with a CLEC without ever subscribing to Qwest service) and no party has presented evidence to show that Qwest will not continue to absorb competitive losses. Whenever Qwest loses a retail customer, it loses the opportunity to generate ongoing retail revenue from the relationship with that customer and the

1 opportunity to increase its revenue through the sale of additional services to that
2 customer. As competition causes loss of customers that purchase high margin
3 services, Qwest's ability to utilize revenues from those services to cover costs of
4 providing service to all customers in its serving area is undermined.

5
6 Parties have expressed confusion about the role of intermodal competition as a
7 factor in this docket. To be very clear, in its Competitive Zones proposal in this
8 docket, Qwest is not relying on intermodal competition as a "competitive trigger"
9 to classify a particular wire center as a competitive zone. However, the Arizona
10 competitive market is very dynamic and the mix of competitive alternatives has
11 changed substantially even since this docket was initiated. Wireless customers
12 are relying on their wireless services to an ever greater degree and VoIP service
13 is now widely available from multiple providers to any Arizona customer with a
14 broadband internet connection. As customer perception of these services as
15 viable alternatives to traditional telephone service continues to expand, these
16 intermodal services represent an ever-increasing form of price constraining
17 competition to Qwest. To the extent the Commission, after reviewing the
18 evidence in this docket, determines that sufficient CLEC competition exists in a
19 particular wire center to warrant designation of that wire center as a competitive
20 zone, the reality of intermodal competition should give the Commission additional
21 comfort that competitive forces will properly regulate Qwest's rate levels there.

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Finally, the parties challenged Qwest's need for AUSF funding to support the provision of local exchange service to customers located in high cost areas of the state. Qwest's costs to provide service to customers in high cost wire centers are indisputably higher than Qwest's costs to provide service in low cost (primarily urban) wire centers. Rather than supporting Qwest's proposal to utilize AUSF funding to defray the cost of serving customers in high cost areas, Qwest's opponents suggest that Qwest should use margins from profitable services (such as optional calling features, intraLATA toll, switched access and business local exchange services) to defray the cost of serving those customers. Unfortunately, this model, which echoes back to the manner in which prices were set in the "monopoly" era, is no longer viable. Since competitors are logically attracted to markets and services with high margins in Arizona, the revenues associated with Qwest's "high margin" services are rapidly dwindling, undermining Qwest's ability to fully recover its costs in the state

An important feature of Qwest's AUSF proposal is that funding is "competitively portable," meaning that it is available to Qwest's competitors who choose to compete with Qwest to win customers in high cost areas. This allows Qwest's competitors to expect to earn a reasonable return on such customers and encourages the growth of competition in areas where competition has been slow

1 to emerge. Approval of Qwest's AUSF proposal means that competitors will
2 have an additional incentive to compete with Qwest in high cost areas and that
3 customers there will have improved prospects of competitive choice.

4

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

6 **A.** Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON)

) ss

AFFIDAVIT OF DAVID L. TEITZEL

COUNTY OF KING)

David L. Teitzel, of lawful age being first duly sworn, deposes and states:

1. My name is David L. Teitzel. I am Staff Director – Public Policy for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.


David L. Teitzel

SUBSCRIBED AND SWORN to before me this 21st day of January, 2005.




Notary Public

My Commission Expires: 7/10/07

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER – CHAIRMAN
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF QWEST) DOCKET NO. T-01051B-03-0454
CORPORATION'S FILING OF RENEWED)
PRICE REGULATION PLAN.)

IN THE MATTER OF THE INVESTIGATION OF) DOCKET NO. T-00000D-00-0672
THE COST OF TELECOMMUNICATIONS)
ACCESS.)

REJOINDER TESTIMONY OF

KERRY DENNIS WU

ON BEHALF OF

QWEST CORPORATION

JANUARY 27, 2005

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1 Mr. Dunkel alleges that my rebuttal testimony states that I disagree with
2 the "straight-line method" of depreciation. He is incorrect. The straight-
3 line method of depreciation is embedded in every Qwest proposal in this
4 docket and in the information provided to Mr. Dunkel. The purpose of that
5 section of my rebuttal was to highlight Mr. Dunkel's selective deletion of
6 the word "may" from his USOA Part 32 quotation.

7
8 Mr. Dunkel says his recommendation relies upon the FCC's 1999
9 depreciation life ranges. With the exception of one equipment category,
10 all of the approximately 30 life ranges were initially established in
11 1994/1995. By saying he relies upon the FCC's 1999 depreciation life
12 ranges, he does not fully acknowledge where the FCC's life ranges
13 originated and Arizona's changed telecommunications environment.

14
15 Mr. Dunkel claims competitor's depreciation lives are not relevant when
16 considering Qwest's. Competitors compete with Qwest for the same
17 customers and have had a significant negative effect on Qwest's market
18 share. Although competitors may use differing depreciation
19 methodologies, their depreciation lives represent the time period their
20 management expects to recover investment costs. For this reason,
21 competitors' lives are relevant.

22
23 Mr. Dunkel implies RUCO does not concur with Qwest's use of
24 Commission prescribed depreciation lives and parameters. This is not
25 correct. RUCO's direct testimony states, "...There is no difference
26 between the annual accruals calculated by the Company and those
27 calculated by RUCO. Accordingly, I have made no adjustments to
28 proforma depreciation expense."

1 **II. IDENTIFICATION OF WITNESS**

2
3 **Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS**
4 **ADDRESS.**

5 A. My name is Kerry Dennis Wu. My title is Staff Director - Capital Recovery
6 for Qwest Corporation. My business address is 1600 7th Avenue, Room
7 3006, Seattle, Washington 98191.

8
9 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

10 A. Yes. I filed direct and rebuttal testimony in this case and testified before
11 this Commission in depreciation Docket T-01051B-97-0689.

12

13

14

III. PURPOSE OF TESTIMONY

15

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

17 A. The purpose of my rejoinder testimony is to address certain issues in Staff
18 consultant Mr. Dunkel's direct and surrebuttal testimony.

19

20 **Q. WHAT ISSUES WILL YOU ADDRESS?**

21 A. I will discuss the following:

22

23 (1) Staff's Mr. Dunkel states that my rebuttal testimony misrepresents his
24 testimony regarding service lives and what he means. Mr. Dunkel's
25 testimony is inconsistent on this issue.

26 (2) Mr. Dunkel alleges that my rebuttal testimony states that I disagree
27 with the "straight-line method" of depreciation. He is incorrect.

28 (3) Mr. Dunkel says that he relies upon the FCC's 1999 depreciation life
29 ranges, not their 1995 life ranges. With a single exception of one life

1 range, the FCC life ranges he relies upon were effectively established
2 in 1994/1995.

3 (4) Mr. Dunkel claims competitor's depreciation lives are not relevant
4 when considering Qwest's depreciation lives. This claim ignores the
5 fact that competitors continue to erode Qwest's market share and that
6 competitors' depreciation lives represent the time periods competitors
7 expect to recover their investment costs.

8 (5) Mr. Dunkel's surrebuttal testimony implies that RUCO does not agree
9 with Qwest's use of Commission prescribed lives and parameters. On
10 the contrary, RUCO's direct testimony states that it agrees with
11 Qwest's depreciation calculation results; therefore, RUCO must agree
12 with the factors that produced those same results.

13
14
15 **IV. SERVICE LIVES**

16
17 **Q. WHAT DID MR. DUNKEL SAY IN HIS DIRECT TESTIMONY ABOUT**
18 **QWEST'S USE OF PRESCRIBED DEPRECIATION LIVES AND**
19 **SERVICE LIVES?**

20 **A.** In his direct testimony, Mr. Dunkel states,

21
22 The Qwest proposal violates the ACC [sic] and Uniform System of
23 Accounts (USOA) utility depreciation requirements. The ACC [sic]
24 and USOA both require that investments be depreciated over their
25 "service life." The "service life" ends when the investments retire
26 from service. However for the purposes of calculating the
27 depreciation rates, Qwest ends the investments alleged "life" before
28 they actually retire, so Qwest is not depreciating the investments
29 over their "service life."¹

¹ Direct Testimony and Schedules of William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, November 2004, p. 36.

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Q. WHAT IS QWEST'S DEPRECIATION LIFE PROPOSAL?

A. As stated in my rebuttal testimony, "In this Docket, Qwest did not request any change to the Commission prescribed depreciation lives or parameters."² In other words, Qwest's proposal utilizes the same depreciation lives, salvage values and survivor curve shapes as ordered by the Commission in May 2000.

Q. HOW CAN QWEST'S PROPOSAL BE IN VIOLATION OF ARIZONA ADMINISTRATIVE CODE (AAC) FOR UTILIZING FACTORS THAT COMPLY WITH THE COMMISSION'S CURRENTLY PRESCRIBED DEPRECIATION ORDER?

A. Qwest's proposal is not in violation of the AAC as Mr. Dunkel alleges. Mr. Dunkel's direct testimony clearly states that utilizing depreciation lives less than physical retirements (also known as mortality), is an ACC violation, yet he too recommends depreciation lives less than implied by historical retirement rates.

Q. WHY SHOULDN'T ACTUAL PHYSICAL RETIREMENT EXPERIENCE (HISTORICAL MORTALITY DATA) BE USED TO SET DEPRECIATION LIVES?

A. The historical mortality rate is an element to consider, but in rapidly changing environments, other factors such as technological obsolescence, changes in the art and technology, changes in consumer demand, etc. must be given more weight. That is precisely what the Commission ordered in May 2000.

² Rebuttal Testimony of Kerry Dennis Wu - Qwest, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, December 20, 2004, p. 1.

1 **Q. WHAT DOES MR. DUNKEL'S SURREBUTTAL TESTIMONY NOW SAY**
2 **ABOUT STAFF'S INTERPRETATION OF WHAT "SERVICE LIFE"**
3 **MEANS?**

4 A. Mr. Dunkel states,

5
6 No. I never testified "that service life must be estimated based
7 solely on historical mortality data." This grossly misrepresents my
8 testimony and the position of Staff. Other than Mr. Wu, no witness
9 or party to this case has stated "that service life must be estimated
10 based solely on historical mortality data."³

11
12 I had actually said that "**Failure to depreciate over the "service**
13 **life"** violates these requirements. Mr. Wu misstates my testimony
14 by falsely claiming that I testified that "**utilizing depreciation lives**
15 **less than implied by historical retirement rates"** violates these
16 requirements."⁴
17

18 **Q. ARE MR. DUNKEL'S DIRECT TESTIMONY STATEMENTS ABOUT**
19 **QWEST'S ALLEGED AAC AND USOA VIOLATION CONSISTENT WITH**
20 **THE POSITION HE NOW ADVOCATES?**

21 A. No. In his direct testimony, Mr. Dunkel states Qwest is in violation of the
22 AAC for utilizing depreciation lives less than service lives. He then states
23 service lives mean from the time assets are placed into service until the
24 time they are retired (retirement experience). In his surrebuttal Mr. Dunkel
25 states,

26
27 I said that depreciation should be over the service life, but I did not
28 saying [sic] the expected service lives cannot be "less than implied
29 by historical retirement rates."⁵
30

³Surrebuttal Testimony William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, January 2005, p. 2.

⁴Ibid. p. 6.

⁵Ibid. p. 7.

1 **Q. GIVEN MR. DUNKEL'S ABOVE SURREBUTTAL STATEMENT, WHAT**
2 **DO YOU THINK HE MEANS BY "SERVICE LIFE"?**

3 A. It appears Mr. Dunkel's surrebuttal position is that "service life" means the
4 expected depreciation life the Commission determines as most
5 appropriate.
6

7 **Q. HOW IS QWEST'S PROPOSAL IN VIOLATION OF THE AAC?**

8 A. It's difficult to see how Qwest's proposal, using depreciation lives and
9 parameters the Commission determined as most appropriate,
10 subsequently affirmed by the Arizona Court of Appeals, is in violation of
11 the AAC.
12
13

14 **V. STRAIGHT-LINE METHOD OF DEPRECIATION**
15

16 **Q. ON PAGE 10 OF HIS SURREBUTTAL, MR. DUNKEL STATES "ON**
17 **PAGE 4 AND 5 OF HIS REBUTTAL MR. WU DISAGREES WITH THE**
18 **'STRAIGHT-LINE METHOD' OF DEPRECIATION." DO YOU**
19 **DISAGREE WITH THE "STRAIGHT-LINE METHOD" OF**
20 **DEPRECIATION?**

21 A. The purpose of the rebuttal pages referenced by Mr. Dunkel is to show his
22 selective deletion of the modifier "may" from the FCC's Part 32 language.
23 Mr. Dunkel's modified Part 32 language was then subsequently used to
24 bolster his AAC and USOA violation allegation. My testimony does not
25 say I disagree with the "straight-line method" of depreciation. A careful
26 reading of pages 4 and 5 in the context if my rebuttal testimony shows that
27 I do not take issue with the "straight-line method" of depreciation. Quite
28 the contrary, all parties including Mr. Dunkel were provided workpapers

1 that clearly show Qwest's depreciation proposal utilizes equal life group
2 straight-line depreciation.
3

4
5 **VI. FCC DEPRECIATION LIFE RANGES**
6

7 **Q. ON PAGE 10 OF HIS SURREBUTTAL, MR. DUNKEL STATES, "MR.**
8 **WU'S CLAIM THAT I USED THE 1995 FCC LIFE RANGES**
9 **MISREPRESENTS THE SOURCE OF THE FCC LIFE RANGES THAT I**
10 **USED FOR THE MAJOR ACCOUNTS. FOR MOST MAJOR**
11 **ACCOUNTS, THE FCC LIFE RANGES I USED WERE FROM THE**
12 **FCC'S DECEMBER 1999 ORDER." PLEASE COMMENT?**

13 A. In 1994 and 1995, the FCC issued life ranges for approximately 30 plant
14 categories. In 1999, the FCC modified a single category – digital switch.
15 The rest were unchanged. When Mr. Dunkel advocates depreciation lives
16 from the FCC's 1999 order, with the exception of digital switch, he
17 recommends life ranges initially suggested by the FCC in 1994/1995.
18

19 **Q. WHEN YOU STATE THE FCC'S 1999 ORDER MODIFIED A SINGLE**
20 **CATEGORY'S LIFE RANGE, WHAT WAS THAT CHANGE?**

21 A. The FCC's original digital switch category life range was 15 to 18 years.
22 In 1999, the FCC simply extended the lower end of that range to 12 years,
23 so that digital switch's modified life range was now 12 to 18 years.
24

25 **Q. WHEN THE FCC MODIFIED THE DIGITAL SWITCH LIFE RANGE,**
26 **WHAT DID THE FCC SAY ABOUT THE REMAINING EQUIPMENT**
27 **CATEGORY LIFE RANGES?**

28 A. The FCC's 1999 order stated,
29

1 ... We agree with MCI-Worldcom, that, except for digital switching
2 equipment, recent carrier accounting data and trends do not
3 support reductions in prescribed projection life ranges. ...⁶
4

5 **Q. WHAT IS SIGNIFICANT ABOUT THIS ORDER?**

6 A. At the time the 1999 order was issued, the FCC's Local Competition
7 Report⁷ shows that nationally 4% of end-user switched access lines were
8 served by CLECs. At the end of 2003, the national average percentage
9 increased to 16%. For the same end of year 2003 period, Arizona-only
10 percentage is shown at 22%. The testimonies of Qwest witnesses Philip
11 E. Grate and David L. Teitzel show that Arizona competitors' market share
12 have continued to increase. The point is that the telecommunications
13 landscape is much different today than when either the FCC's 1995 or
14 1999 order was issued.

15
16 **Q. WHAT DID MR. DUNKEL SAY ABOUT INDIANA'S AND ILLINOIS'**
17 **RECOGNITION THAT THE FCC'S LIFE RANGES ARE NO LONGER**
18 **APPROPRIATE?**

19 A. Mr. Dunkel stated that these Commission decisions were in the context of
20 interconnection dockets and therefore were not relevant to his testimony.
21 The issues raised and their effects on Arizona equipment lives apply to
22 telecommunications investment, regardless of use. For example,
23 regarding use of the FCC's depreciation life ranges, the Indiana
24 Commission 2004 order stated,

25
26 ... we reject any claim that we are somehow bound to adopt
27 regulatory lives, or even that they must be used as a starting point.

⁶ FCC 99-137, Report and Order in Docket No. 98-137, Memorandum Opinion and Order in ASD 98-91, Released December 30, 1999, para. 14.

⁷ Local Telephone Competition: Status as of December 31, 2003, Industry Analysis and Technology Division, Wireline Competition Bureau, June 2004.

1 Whatever the merit of such an argument may have been in 1996, it
2 carries no weight in 2003.

3
4 Despite the frequent use of regulatory lives by other states in the
5 first round of TELRIC proceedings, this Commission led the way
6 toward a more progressive view of depreciation, tied more closely
7 to the ongoing development of new technology and the growth of
8 competition. . . .

9
10 We believe that our decision was correct in 1998 and is even more
11 appropriate today. Technological advancement continues at a
12 rapid pace, leading to faster obsolescence of all types of
13 telecommunications equipment. If anything, the pace of
14 technological advancements should only increase as unbundling
15 and pricing determinations are brought more in line with the goals
16 of the 1996 Act in the wake of the 1999 Biennial Order, the
17 Triennial Review Order, and the TELRIC NPRM, and as the
18 incentive for facilities-based investment and innovation increases.

19
20 We want to encourage SBC Indiana to take advantage of and
21 deploy technological advancements, and one way to do that is to
22 allow it to use reasonable depreciation lives based on criteria SBC
23 employs for financial reporting purposes. We also note the
24 increase in competition faced by SBC Indiana, both intermodal and
25 intramodal, compels use of shorter depreciation lives. (Triennial
26 Review Order, ¶ 685) SBC Indiana also has now “fully and
27 irreversibly opened” the local market to competition, as evidenced
28 by the FCC’s grant of Section 271 long-distance authority, and such
29 approvals often accelerate the pace and level of competition for the
30 ILEC. For all of these reasons, we adopt SBC Indiana’s proposal to
31 use financial reporting lives in computing depreciation expense.⁸

32
33 The FCC’s depreciation life ranges are simply not appropriate in today’s
34 telecommunications environment. It is naïve to believe environmental
35 changes described above in Indiana’s order are uniquely isolated to just
36 interconnection equipment.

⁸ Investigation and Generic Proceeding of Rates and Unbundled Network Elements and Collocation for Indiana Bell Telephone Company, Incorporated D/B/A SBC Indiana Pursuant to the Telecommunications Act of 1996 and Related Indiana Statutes, Cause No. 42393, Section B. Commission Findings and Conclusions, January 5, 2004.

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VII. QWEST'S COMPETITORS' LIVES ARE RELEVANT TO QWEST

Q. MR. DUNKEL STATES THAT QWEST'S COMPETITORS' "FINANCIAL REPORTING' LIVES CANNOT BE USED AS QWEST'S REGULATED UTILITY LIVES." PLEASE COMMENT.

A. Mr. Dunkel proffers a few technical reasons why he objects to using Qwest's competitor's lives as Qwest's regulated utility lives, but does not address the larger strategic issues. Is new technology shortening the depreciation lives of Qwest's assets? Is competition and loss of market share reducing the expected lives of Qwest's investments?

Q. WHAT DID THE COMMISSION SAY ABOUT THIS ISSUE?

A. The Commission stated in May 2000,

Advancements in technology, coupled with the desire to create robust competition in Arizona's telecommunications industry, warrants setting U S WEST's depreciation lives within the range of its competitors.⁹

Q. WHAT DID THE ARIZONA COURT OF APPEALS SAY WITH RESPECT TO USE AND RELEVANCE OF COMPETITOR'S LIVES IN DETERMINING QWEST'S DEPRECIATION LIVES?

A. As stated in my rebuttal testimony,

The Commission's regulations governing the establishment of depreciation rates authorize a public service corporation to "propose any reasonable method for estimating service lives." A.A.C. R14-2-102(C) (2). We do not find it unreasonable for the

⁹ Arizona Docket No T-01051B-97-0689 Decision No. 62507, Conclusions of Law, May 4, 2000, Para 3, p. 14.

1 Commission to conclude that in a competitive environment, the
2 lives of U.S. WEST's property should be set comparably to those of
3 companies with which U.S. WEST would be competing. Given that
4 premise, we are not persuaded that use of the SEC data was
5 arbitrary or unreasonable.¹⁰
6

7 **Q. WHAT WERE SOME OF THE REASONS MR. DUNKEL STATES THAT**
8 **QWEST'S COMPETITORS' "FINANCIAL REPORTING" LIVES**
9 **CANNOT BE USED AS QWEST'S REGULATED UTILITY LIVES?"**

10 A. Mr. Dunkel states,

11
12 ... As discussed on pages 46 – 54 of my Direct Testimony, there
13 were several reasons the CLEC/IXC "financial reporting" lives
14 cannot be used as Qwest's regulated utility lives. These reasons
15 are: (1) CLEC/IXC's depreciation rates are not calculated
16 consistent with the USOA/ACC requirements; ... (4) and there
17 would be a mismatch of the way utility regulated depreciation rates
18 are applied if depreciation rates are calculated on a different
19 standard.¹¹
20

21 I agree CLEC/IXCs calculate rates differently, but their depreciation lives
22 represent the time periods over which CLECs plan to fully recover their
23 invested capital.

24

25

26 **VIII. RUCO DEPRECIATION RECOMMENDATION**

27

28 **Q. ON PAGE 12 OF HIS SURREBUTTAL, MR. DUNKEL QUOTES RUCO'S**
29 **DATA RESPONSES IN WHICH RUCO STATES THAT DOES NOT**
30 **TAKE A POSITION ON QWEST'S DEPRECIATION PARAMETERS.**

¹⁰ Residential Utility Consumer Office v. The Arizona Corporation Commission and Qwest Corporation, Court of Appeals, July 24, 2001, P20, pp. 11-12.

¹¹ Surrebuttal Testimony William Dunkel on Behalf of Staff of the Arizona Corporation Commission, Docket No. T-0151B-03-0454 and No. T-00000D-00-0672, January 2005, pp. 13 - 14.

1 state of the art and technology and regulatory requirements. For the
2 major plant accounts, Mr. Dunkel wants to "roll back the clock" and, with
3 the exception of a single plant category, advocates lives initially
4 established in the 1994/1995 time frame. Qwest did not propose any
5 change to the appropriate depreciation lives already ordered by this
6 Commission.

7

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

9 **A.** Yes it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST
CORPORATION'S FILING OF RENEWED
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE INVESTIGATION
OF THE COST OF
TELECOMMUNICATIONS ACCESS.

DOCKET NO. T-00000D-00-0672

STATE OF WASHINGTON)

COUNTY OF KING)

ss

AFFIDAVIT OF KERRY DENNIS WU

Kerry Dennis Wu, of lawful age being first duly sworn, deposes and states:

1. My name is Kerry Dennis Wu. I am Staff Director – Capital Recovery for Qwest Corporation in Seattle, Washington. I have caused to be filed written rejoinder testimony in Docket No. T-01051B-03-0454 and T-00000D-00-0672.
2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Kerry Dennis Wu
Kerry Dennis Wu

SUBSCRIBED AND SWORN to before me this 18th day of January, 2005.



Lori L. White
Notary Public

My Commission Expires: 7/10/07