



Arizona Utility  
Investors Association

2100 N. Central, Ste. 210  
P. O. Box 34805  
Phoenix, AZ 85067

Tel: (602) 257-9200  
Fax: (602) 254-4300

Email: info@auia.org  
Web Site: www.auia.org

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BEFORE THE ARIZONA CORPORATION COMMISSION

30

Jeff Hatch-Miller  
Chairman  
William A. Mundell  
Commissioner  
Marc Spitzer  
Commissioner  
Mike Gleason  
Commissioner  
Kristin Mayes  
Commissioner

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

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

DOCKET NO.  
T-01051B-03-0454

DOCKET NO.  
T-00000D-00-0672

NOTICE OF FILING TESTIMONY

Pursuant to the procedural order issued on August 26, 2005, the ARIZONA UTILITY INVESTORS ASSOCIATION (AUIA) hereby submits the initial testimony of Walter W. Meek in support of the proposed Settlement Agreement.

Respectfully submitted, this 6<sup>th</sup> day of September, 2005.

Walter W. Meek, President

AZ CORP COMMISSION  
DOCUMENT CONTROL

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**CERTIFICATE OF SERVICE**

An original and 15 copies of the referenced testimony filed this 6th day of September, 2005, with:

Docket Control  
Arizona Corporation Commission  
1200 W. Washington Street  
Phoenix, AZ 85007

Copies of the referenced testimony hand delivered this 6th day of September, 2005, to:

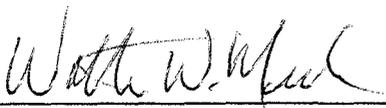
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Mark Spitzer, Commissioner  
Philip Dion, Executive Assistant  
Mike Gleason, Commissioner  
Kenneth Rozen, Executive Assistant  
Kristin Mayes, Commissioner  
Matt Derr, Executive Assistant  
Maureen A. Scott, Esq., Legal Division  
Jane Rodda, Esq., Hearing Division  
Ernest Johnson, Esq., Utilities Division  
Arizona Corporation Commission

A copy of the referenced testimony was mailed this 6th day of September, 2005, to:

Timothy Berg, Esq.  
Fennemore Craig  
3003 N. Central Ave., Suite 2600  
Phoenix, AZ 85012-2913

Norman Curtright, Esq.  
Qwest Law Department  
4041 N. Central Avenue, 11<sup>th</sup> Floor  
Phoenix, AZ 85012

Parties of Record

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WALTER W. MEEK

DOCKET NO. T-01051B-03-0454

SETTLEMENT TESTIMONY OF WALTER W. MEEK

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1 A. Yes. AUIA filed my rebuttal testimony on December 20, 2004.

2 Q. **ARE YOU WITHDRAWING THAT TESTIMONY?**

3 A. No. I request that it remain a part of the record in this proceeding.

4 Q. **WHAT IS THE OVERALL PURPOSE OF THIS TESTIMONY?**

5 A. I am testifying in support of the settlement agreement that is proposed to  
6 define an amended and renewed price regulation plan for Qwest  
7 Corporation.

8 Q. **IS AUIA A SIGNATORY TO THE SETTLEMENT AGREEMENT?**

9 A. Yes. I have signed the agreement on behalf of AUIA.

10 Q. **CAN YOU SUMMARIZE THE ELEMENTS OF YOUR TESTIMONY?**

11 A. Yes. I will start by reviewing the reasons why AUIA supports the settlement  
12 agreement, including a brief discussion of how and whether it addresses  
13 certain concerns we raised in our rebuttal testimony. Next, I will comment on  
14 eight key elements of the settlement agreement and the price cap plan.  
15 Finally, I will discuss consumer benefits that flow from the agreement and  
16 indicate the various reasons why the Arizona Corporation Commission  
17 should support the settlement. Throughout my testimony, I will refer to the  
18 settlement agreement and the price cap plan interchangeably because a  
19 serious attempt was made by the parties to eliminate the possibility of any  
20 conflicting language and to make the two documents conform.

21

22 **II. THE SETTLEMENT BENEFITS QWEST AND ITS CUSTOMERS.**

23

24 Q. **IN GENERAL, WHY DOES AUIA SUPPORT THE SETTLEMENT?**

25 A. As I indicated in my rebuttal testimony, Qwest is in dire need of an infusion  
26 of new revenue to make up for some of the market share it has lost during the  
27 period of the current price cap plan. In addition, the company needs more  
28 flexibility in pricing and packaging its services in order to compete effectively  
29 with other telecom providers. The settlement agreement addresses both of  
30 these issues to some degree.

31 Q. **DOES THE AGREEMENT PROVIDE A PERMANENT SOLUTION TO  
32 QWEST'S COMPETITIVE PROBLEMS?**

33 A. I don't believe so. I would characterize the amended price cap plan that is

1 proposed here as triage rather than major corrective surgery.

2 **Q. WHAT IS NEEDED IN THE LONG TERM?**

3 A. In its rebuttal testimony, AUIA supported Qwest's concept of designating  
4 competitive zones in which virtually all services would be free of price  
5 regulation. At some point, I believe the Commission must confront the  
6 realities of the competitive market as it has developed and modify its  
7 regulatory regime in a significant way. However, in shaping this agreement,  
8 the settling parties agreed that now is not the time to pursue that concept and  
9 the settlement prohibits Qwest from renewing that proposal during the  
10 period of the amended price cap plan.

11 **Q. HOW DO CUSTOMERS FARE UNDER THE SETTLEMENT?**

12 A. Apart from specific consumer benefits which I will discuss later, there are two  
13 broad areas of consumer interest that result from the settlement. First, the  
14 key elements of the agreement are designed to provide Qwest with more  
15 financial stability. That is an unrecognized but critical benefit to consumers  
16 who rely on Qwest to maintain the backbone of telecom service in Arizona  
17 and to act as the provider of last resort. Second, in spite of its potential  
18 benefits to Qwest, the settlement does not impose a general rate increase on  
19 Qwest's customers, which is the end result of most utility rate cases.

20 **Q. WHAT IS THE IMPACT OF THE PROPOSED REVENUE INCREASE?**

21 A. In the first place, the authorized increase in revenues (\$31.8 million in the first  
22 year of the new price cap plan) is very nominal in comparison with Qwest's  
23 total annual revenues. In the second place, the settlement agreement only  
24 grants Qwest the *opportunity* to generate greater revenue through increased  
25 sales and/or selective price increases on some of its services. There is no  
26 guarantee that Qwest will realize any amount of increased revenue as a result  
27 of flexible pricing.

28 **Q. IS THIS OUTCOME DIFFERENT FROM TYPICAL UTILITY**  
29 **RATEMAKING?**

30 A. Yes. It is true that in Arizona, a regulated utility is never given more than an  
31 opportunity to earn an authorized return. But in a typical rate decision, an  
32 electric, gas or water utility would be granted a specific set of rates that are  
33 designed to produce that return under prudent management and normal

1 operating conditions. In this case, Qwest will be on its own to determine how  
2 to price its services to produce the desired economic result while striving to  
3 remain competitive in the marketplace.

4 **Q. HOW IS THE OUTCOME DIFFERENT FOR CONSUMERS?**

5 A. There is no general rate increase that everyone has to pay. In practice, the  
6 only customers who will contribute to the higher revenue stream are those  
7 who purchase the specific services or packages of services that are subject to  
8 price increases. In most cases, if not all, that will be an individual decision. If  
9 the resulting prices are not acceptable to consumers, they can decline to buy  
10 the services or in many cases, they can turn to a competitive provider.

11  
12 **III. KEY ELEMENTS OF THE SETTLEMENT AGREEMENT**

13  
14 **Q. ARE THERE SPECIFIC ELEMENTS OF THE SETTLEMENT**  
15 **AGREEMENT THAT YOU WOULD LIKE TO DISCUSS?**

16 A. Yes. I will discuss eight elements of the agreement seriatim.

17 • **Basket Arrangement and Contents**

18 The settlement agreement proposes to rearrange the service baskets to  
19 give Qwest more room to maneuver in pricing and packaging its products.  
20 Basket 1 continues to house basic services, which are hard-capped at their  
21 current price levels. Under the agreement, Basket 2 would contain retail  
22 services that are given limited pricing flexibility. Price increases for these  
23 services cannot exceed 25 percent in any 12-month period. Basket 3 continues  
24 to hold competitive services that are flexibly priced, except that there is an  
25 overall cap on revenue increases from that basket. Wholesale services are  
26 moved from Basket 2 to a new Basket 4.

27 As a part of the move toward increased flexibility, the parties agreed to  
28 transfer some services from Basket 1 to Baskets 2 and 3. Examples include  
29 Additional Lines, PBX Trunks, DID Service and Custom Calling Features,  
30 which move to Basket 2, and Basic Service Packages, Market Expansion Line  
31 and Uniform Access Solution Service, which move to Basket 3.

32 These changes give Qwest additional revenue potential within the  
33 limits described below.

1       • **Inflation/Productivity Adjustment**

2             The settling parties agreed that the inflation/productivity adjustment  
3 applied to Basket 1 services in the current price cap plan should be  
4 eliminated. This device is anachronistic and because it is designed to  
5 suppress earnings, it has become punitive to the company. However, the  
6 settlement agreement provides that Qwest is responsible for the April 1, 2005  
7 adjustment and accounts for that by reducing Qwest's revenue opportunity  
8 by \$12 million in the first year of the amended price cap plan.

9       • **Switched Access Charges**

10            The settlement agreement provides for a permanent annual reduction  
11 in switched access charges of \$12 million. However, the parties also agreed  
12 that this reduction should be revenue neutral to Qwest, with a resulting  
13 impact on Qwest's pricing opportunities described below. While there may  
14 not be a dollar-for-dollar impact, this reduction will result in lower costs for  
15 some consumers.

16       • **Authorized Revenue Increases**

17            The settlement agreement authorizes Qwest to increase its annual  
18 jurisdictional revenues by \$31.8 million. As I noted earlier, this does not  
19 occur through a general rate increase, but through the opportunity for Qwest  
20 to price some of its services in ways that will produce greater revenues.  
21 Qwest's pricing opportunity is modified in the following ways:

22            The authorized revenue increase of \$31.8 million is enlarged by \$12  
23 million as an offset to the switched access reduction, bringing the total of the  
24 increased revenue opportunity to \$43.8 million. However, in the first year of  
25 the plan, Qwest's pricing opportunity is also reduced by \$12 million to  
26 account for the April 1, 2005 inflation/productivity adjustment, bringing it  
27 down to \$31.8 million.

28            The overall pricing opportunity of \$43.8 million would be allocated  
29 between Baskets 2 and 3, as follows: a maximum of \$13.8 million to Basket 2  
30 and \$30 million to Basket 3, plus any unused portion of the Basket 2  
31 allocation.

32            However, in the first year, the Basket 2 allocation would be limited to  
33 \$1.8 million as a consequence of the inflation/productivity adjustment for

1 April 1, 2005.

2 The settlement agreement requires Qwest to file a schedule of  
3 minimum-maximum rates for its services in Baskets 2 and 3 within 30 days of  
4 the entry of a Commission order in this proceeding. This requirement is in  
5 response to a recent appellate court decision regarding the Commission's  
6 responsibility for utility price-setting.

7 • **Rate of Return**

8 The settlement agreement calls for an overall rate of return of 9.5  
9 percent. Staff's direct testimony dealing with capital costs recommended the  
10 same rate of return based on an actual capital structure of 75 percent debt and  
11 25 percent equity, applied to a cost of debt of 7.8 percent and a recommended  
12 return on equity of 14.6 percent. Qwest's financial condition and the risk  
13 attendant to equity investment in the company might argue for a hypothetical  
14 capital structure and a higher return on equity, but overall, the weighted cost  
15 of capital adopted in the agreement is reasonable.

16 • **Special Offerings**

17 The settlement agreement provides that Qwest shall have the added  
18 flexibility of introducing promotional offerings with one day prior notice to  
19 the Commission and may include packaged offerings in Basket 3, provided  
20 that the individual services must be available on a ala carte basis in Basket 1,  
21 2 or 3. The 1-day notice provision replaces a 30-day notice requirement in the  
22 current price cap plan, which puts Qwest at a serious disadvantage with its  
23 competitors.

24 • **Deregulated Services**

25 The parties agreed that the standard has been met the for deregulation  
26 of voice mail service and billing and collection services. The evidence is that  
27 there are sufficient competitive alternatives for these services to become  
28 unregulated. However, the agreement codifies the Commission's right to  
29 take appropriate action if it determines that these services are offered in a  
30 discriminatory or anti-competitive manner.

31 • **Dismissal of Court Appeals**

32 The settlement agreement provides that Qwest will dismiss its pending  
33 court appeals of commission Decision Nos. 66772 and 67047, when the

1 Commission's process in this case has been completed; that is, if no one has  
2 filed an application for rehearing within the time provided by statute or, if  
3 there has been an application, it has been denied by the Commission or by  
4 operation of law. Clearly the dismissal of these lawsuits removes a cloud  
5 over previous Commission actions and a palpable threat to consumers.

6  
7 **IV. CONSUMER BENEFITS**

8  
9 **Q. WHAT CONSUMER BENEFITS ARE EMBODIED IN THE AMENDED**  
10 **PRICE CAP PLAN?**

11 **A.** The settlement agreement and its amendments to the price cap plan provide  
12 some global benefits to consumers in addition to incremental adjustments to  
13 various services.

14 I must reiterate that the increased revenue opportunities, if they are  
15 implemented successfully, will contribute to Qwest's financial stability,  
16 which relates directly to the system reliability and quality of service that  
17 Qwest is able to deliver. Qwest continues to provide the backbone of the  
18 telecommunications system in Arizona and is the designated provider of last  
19 resort.

20 Moreover, the additional marketing and pricing flexibility provided by  
21 the amended price cap plan will make Qwest more nimble and responsive to  
22 conditions in the marketplace. In other words, Qwest will be able to compete  
23 more effectively, and robust competition benefits the consumer.

24 In addition to these broad benefits, there are other, specific changes in  
25 the price cap plan that will deliver benefits to consumers:

- 26 • The existing zone increment charges will be reduced by 50 percent.
- 27 • The rates for non-published and non-listed telephone numbers will  
28 also be reduced by half.
- 29 • Funding for the Telephone Assistance Plan (TAP) for the medically  
30 needy will be doubled, from \$1 million to \$2 million annually and there will  
31 be additional efforts devoted to increasing public awareness of the program.

32 Together with the fact that this case will not result in a general rate  
33 increase, there is much in the settlement agreement to benefit consumers.

1 V. CONCLUSION: THE COMMISSION SHOULD APPROVE THE  
2 SETTLEMENT AGREEMENT.

3

4 Q. DO YOU HAVE SOME CONCLUDING RECOMMENDATIONS FOR  
5 THE COMMISSION?

6 A. Yes. The evidence in this case is that Qwest has lost more than 577,000  
7 residential wire lines since 2000. Excluding wireless connections, Qwest's  
8 competitors have acquired an estimated 22 percent of the combined business  
9 and residential wire-line market. When wireless penetration is included,  
10 Qwest's market share shrinks to a probable 40 percent. That is no longer a  
11 monopoly business.

12 As a result of shrinking market share, Qwest asserted in its direct case  
13 that it is suffering an annual revenue deficiency of \$350 million. While  
14 Qwest's revenue deficiency was not fully vetted in settlement negotiations,  
15 there was no assertion by any party that Qwest was not entitled to an increase  
16 in jurisdictional revenues.

17 Clearly, the parties to this settlement agreement, which include some  
18 of Qwest's key competitors, believe that the changing market environment in  
19 Arizona justifies regulatory action to provide Qwest with increased  
20 marketing flexibility and greater earning opportunities.

21 In AUIA's view, the elements of the settlement agreement represent  
22 the minimum steps required to stave off a disaster for the state's leading  
23 provider of telecommunications services and its provider of last resort. We  
24 urge the Commission to adopt the settlement agreement without material  
25 alteration.

26 Q. DOES THAT CONCLUDE YOUR SETTLEMENT TESTIMONY?

27 A. Yes, it does.