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BEFORE THE ARIZONA CORPORATION COMMISSION

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JEFF HATCH-MILLER
Chairman
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MARC SPITZER
Commissioner
MIKE GLEASON
Commissioner
KRISTIN K. MAYES
Commissioner

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AZ CORP COMMISSION
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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

**NOTICE OF FILING SUPPLEMENTAL
TESTIMONY IN SUPPORT OF THE
SETTLEMENT AGREEMENT**

The Arizona Corporation Commission Staff ("Staff") hereby files the Supplemental Testimony of Elijah Abinah (Redacted), Matthew Rowell, Del Smith, Michael Brosch, Steve Carver and William Dunkel in support of the Settlement Agreement between Staff, Qwest Corporation, the Department of Defense and all other Federal Executive Agencies, Cox Arizona Telcom, LLC, the regulated subsidiaries of MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association and XO Communications Services Inc., in these Dockets.

Non-Redacted copies of Staff Witness Abinah's Supplemental Testimony have been provided to Parties that have signed the Protective Agreement in this case.

RESPECTFULLY submitted this 6th day of September, 2005.

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Arizona Corporation Commission
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...

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2 foregoing filed this 6th day
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5 Phoenix, Arizona 85007

6 Copies of the foregoing mailed this
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**SUPPLEMENTAL
TESTIMONY
OF
ELIJAH A. ABINAH
MATTHEW ROWELL
DEL SMITH
MICHAEL L. BROSCHE
STEVEN C. CARVER
WILLIAM DUNKEL**

**DOCKET NO. T-01051B-03-0454
DOCKET NO. T-00000D-00-0672**

**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**

SEPTEMBER 8, 2005

ABINAH

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) DOCKET NO. T-01051B-03-0454
FILING OF RENEWED PRICE REGULATION)
PLAN)
_____)

IN THE MATTER OF THE INVESTIGATION OF) DOCKET NO. T-00000D-00-0672
THE COST OF THE TELECOMMUNICATIONS)
ACCESS)
_____)

**SUPPLEMENTAL
TESTIMONY
OF
ELIJAH O. ABINAH
FOR THE
ARIZONA CORPORATION COMMISSION
UTILITIES DIVISION
(PUBLIC VERSION)**

September 6, 2005

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EXECUTIVE SUMMARY
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672

My testimony contains an overall summary of the provisions of the Settlement Agreement that was reached in this proceeding between Staff and all other active parties, with the exception of RUCO. Mr. Rowell addresses the provisions of the Settlement Agreement which pertain directly to the Price Cap Plan's design and operation. Mr. Smith will be covering the Settlement Sections that pertain to the Telephone Assistance Plan for the Medically Needy, Service Quality and Line Extension Credit. Staff's consultants' testimony covers the Settlement Sections that involve the technical areas of revenue deficiency, accounting, depreciation lives and related areas.

The negotiations between the parties in this proceeding were open and all-inclusive. All intervenors received notice of the negotiations and were invited to participate in the ongoing discussions between the parties. The Settlement Agreement that was reached and docketed by the Parties on August 23, 2005 has widespread support from the active participants to this docket with the exception of RUCO, and resolves all disputed issues in this Docket. It also results in the dismissal of two appeals by Qwest of the prior Plan which are pending before the Arizona Court of Appeals.

Staff believes that this Agreement is in the public interest because it reflects a careful balancing of the various interests represented in this Proceeding. It contains many benefits for consumers, including a continuation of the hard cap on existing residential and business local exchange rates for another 3 years. Other consumers benefits include the reduction to zone charges, a reduction to Non-Listed and Non-Published Number rates and an increase in funding for the Medically Needy Program established by the Commission many years ago. It also will benefit consumers through its provisions relating to the continuation of existing rates and the one call allowance for Directory Assistance and an increase to the Company's pro rata contribution to construction expenses. The Agreement also affords Qwest more pricing flexibility for its more competitive services which should allow the Company to more effectively respond to competition. Overall, Staff believes that the Agreement is in the public interest and recommends its approval by the Commission.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Elijah O. Abinah. My business address is 1200 West Washington Street,
4 Phoenix Arizona, 85007.

5
6 **Q. Where are you employed and in what capacity?**

7 A. I am employed by the Utilities Division ("Staff") of the Arizona Corporation Commission
8 ("ACC" or "Commission") as Assistant Director.

9
10 **Q. How long have you been employed with the Utilities Division?**

11 A. I have been employed with the Utilities Division since January 2003.

12
13 **Q. Please describe your educational background and experience.**

14 A. I received a Bachelor of Science degree in Accounting from the University of Central
15 Oklahoma in Edmond, Oklahoma. I also received a Master of Management degree from
16 Southern Nazarene University in Bethany, Oklahoma. Prior to my employment with the
17 ACC, I was employed by the Oklahoma Corporation Commission for approximately eight
18 and a half years in various capacities in the Telecommunications Division.

19
20 **Q. What are your current Responsibilities?**

21 A. As Assistant Director, I review submissions that are filed with the Commission and make
22 policy recommendations to the Director regarding those filings.

23
24 **Q. Are you the same Elijah O. Abinah who provided earlier testimony in this matter?**

25 A. Yes.

1 **Q** **Did you participate in the discussion which gave rise to the Settlement Agreement**
2 **between Staff, Qwest Corporation, the Department Of Defense and all other Federal**
3 **Executive Agencies, The regulated subsidiaries of MCI, Inc., Time Warner Telecom**
4 **of Arizona, LLC, the Arizona Utility Investors Association, Cox Telcom and XO**
5 **Communications Services Inc.?**

6 A Yes, I did. I was part of the Staff negotiating team.

7
8 **Q.** **What is the purpose of your testimony?**

9 A. The purpose of my testimony is to describe the Settlement process and to explain Staff's
10 view regarding the Settlement Agreement between Staff of the Arizona Corporation
11 Commission ("Staff") and other parties.

12
13 **Q.** **Is every party to the docket a signatory to the Agreement?**

14 A. No. The Residential Utility Consumer Office ("RUCO") is not a signatory to the
15 Settlement Agreement.

16
17 **Q** **What specific areas will your testimony address?**

18 A Specifically, my testimony will address the following areas:

- 19 • Process
20 • Public Interest

21 In addition to the process and the public interest components, my testimony will in general
22 summarize the entire Agreement and will later address in detail the following sections:

23
24 Section 8. Switched Access Charge Reductions

25 Section 9. Special Access Charge Reductions

- 1 Section 13. Additional consumer benefits
- 2 Section 14. Directory Assistance
- 3 Section 18. Extension, Revision and Termination Of the Price Cap Plan
- 4 Section 19. Universal Service
- 5 Section 24. Notice to Customers
- 6 Section 26. Qwest Competitive Zone Proposal
- 7 Section 27. Elimination of Certain Reporting Requirements
- 8 Section 28. Dismissal of Consolidated Appeals
- 9 Section 29. General Rate Change Moratorium

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(1) Staff Witness Matt Rowell will be covering in more detail the Settlement Sections that pertain directly to the Price Cap Plan's design and operation.

(2) Staff Witness Del Smith will be covering in more detail the Settlement Sections that pertain to Telephone Assistance Plan for the Medically Needy, Service Quality and Line Extension Credit.

(3) Staff's Consultants will be covering in more detail the Settlement Sections that involve the technical areas of revenue deficiency, accounting, depreciation lives, and related areas.

SETTLEMENT PROCESS

Q. Please discuss the settlement process.

A. Staff was contacted by a Qwest representative about the possibility of conducting settlement discussions regarding Qwest's pending Price Cap Plan. On February 1, 2005, Qwest, at Staff request, filed with the Commission's Docket Control a notice informing the Commission and all interested parties that Staff and Qwest intended to engage in a settlement discussion.

1 **Q. Were other Staff members participants in this discussion?**

2 A Yes, the staff negotiating team consisted of Ernest Johnson, (Director of Utilities Division),
3 Matthew Rowell (Chief of Telecom and Energy), Del Smith (Chief of Engineering), Will
4 Shand (Telecom Manager), Armando Fimbres (Telecom Analyst), Richard Boyles
5 (Engineer), Maureen Scott (Staff Legal Counsel), Christopher Kempley (Chief Counsel)
6 and myself.

7
8 **Q. Did anyone seek to intervene in this matter after settlement discussions began?**

9 A. Yes. XO Communications Services, Inc. filed for intervention on March 3, 2005, and was
10 granted intervention on April 8, 2005.

11
12 **Q. When did the negotiation process actually begin?**

13 A. On February 4, 2005, Staff and the parties submitted a filing to Docket Control informing
14 the ALJ of various dates set and agreed to by the parties for meetings in order to start the
15 settlement discussion.

16
17 **Q. Did all parties involved in this docket participate in the negotiations process?**

18 A. Initially, most of the intervenors to this docket were involved in the negotiations process.

19
20 **Q. Did any of the parties withdraw from the negotiations?**

21 A. Yes. On April 13, 2005, Staff, and I believe all parties, received an email from the Director
22 of RUCO informing all parties of RUCO's intention to withdraw from the Settlement
23 negotiations.

24

1 **Q. Did the other parties continue with the negotiations?**

2 A. Yes.

3
4 **Q. Were you able to resolve all the issues at hand?**

5 A. Settlement negotiation is a process of give and take. Parties were able to reach an
6 agreement in principle, except for one issue – Special Access.

7
8 **Q. Can you explain what happened after the remaining parties reached an agreement in
9 principle?**

10 A. All the parties agreed that Qwest, Time Warner Telecom and XO should continue
11 negotiating to reach a resolution on the Special Access issue. A subgroup was formed to
12 work on this issue. Other parties and Staff participated. Qwest, Time Warner Telecom and
13 XO were encouraged to work together to resolve their differences and to keep all parties
14 informed of their progress or status.

15
16 **Q. Did Staff participate in the Special Access negotiations?**

17 A. Yes. Staff was involved in the process. Qwest, Time Warner and XO, however, negotiated
18 the actual language of the contract between them, which is Attachment D to the
19 Agreement.

20
21 **Q. While Qwest, Time Warner Telecom and XO were continuing negotiations
22 concerning Special Access, what else took place?**

23 A. On April 24, 2005, Staff filed with the Docket Control the Principles of Agreement
24 between the Parties.

25

1 **Q. Did Qwest, Time Warner Telecom and XO reach an agreement on Special Access?**

2 A. Yes. The parties ultimately reached an agreement in principle on Special Access.

3
4 **Q. When did Staff and the parties commence the process of reducing the agreement to**
5 **writing?**

6 A. As soon as agreement in principle was reached on the Special Access issue, the Parties
7 began reducing the Agreement to writing. All Parties to the Agreement participated in this
8 process.

9
10 **OVERVIEW OF THE SETTLEMENT AGREEMENT**

11 **Q. Please briefly provide an overview of the Settlement Agreement.**

12 A. For ratemaking purposes and in accordance with the terms of this Agreement, the Parties
13 agree that Qwest's jurisdictional Revenue Deficiency is \$31.8 Million.

14
15 The Parties agree to the resolution of certain accounting issues in the following manner:

16 - Qwest shall be treated as having adopted on April 1, 2001, Statement of Financial
17 Accounting Standards ("SFAS") 106 to account for Other Post Employment Benefits
18 ("OPEBs"), with a ten year amortization of Qwest's December 31, 2000
19 Accumulated Post-Retirement Benefit Obligation ("APBO") starting April 1, 2001.

20
21 - Qwest shall be treated as having adopted on January 1, 2001 the American Institute
22 of Certified Public Accountants' Statement of Position 98-1 ("SOP 98-1") to account
23 for the costs of internal use computer software, effective January 1, 2001.

24

1 - The Parties agree that Qwest will provide Staff with a confidential copy of its year-
2 to-date December 1990s report for Arizona.

3
4 Qwest agrees to a \$255 Million reduction in the annual intrastate depreciation expense for
5 each year of the first five years, and approximately a \$225 Million annual reduction below
6 the test year level in the intrastate depreciation expense thereafter.

7
8 Qwest shall on a going forward basis charge BSI for the cost of installing pedestals and
9 cabinets used by BSI in accordance with the FCC's affiliate billing rules and will continue
10 to bill BSI for all other costs in accordance with those same rules.

11
12 Staff and Qwest agree that, to the extent permissible under the FCC Part 36 separations
13 rules, the DSL costs also should not be considered intrastate jurisdictional costs.

14
15 Under Decision No. 67734, Qwest is obligated to demonstrate that final rates approved in
16 this docket result in ratepayers receiving the full value of the suspended April 1, 2005
17 Productivity Adjustment as if it had been effective April 1, 2005. To implement the
18 requirement, Qwest agrees to a \$12.0 Million reduction to its allowable increase in
19 revenues in Year 1 of the Plan.

20
21 The existing Price Cap Plan productivity/inflation indexing mechanism for Basket 1 is
22 eliminated. Qwest agrees to implement, as part of the Renewed Price Cap Plan additional
23 benefits, in lieu of the productivity/inflation indexing mechanism.

24

1 Qwest shall make Switched Access Charge (Basket 4) reductions totaling \$12.0 Million at
2 the start of Year 1 of the Renewed Price Cap Plan. This shall be a permanent reduction in
3 Switched Access Charges. The Parties agree that the \$12 Million reduction shall be
4 revenue neutral.

5
6 Qwest also agrees to offer to Time Warner Telecom, XO and other carriers intrastate DS1
7 private line services on a contract basis according to the same terms, conditions, and prices
8 as contained in Attachment D of the Agreement.

9
10 The Renewed Price Cap Plan will consist of three retail baskets and one wholesale basket.
11 The services contained in each Basket shall not be subject to change, except for the
12 addition of new services, during the term of the Renewed Price Cap Plan and until such
13 time as the Commission approves a new or modified Plan or terminates the Renewed Price
14 Cap Plan.

15
16 The Parties agree that Qwest shall be granted the opportunity to increase its revenue
17 through limited price changes during the terms of the Renewed Plan. The revenue
18 increases shall be derived from Baskets 2 and 3.

19
20 In Year 1 of the Plan, the allowable net increase in revenues resulting from price changes¹
21 shall not exceed \$31.8 Million, allocated between Baskets 2 and 3 of the Plan.

22

¹ The phrase "net increase in revenues resulting from price changes" recognizes that reported revenues can change due to two factors; changes in volumes and changes in prices. Because the Renewed Price Cap Plan sets a limit on the revenue increase allowed in Basket 2 and 3 from changes in prices during each Plan year, this phrase is intended to indicate that any net price changes implemented by Qwest cannot result in greater net revenues than the allowed limit.

1 In Year 2 of the Plan, and in subsequent years in which the Plan is in effect, Qwest will be
2 allowed to implement net price changes for services in Baskets 2 and 3 that increase annual
3 revenues no more than \$43.8 Million (which represents the \$31.8 Million Revenue
4 Deficiency plus \$12.0 Million to offset the Switched Access Charge reduction in Basket 4).

5
6 Qwest will implement the following additional consumer benefits. The benefits identified
7 will total approximately \$5.5 Million dollars.

8
9 - Reduction in Zone Charges: The current Zone 1 charge of \$1.00 will be reduced to
10 \$0.50. The current Zone 2 charge of \$3.00 will be reduced to \$1.50.

11
12 - Reduction to Non-Published and Non-Listed Telephone Number Rates: The current
13 rate of \$1.65 for residential non-published numbers shall be reduced to \$1.15. The
14 current rate of \$1.30 for residential non-listed numbers shall be reduced to \$0.80.

15
16 - Increase in Funding for the Telephone Assistance Plan for the Medically Needy:
17 Qwest shall increase its current \$1.0 Million annual funding of the Telephone
18 Assistance Plan for the Medically Needy ("TAP"), which was established by the
19 Commission in Decision 57462, dated July 15, 1991, to a total of \$2.0 Million
20 annually.

21 Directory Assistance will be capped at its existing rate of \$1.15 per call, which shall
22 include: (a) the current one call allowance per month without charge, (b) two inquiries per
23 usage, and (c) call completion.

24
25 Qwest shall increase the current Line Extension Allowance from \$3,000 to \$5,000.

1 The term of Qwest's Renewed Price Cap Plan shall be for a period of three years from the
2 effective date specified by the Commission in its Order approving this Agreement and
3 Renewed Price Cap Plan.

4
5 Qwest shall withdraw its request for \$64 Million of Arizona Universal Service Fund
6 ("AUSF") support.

7
8 The Parties agree that Qwest has met the criteria for deregulation of both Voice Mail
9 Service and Billing and Collection Services.

10
11 Qwest shall be allowed to introduce promotional offerings upon one (1) day prior notice to
12 the Commission.

13
14 Qwest may include packaged offerings in Basket 3 under the Renewed Price Cap Plan
15 subject to the conditions that each of the individual elements of packages must be available
16 on an ala carte basis in Baskets 1, 2 or 3.

17
18 Qwest shall withdraw its proposal for competitive zones in Arizona.

19
20 Qwest shall no longer be required to file the deposit calculation report or the PAL line
21 report as currently required under Decision Nos. 57911 and 55817.

22
23 Qwest will dismiss the Consolidated Appeals following the issuance of a Commission
24 Order approving this Settlement Agreement.

25

1 **SECTION 8: SWITCHED ACCESS REDUCTIONS**

2 **Q. Can you briefly explain the meaning of Switched Access?**

3 A. Switched Access charges are the historical means by which local exchange companies have
4 been compensated by interexchange carriers (“IXCs”) for the benefits received for use of
5 the local exchange network. Over time, the FCC has changed the interstate Switched
6 Access charge minute of use (“MOU”) methodology to one that is now in part seen on all
7 end-user bills as a fixed subscribe line charge (“SLC”). An SLC results in all end-users
8 paying for the equivalent ability to access interexchange services whether those services
9 are used or not.

10

11 **Q. Describe Staff’s understanding of this section of the Settlement Agreement?**

12 A. Staff believes that a reduction in intrastate Switched Access charges is warranted. By such
13 a reduction, the IXC end-user will hopefully experience a reduction in their intrastate per
14 minute rate. The settlement figure of \$12.0 Million is a compromise figure reached during
15 the settlement process. It differs only slightly from the reduction originally recommended
16 by Staff. The impact of the \$12.0 Million reduction is revenue neutral and described
17 further in section 10 of the Settlement Agreement. The impact of this reduction and its
18 inclusion in the pricing flexibility granted to Qwest should benefit long distance users and
19 long distance providers.

20

21 Staff, in its prefiled testimony, recommended that intrastate Switched Access charges be
22 reduced by \$8.9 Million as proposed by Staff Witness Regan. For the reasons given in Mr.
23 Regan’s testimony, Staff recommended that Qwest be able to recover the revenue loss due
24 to any Switched Access charge reductions.

25

1 **Q. What is the goal of the Commission regarding Switched Access?**

2 A. The goal of the Commission in the current Price Cap Plan is to ensure that the intrastate
3 Switched Access is at parity with interstate Switched Access.
4

5 **Q. Will the proposed access charge reduction in this agreement accomplish this goal?**

6 A. No, but as I stated earlier this is a compromise.
7

8 **Q. What was the position taken by the interexchange carriers?**

9 A. Initially, the IXCs wanted intrastate Switched Access to be at parity with interstate
10 Switched Access, but as I mentioned earlier the \$12.0 Million figure is a compromise.
11

12 **Q. What was Qwest's position on the reduction?**

13 A. Qwest is not opposed to such a reduction as long as it is revenue neutral.
14

15 **Q. In its prefiled testimony, did Qwest advocate for a certain method of recovery?**

16 A. Yes. Qwest wanted to mirror the recovery method utilized at the Federal level which
17 would be a state SLC.
18

19 **Q. Is Staff in agreement with Qwest?**

20 A. Staff does not support the concept of an intrastate end-user line charge to recover revenues
21 lost through reductions in Switched Access charges.
22

1 **SECTION 9: SPECIAL ACCESS REDUCTIONS**

2 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

3 A. Special Access reductions have been included in this Plan to deal with intrastate Special
4 Access issues important to CLECs. These reductions, however, do not in any way change
5 the Revenue Deficiency associated with this Settlement Agreement. Staff was a party to
6 negotiations that resulted in the Special Access reductions and is satisfied that this
7 provision is fair and reasonable.

8
9 **Q. How does this provision differ from Staff's original position?**

10 A. Special Access appeared initially to be of exclusive interest to only one CLEC, Time
11 Warner Telecom. Ultimately, the issue became of importance to another CLEC participant
12 as well, XO. Staff also noted that the issues concerning Special Access were related to the
13 FCC's interstate Special Access tariffs that had yielded unexpected market results. As
14 such, initially intrastate Special Access tariffs did not appear to Staff to be the dominant
15 issue and, therefore, not relevant to the renewal of Qwest's Price Cap Plan. For those
16 reasons, Staff did not take an initial position on Special Access in its testimony.

17
18 **SECTION 13: ADDITIONAL CONSUMER BENEFITS**

19 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

20 A. This section of the Agreement addresses three areas of benefit to Arizona's end-users:
21 (1) Zone Charges
22 (2) Non-Published and Non-Listed Telephone Number Rates
23 (3) Telephone Assistance Plan (TAP) for the Medically Needy

24

1 **Q. What are Zone Charges**

2 A. These are charges that apply to customers outside the base rate areas of given exchanges.
3 Zone charges are supposed to recover additional costs of providing service in high cost
4 areas.

5
6 Currently, customers in retail Zone 1 and Zone 2 of Qwest's Arizona wire centers incur
7 additional charges over and above the basic 1FR and 1FB service because of the so called
8 mileage charges.

9
10 **Q. Did Qwest propose to eliminate the zone charges in its original application?**

11 A. Yes.

12
13 **Q. In Staff's prefiled testimony what was Staff's position?**

14 A. Staff was opposed to such elimination, because it would increase the overall revenue
15 deficiency of the Company.

16
17 **Q. Please describe why Staff believes the reduction of Zone Charges is a benefit to end-
18 users?**

19 A. In Staff's opinion, a reduction in zone charges is a benefit since any type of reduction to
20 basic rates is a benefit to end-users.

21
22 **Q. How many customers will benefit from this change?**

23 A. A reduction in Zone 1 and Zone 2 charges of \$0.50 and \$1.50, respectively, will benefit
24 approximately [CONFIDENTIAL] total customers, comprised of approximately
25 [CONFIDENTIAL] residential customers and [CONFIDENTIAL] business customers.

1 **Q. Please describe Non-Published and Non-Listed Telephone Number services.**

2 A. As part of basic local exchange service, end-users are entitled to listings in the white pages
3 and directory assistance, in accordance with the Company's local exchange tariffs. The
4 two services provide slightly different levels of listing privacy. Non-Published service
5 removes the name, address and phone numbers of subscribers from all of Qwest's listings
6 services. Non-Listed services removes the name, address and phone number from the
7 white pages directory but does provide it via directory assistance.

8
9 **Q. How many customers will benefit from this reduction in rates?**

10 A. A reduction of Non-Published and Non-Listed Telephone Number rates by \$0.50 is
11 estimated to benefit approximately [CONFIDENTIAL] Non-Published and
12 [CONFIDENTIAL] Non-Listed customers.

13
14 **Q. Please describe the Telephone Assistance Plan (TAP) for the Medically Needy.**

15 A. The TAP for the Medically Needy is self-descriptive. The intent is to support end-users
16 with medical needs when they are unable to pay for basic local exchange service.

17
18 **Q. Currently, how many individuals will benefit from this program change?**

19 A. Based on the information provided to Staff on a quarterly basis, by DES, the number of
20 individuals in this program are about 11,000.

21
22 An increase in funding for the Telephone Assistance Plan for the Medically Needy is a
23 major benefit in this Plan. Most significant are the \$1 Million annual funding increase by
24 Qwest and the public awareness plan intended to raise the utilization and effectiveness of
25 TAP for the Medically Needy. Participation levels may rise to approximately 16,000

1 customers annually from this program change. Staff Witness Smith will address this issue
2 in more detail in his testimony.

3
4 **Q. What is the value of the benefit to the end-users?**

5 A. Based on Staff's calculations, the reduction in Zone Charges, the reduction in Non-Listed
6 and Non-Published Telephone Number services, and the increase in the Medically Needy
7 or TAP program amounts to approximately \$5.5 Million in consumer benefits broken down
8 as follows:

9
10 Zone 1 & 2 reduction \$2.0 Million (approximate)
11 Non-Pub/Non-List \$2.5 Million (approximate)
12 Medically Needy \$1.0 Million (approximate)

13 The 5.5 million in consumer benefits would be roughly equivalent to retention of the 4.2 %
14 productivity factor applied to new Basket 1 services.

15
16 **Q. Do the consumer benefits identified above benefit all end-users?**

17 A. The reduction to rates for Non-Published and Non-Listed Telephone Number services have
18 the potential to benefit all end-users. The increase in funding for the Medically Needy or
19 TAP program and reduction of Zone Charges will benefit particular groups of customers.

20
21 **Q. Are there other benefits to all end-users under the Plan?**

22 A. Yes. Under the Plan, basic local rates for residential and business customers will not
23 increase beyond their current levels for at least another 3 years. Like the terms of the last
24 Plan, these services will be hard-capped for the duration of the Plan. I believe this is a
25 significant benefit to all residential and business end-users.

1 Under the prior plan, Qwest did not apply any of the productivity inflation reductions to
2 basic local service rates. Thus the productivity/inflation offset did not benefit all end-users
3 under the prior plan. Further, a 5.5 Million productivity/inflation offset would amount to a
4 de minimis reduction in local exchange rates.

5

6 **SECTION 14: DIRECTORY ASSISTANCE**

7 **Q. Did Qwest propose the elimination of the one free call allowance for Directory**
8 **Assistance in its Application?**

9 A. Yes.

10

11 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

12 A. This Settlement Agreement caps, for the term of this Plan, calls to Directory Assistance at
13 \$1.15 per month and maintains the current one call per month allowance. Key features of
14 two inquiries per month and call completion remain unchanged. This element of the
15 Agreement is a clear benefit to all local exchange end-users that utilize DA.

16

17 **Q. How does this provision differ from Staff's original position?**

18 A. This section is consistent with Staff's original position. Staff did not support the
19 elimination of the one free Directory Assistance call per month allowance as requested by
20 Qwest in its Application.

21

1 **SECTION 18: EXTENSION, REVISION AND TERMINATION OF THE PRICE CAP**
2 **PLAN**

3 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

4 A. As outlined in section 17, the term of the Plan is three years from the effective date the
5 Commission order and until the Commission approves a renewed or revised plan or
6 terminates the existing Plan. Section 18 provides that at least 9 months prior to the
7 expiration of the Plan, Qwest may initiate proceedings before the Commission to extend,
8 revise or terminate the Price Cap Plan. This section imposes an obligation on Qwest to
9 seek Commission approval of an extension, revision or termination the Plan. In addition,
10 Qwest must provide certain information to Staff to help Staff evaluate and make
11 appropriate recommendations to the Commission. This section also clarifies that Qwest is
12 to serve all Parties to this Agreement a copy of its Application. Finally, this section
13 clarifies the terms and conditions under which Qwest must file a rate case under A.A.C.
14 R14-02-103.

15
16 **Q. How does this provision differ from Staff's original position?**

17 A. Staff's original position is consistent with the provisions of the Settlement Agreement.
18

19 **SECTION 19: UNIVERSAL SERVICE**

20 **Q. Please describe your understanding of Qwest's original position in its Application on**
21 **AUSF?**

22 A. In its original Application, Qwest proposed to recover \$64 Million from the Arizona
23 Universal Services Fund ("AUSF"). Qwest's proposal would have been borne by all
24 Arizona telephone subscribers.
25

1 **Q. How is Qwest's request addressed in the Settlement Agreement?**

2 A. Under the Agreement, Qwest agrees to withdraw its request to recover \$64 Million from
3 the AUSF.

4 **Q. How does this provision differ from Staff's original position?**

5 A. Staff disagreed with Qwest's proposal to recover \$64 Million from the Arizona Universal
6 Service Fund (AUSF). Staff believed that use of AUSF funds amounted to an indirect rate
7 increase of many millions of dollars which all Arizona telephone customers would have to
8 pay.

9
10 **SECTION 24: NOTICE TO CONSUMERS**

11 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

12 A. This section establishes timeframes, processes and various requirements on Qwest with
13 respect to customer notice. Consistent with Commission policy, rules and regulations,
14 Staff believes that consumers must be notified of any and all changes to the Company's
15 rates, terms and conditions. This section ensures that processes are in place to ensure
16 timely notice to customers of Plan information and that Staff will have advance notice of
17 any proposed consumer communication so that it may review and comment on same.

18
19 More specifically, this section clarifies when (following Commission approval) notice to
20 consumers regarding this agreement must take place and how (in two subsequent bills)
21 notice to consumers regarding this agreement must take place.

22
23 Customers ordering packages with choices that result in higher prices than a la carte prices
24 is of concern to Staff. This section addresses that concern. In accordance with this section,

1 customers ordering Qwest packages should be notified if their package choices could be
2 purchased at a lower price on an a la carte basis.

3
4 This section clarifies how and when Qwest shall work with DES to ensure communication
5 of directory assistance services for the Special Needs Program.

6
7 Finally, this section clarifies that pursuant to Decision No. 662304, Qwest will remain
8 obligated through its contractual arrangements with DEX to continue to provide
9 information in the red "Phone Service Pages" highlighting the availability of the Special
10 Needs Program.

11
12 **Q. How does this provision differ from Staff's original position?**

13 A. While this subject was not addressed in Staff's earlier testimony, some of these issues were
14 addressed in the last settlement agreement. Staff added clarity to the provisions of the prior
15 settlement agreement where needed.

16
17 **SECTION 26: QWEST COMPETITIVE ZONE PROPOSAL**

18 **Q. What was Qwest's position in its original Application with respect to Competitive**
19 **Zones?**

20 A. In its original Application, Qwest proposed to establish competitive zones to afford it
21 pricing flexibility within geographic areas.

22

1 **Q. How are competitive zones addressed in the Settlement Agreement?**

2 A. As part of the overall Settlement Agreement, Qwest has withdrawn its application for
3 competitive zones and will not renew its application for competitive zones during the term
4 of this Plan.

5
6 **Q. How does this provision differ from Staff's original position?**

7 A. Staff indicated in its testimony that it is appropriate for the Plan to recognize the changing
8 competitive conditions in Qwest's service territory, and where warranted, to allow Qwest
9 additional pricing flexibility. While Staff did not agree with Qwest's competitive zone
10 proposal as set forth in Qwest's Application and testimony, Staff did propose alternatives
11 for considering the subject of competitive zones. At this point, the Parties have agreed that
12 the Renewed Plan provides sufficient flexibility to Qwest, so that competitive zones are no
13 longer a consideration at this time.

14

15 **SECTION 27: ELIMINATION OF CERTAIN REPORTING REQUIREMENTS**

16 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

17 A. Pursuant to Commission Decisions 57911 and 55817 Qwest was required to provide
18 information or reports to the Commission concerning deposit calculation and PAL lines.
19 This provision of the Settlement Agreement would eliminate the requirement for Qwest to
20 provide these reports in the future. Based upon the reasons set forth in Staff's prefiled
21 testimony, Staff agrees that there is no longer a need for these reporting requirements and
22 that they should be eliminated.

23

1 **SECTION 28: DISMISSAL OF CONSOLIDATED APPEALS**

2 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

3 A. In this section of the Agreement, Qwest agrees to dismiss the two pending court appeals of
4 Commission decisions Nos. 66772 and 67047, contingent on the Commission's approval of
5 the Settlement Agreement. Qwest does not waive its rights to present certain arguments in
6 the event the Agreement is disturbed by a court order or Commission order.

7
8 **Q. How does this provision differ from Staff's original position?**

9 A. Staff have always believed that dismissal of the two pending appeals by Qwest was critical
10 in achieving a settlement in this case.

11
12 **SECTION 29: GENERAL RATE CHANGE MORATORIUM**

13 **Q. Describe Staff's understanding of this section of the Settlement Agreement?**

14 A. This section emphasizes no parties shall file an application for, or complaint seeking an
15 adjustment in Qwest's general rates and charges that would be effective during the term of
16 the renewed Price Cap Plan. However, challenges may be brought regarding compliance
17 with A.A.C. R14-02-1109 or R14-02-1310, or concerning the lawfulness of any wholesale
18 or competitive rate.

19
20 **Q. How does this provision differ from Staff's original position?**

21 A. This subject was not addressed in Staff's earlier testimony, however a similar provision
22 was contained in the last AFOR settlement agreement. The Parties have added some
23 important clarification to this provision which Staff supports.

24

1 **SUMMARY AND CONCLUSIONS**

2 **Q. Describe Staff's understanding of the overall Settlement Agreement?**

3 A. Staff and all parties to this Agreement have devoted considerable time, resources and effort
4 to reach a conclusion that is fair and reasonable. All parties have acknowledged their
5 acceptance of this Agreement, reached through open and frank discussions.

6
7 **Q. Do you believe that this Agreement is in the public interest?**

8 A. Yes. The Settlement Agreement reflects the negotiated resolution of all contested issues in
9 this Docket and has widespread support from all active Parties to this Docket, except for
10 one. It reflects a careful balancing of the interests of the various Parties involved. It allows
11 Qwest added pricing flexibility for its more competitive services, giving it the ability to
12 more effectively respond to competition. It is fair and beneficial to consumers in that it
13 once again ensures that basic residential and business local rates will not increase beyond
14 existing levels for another 3 years. Additional consumers benefits are contained in the
15 Agreement pertaining to the reduction of zone charges, an increase to funding for the
16 Medically Needy or TAP Program and a reduction in rates for Non-Listed and Non-
17 Published Telephone Number services. Consumers will also directly benefit from
18 provisions relating to Directory Assistance and Line Extension Charges. All parties,
19 including consumers, also benefit by Qwest's dismissal of the Consolidated Appeals.
20 Overall, Staff is satisfied that the Agreement is in the public interest and it recommends
21 that the Commission adopt it.

22

23 **Q. Does this conclude your direct testimony?**

24 A. Yes, it does.

ROWELL

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
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

SUPPLEMENTAL

TESTIMONY

OF

MATTHEW ROWELL

CHIEF ECONOMIST

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

SEPTEMBER 6, 2005

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**EXECUTIVE SUMMARY
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

My testimony describes the following section of the proposed Settlement Agreement filed on August 24, 2005:

- Section 7: April 1, 2005 Productivity Adjustment
- Section 12: Price Cap Plan
- Section 17: Term of Plan
- Section 20: Imputation and Price Floor Proceeding
- Section 21: Deregulation of Voice Mail Services and Billing and Collection Services
- Section 22: Promotional Offerings
- Section 23: Packaged Offerings

1 **I. Introduction**

2 **Q. Please state your name and business address for the record.**

3 A. My name is Matthew Rowell. My business address is: Arizona Corporation Commission,
4 1200 W. Washington St., Phoenix, Arizona 85007.

5
6 **Q. What is your position at the commission?**

7 A. I am the Chief of the Telecommunications and Energy section of the Commission's
8 Utilities Division.

9
10 **Q. Please describe your education and professional background.**

11 A. I received a BS degree in economics from Florida State University in 1992. I spent the
12 following four years doing graduate work in economics at Arizona State University where
13 I received a MS degree and successfully completed all course work and exams necessary
14 for a Ph.D. My specialized fields of study were Industrial Organization and Statistics.
15 Prior to my Commission employment I was employed as a lecturer in economics at
16 Arizona State University, as a statistical analyst for Hughes Technical Services, and as a
17 consulting research analyst at the Arizona Department of Transportation. I was hired by
18 the Commission in October of 1996 as an Economist II. I was promoted to the position of
19 Senior Rate Analyst in November of 1997 and to Chief Economist in July of 2001. In my
20 current position I am responsible for supervising nine professionals who work on a variety
21 of telecommunications and energy matters.

22
23 **Q. What is the purpose of your testimony?**

24 A. My testimony will explain certain sections of the proposed Settlement Agreement entered
25 into by many of the parties to this case which was filed on August 23, 2005 ("the
26 Agreement.") Specifically I will address the following sections of the agreement:

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Section 7: April 1, 2005 Productivity Adjustment
Section 12: Price Cap Plan
Section 17: Term of Plan
Section 20: Imputation and Price Floor Proceeding
Section 21: Deregulation of Voice Mail Services and Billing and Collection Services
Section 22: Promotional Offerings
Section 23: Packaged Offerings

II. Section 7: April 1, 2005 Productivity Adjustment

Q. Please explain why the parties to the settlement believed it was necessary to account for the April 1, 2005 Productivity Adjustment?

A. The currently effective Price Cap Plan calls for annual revenue adjustments based on a productivity/inflation adjustment factor. That adjustment would have amounted to \$12 million had it been made this past April 1. However, the Commission's Decision No. 67734 suspended the productivity adjustment for April 2005 and obligated Qwest to demonstrate that final rates approved in the Renewed Price Regulation Plan docket result in ratepayers receiving the full value of the suspended April 2005 adjustment.

Q. How does the Settlement account for the suspended April 1, 2005 Productivity Adjustment?

A. The Settlement provides that \$12 million will be deducted from the allowable revenue increases during the first year of the plan.

Q. How will this \$12 million deduction be allocated among the Baskets?

A. All of the \$12 million will be deducted from the revenue increase associated with Basket 2.

1 **III. Section 12: The Price Cap Plan**

2 **Q. Please briefly summarize the changes to the Price Cap Plan agreed to by the parties.**

3 A. The most significant change contained in the Proposed Price Cap Plan ("Plan") is the
4 elimination of the annual productivity adjustment. Additionally under the Agreement the
5 "basket" structure of the plan and the rules governing price changes have been revised.
6

7 **Q. Please summarize the provisions of Qwest's current price regulation plan.**

8 A. In Decision No. 63487 (March 30, 2001) the Commission approved an alternative form of
9 regulation ("AFOR") plan for Qwest. The AFOR divided Qwest's services in to three
10 baskets:

- 11 • Basket 1: Basic/Essential Non-Competitive Services
- 12 • Basket 2: Wholesale Services
- 13 • Basket 3: Flexibly-Priced Competitive Services

14 **Basket 1**

15 The weighted average price level ("Price Index") of all services contained in Basket 1 is
16 capped using an annual inflation/productivity adjustment factor (described in detail
17 below.) On an annual basis Qwest adjusted prices in Basket 1 to account for the effect of
18 the inflation/productivity adjustment. Prices for many services could be adjusted up or
19 down with 30 days notice (but increases were capped at 25% per year.) Certain basic
20 services in Basket 1 have "hard caps," that is, their prices can not increase (but they can
21 decrease.) Individual service prices must exceed Total Service Long Run Incremental
22 Cost ("TSLRIC") and comply with the imputation requirements of A.A.C. R14-2-
23 1310(C).

24 **Basket 2**

25 Basket 2 contains wholesale services such as access charges, PAL lines, and Unbundled
26 Network Elements ("UNEs"). Many of these services are governed by their own specific

1 pricing rules and those rules continued during the term of the AFOR. Intrastate switched
2 access rates were to reduce by \$5 million per year during the initial term of the plan.

3 **Basket 3**

4 Basket 3 includes services that have been accorded pricing flexibility or have been
5 determined to be competitive under A.A.C. R14-2-1108. The Basket 3 price cap index
6 was set at the then existing revenues from Basket 3 services plus 13.4% and was adjusted
7 upwards by \$5 million a year to account for the access charge reductions. New services
8 could be placed in Basket 3; however, the Commission can require a different
9 classification. New services are filed as tariff filings. Packages of services from Basket 1
10 and Basket 3 need to be filed for review by Staff, pursuant to A.A.C. R14-2-1108. The
11 price of a Basket 3 service or service package must exceed the TSLRIC of the service or
12 package and comply with the imputation requirements of A.A.C. R14-2-1310(C).

13
14 **Q. Please summarize the provisions of the revised Plan agreed to by the parties to the**
15 **Agreement.**

16 **A.** The revised plan agreed to by the parties divides Qwest's services into four baskets:

- 17 • Basket 1: Hard Capped Retail Services
- 18 • Basket 2: Limited Pricing Flexibility Retail Services
- 19 • Basket 3: Flexibly-Priced Competitive Services
- 20 • Basket 4: Wholesale Services

21 Under the current plan, Basket 1 contains both basic services that are hard capped and
22 other services that have a 25% annual cap on price increases. Essentially, the proposed
23 plan gives each of these two classes of services their own basket. The parties believed that
24 separating these two classes of service into two different baskets would make the plan
25 more straightforward and easier to understand. The pricing rules for each of the baskets
26 follow:

1 **Basket 1:** The prices of Basket 1 services are hard capped, that is they can not be
2 increased during the term of the Plan. Any changes to the terms and conditions of Basket
3 1 services must be approved by the Commission.

4 **Basket 2:** The prices of Basket 2 services may not be increased by more than 25% in any
5 12 month period. Any changes to the terms and conditions of Basket 2 services must be
6 approved by the Commission. Prior to increasing the price of any Basket 2 service Qwest
7 must comply with the requirements of A.A.C. R14-2-1109 and 1110. A.A.C. R14-2-1110
8 requires that companies receive Commission approval before increasing the maximum
9 rate for a service and sets out the information companies seeking such an increase are
10 required to file with the Commission. The Plan also requires Qwest to provide at least 30
11 days notice to its customers of any price increase.

12 **Basket 3:** There is no cap on individual price increases for Basket 3 services. However,
13 prior to increasing the maximum rate of any Basket 3 service, Qwest must comply with
14 the requirements of A.A.C. R14-2-1109 and 1110. A.A.C. R14-2-1110 requires that
15 companies receive Commission approval before enacting any increase to the maximum
16 rate for a service and sets out the information companies seeking such an increase are
17 required to file with the Commission.

18 **Basket 4:** Basket 4 is made up of wholesale services that are governed by their own
19 specific pricing rules. For example, rates for Unbundled Network Elements (“UNEs”) are
20 established by the Commission based on the provisions of the Telecommunications Act of
21 1996 and FCC rules. Wholesale service prices are capped at the tariff or contract levels
22 for the term of the plan or until contracts are renegotiated or the FCC, the Commission, or
23 the courts determine that other prices are appropriate.
24

1 **Q. With respect to Basket 3, please discuss the provisions of the Plan other than the**
2 **pricing provisions discussed above.**

3 A. The Plan provides that service packages will be included in Basket 3 subject to two
4 conditions: (1) that the individual services in those packages will still be available as
5 individual service and (2) that the price of any package shall not exceed the sum of the
6 highest prices of the individual services in the package. Should Qwest introduce a new
7 package containing Basket 1 and Basket 2 services it is required to inform its customers,
8 through its marketing of such packages that the services in Basket 1 and 2 remain
9 available as separate services. New services will be Basket 3 services subject to
10 Commission consideration of the tariff filing introducing such services.

11
12 **Q. The proposed Plan does not include a productivity/inflation adjustment factor.**
13 **Please discuss Staff's rationale for agreeing to the elimination of the**
14 **productivity/inflation adjustment factor.**

15 A. Staff did not support the continuation of the productivity/inflation adjustment factor in its
16 direct case. In my testimony filed in this case on November 18, 2004, Staff's rationale for
17 agreeing to eliminate the productivity/inflation adjustment factor was discussed. Staff's
18 research indicated that most states had abandoned the use of productivity/inflation
19 adjustment factors. Additionally, I testified as follows:

20
21 "At the time that the initial price cap plan was implemented, Qwest had been
22 operating in an environment where it had limited competition and little incentive to
23 increase its efficiency in the provision of services. In addition, Qwest was not
24 subject to competition in its core business to the extent that it is today. Staff's
25 analysis of Qwest's financial and competitive information suggests that Qwest is
26 losing lines and revenues as a result of that competition. Given the line and

1 revenue losses that Qwest has experienced recently Staff does not believe a
2 productivity adjustment is appropriate. In an environment where revenues are
3 growing a productivity adjustment may be appropriate to provide incentives to the
4 company to operate efficiently. However, in an environment where revenues are
5 declining imposing such incentives should not be necessary.”¹
6

7 **Q. Is Staff aware of any changes regarding productivity/inflation adjustment factors**
8 **that have occurred since Staff’s direct testimony was filed?**

9 A. Yes. In my direct testimony Utah was listed as one of the few states that still employs a
10 productivity/inflation adjustment factor. As of May of this year Qwest has been largely
11 deregulated in Utah and is no longer subject to a productivity/inflation adjustment factor
12 there.
13

14 **Q. How will the opportunity for price increases be allocated between the various**
15 **baskets?**

16 A. For Year 1, the overall net revenue increase resulting from price changes shall not exceed
17 \$31.8 Million. That \$31.8 Million shall be allocated as follows: any amount up to \$1.8
18 Million shall be allocated to Basket 2 (\$13.8 Million less \$12.0 Million to account for the
19 April 1, 2005 reduction) and the remainder shall be allocated to Basket 3.
20

21 For Year 2, and for subsequent years in which the Renewed Price Cap Plan is effective,
22 the overall net revenue increase from price changes shall not exceed \$43.8 Million. That
23 \$43.8 million shall be allocated as follows: any amount up to \$13.8 Million shall be
24 allocated to Basket 2 and the remainder shall be allocated to Basket 3. All revenue
25 increases are relative to current revenue levels.

¹ Direct Testimony of Matthew Rowell filed November 18, 2004, Page 11, Line 15.

1 **Q. What sort of informational filings does the Plan require of Qwest?**

2 A. Each time Qwest makes a change in a Basket 2 or 3 service's price, Qwest will provide to
3 Staff, in electronic form, an Excel spreadsheet that is a database of the prices and
4 quantities of each service in Baskets 2 and 3 for which Qwest has proposed a price change
5 during the term of the Renewed Price Cap Plan. The spreadsheet will include the formula
6 for calculating the net change in revenues resulting from the price change for Baskets 2
7 and 3. The spreadsheet format should enable Staff to instantaneously observe the effect of
8 the price change.

9
10 A spreadsheet for each Basket will be updated with each price change throughout the year,
11 cumulatively, in order to calculate the net change in revenues resulting from the price
12 change. The calculated net change in revenues resulting from price changes for each
13 Basket shall remain at or below the Basket's authorized additional revenue level as
14 discussed above, in order for rate changes to be considered lawful upon filing. The
15 spreadsheet shall be equipped with the formula that enables instantaneous verification that
16 a price change by Qwest is within the prescribed cap.
17

18 These filing requirements will allow Staff to ensure that Qwest's proposed price changes
19 will not result in revenues that exceed the caps described above.
20

21 **Q. What will happen when the three year term of the Plan comes to an end?**

22 A. Qwest must propose to continue, revise or terminate the Plan by submitting an application
23 to the Commission at least 9 months prior to the expiration of the Plan. If Qwest's
24 proposal would increase its Arizona regulated revenues by more than a de minimis
25 amount, Qwest must file a rate case under A.A.C. R-14-2-103.
26

1 **IV. Section 17: Term of the Plan**

2 **Q. What is the term of the Plan?**

3 A. The term of the Plan shall be three years from the effective date of the Plan. The Plan
4 shall continue until the Commission approves a renewed or revised plan or until it is
5 terminated by the Commission.
6

7 **V. Section 20: Imputation and Price Floor Proceeding**

8 **Q. Section 20 of the Agreement provides that the generic docket instituted to investigate**
9 **the Commission's rules on imputation and price floors (Docket No. RT-00000J-01-**
10 **0407) shall be closed. Please explain why Staff agreed to this provision.**

11 A. The generic docket was opened as a result of the last price cap proceeding. During that
12 case certain parties argued that the Commission's rules on imputation and price floors
13 needed to be reviewed and possible revised. No party to the current case, however, took
14 the position that there is a problem with the Commission's rules on imputation and price
15 floors. Additionally, the parties who advocated that the generic docket be opened during
16 the last case were not able to articulate what they believed to be the problem at that time.
17 Further, Staff is not aware of any problems or complaints concerning imputation or price
18 floor issues that have arisen during the term of the current Price Cap Plan.
19

20 **VI. Section 21: Deregulation of Voice Mail Service and Billing and**
21 **Collection Service**

22 **Q. The Agreement calls for Qwest's voice mail and billing and collection services to be**
23 **deregulated. Why did Staff agree that these services should be deregulated?**

24 A. Staff's agreement to support deregulation of these services is consistent with Staff's
25 position in our filed case. In my Direct Testimony in this case, I indicated that Staff
26 supported Qwest's request to deregulate voice mail and billing and collections ("B&C")

1 services. In our investigation of Voice Mail Services we found that voice messaging
2 service is not essential and integral to basic telephone service, that it is discrete and
3 separable from the public switched telephone network and that it is subject to private
4 contracts. These findings lead Staff to recommend that the Commission grant Qwest's
5 petition to deregulate voice messaging service. Similarly, Staff found that B&C service is
6 not essential and integral to the provision of telephone service. The B&C services
7 provided by Qwest can be used by both IXCs and CLECs. However, Staff found that
8 most IXCs and CLECs do not use Qwest's B&C services and that all IXCs and CLECs
9 have alternatives to Qwest's B&C services.
10

11 **VII. Section 22: Promotional Offerings**

12 **Q. Section 22 of the Agreement provides that Qwest shall be allowed to offer**
13 **promotional offerings upon one day notice to the Commission. Why did Staff agree**
14 **to this provision?**

15 A. This provision of the Agreement is consistent with Staff's recommendation in its filed
16 case. Staff recognized that many of Qwest's competitors are allowed to offer promotions
17 on very short notice. Providing Qwest similar flexibility will allow Qwest to compete
18 more effectively.
19

20 **VIII. Section 23: Packaged Offerings**

21 **Q. Section 22 of the Agreement provides that packages containing Basket 1 and 2**
22 **services can be included in Basket 3. Why did Staff agree to this provision?**

23 A. In my Direct Testimony in this case, I indicated that Staff would support placing all
24 packages in Basket 3 as long as the services in the package are available individually and
25 as long as the price of the package does not exceed the individual prices of the services in

1 the package. The provisions of Section 22 of the Agreement are consistent with the
2 conditions discussed in my Direct Testimony.

3

4 **Q. Does this conclude your direct testimony?**

5 A. Yes, it does.

D. SMITH

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

SUPPLEMENTAL
TESTIMONY
OF
DEL SMITH
UTILITIES ENGINEER SUPERVISOR
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION

SEPTEMBER 6, 2005

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EXECUTIVE SUMMARY
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672

My Supplemental Testimony in support of the proposed Settlement Agreement is organized into three sections. The first section addresses service quality and the customer benefits from revisions to Qwest's Service Quality Plan Tariff. Section two discusses benefits that will result from an increase in funding to the Telephone Assistance Plan for the Medically Needy. In the third section I address consumer benefits that will be derived from an increase in the share of rural construction charges that the Company is responsible for.

The result of the changes to Qwest's Service Quality Plan Tariff that Staff proposed in this case, and which were adopted in the Settlement Agreement, provide an important continuing incentive to Qwest to maintain the service quality levels it has achieved which provides a direct benefit to customers.

The funding level for the Telephone Assistance Plan for the Medical Needy has not been increased since the inception of the program in 1991. New enrollments in the program have had to be restricted due to the level of current funding. The Settlement Agreement provides for an increase in funding of \$1 million annually so that that additional qualified applicants may be assisted and participate in the program.

The cost to extend new facilities may preclude a rural customer from being able to have basic phone service established. Consistent with Staff's testimony in this matter, the Settlement Agreement provides for an increase in Qwest's pro rata share of Rural Construction Charges from \$3,000 to \$5,000 to further promote telephone subscribership and public safety.

1 **INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Del Smith. My business address is 1200 West Washington Street, Phoenix,
4 Arizona 85007.

5
6 **Q. Are you the same Del Smith who previously submitted prepared Direct and**
7 **Surrebuttal Testimony in this Docket?**

8 A. Yes. My qualifications and work experience were provided in my Direct Testimony.

9
10 **Q. What is the purpose of your Supplemental Testimony in this case?**

11 A. I am filing this testimony in support of the Proposed Settlement Agreement offered by the
12 parties. My Supplemental Testimony addresses those portions of the Settlement
13 Agreement that relate to retail service quality, the Telephone Assistance Plan for the
14 Medical Needy and rural construction charges. I provide an explanation of the consumer
15 benefits associated with these elements of the Settlement Agreement.

16
17 **SUMMARY OF TESTIMONY**

18 **Q. Briefly discuss how your Supplemental Testimony is organized.**

19 A. My Supplemental Testimony in support of the proposed Settlement Agreement is
20 organized into three sections. The first section addresses service quality and the customer
21 benefits from revisions to Qwest's Service Quality Plan Tariff. Section two discusses
22 benefits that will result from an increase in funding to the Telephone Assistance Plan for
23 the Medically Needy. In the third section I address consumer benefits that will be derived
24 from an increase in the share of rural construction charges that the Company is responsible
25 for.

26

1 **Q. Please summarize your Supplemental Testimony as it pertains to service quality.**

2 A. The changes to Qwest's Service Quality Plan Tariff that Staff proposed in this case, and
3 which were adopted in the Settlement Agreement, provide an important continuing
4 incentive to Qwest to maintain the service quality levels it has achieved which provides a
5 direct benefit to customers.

6
7 **Q. Please summarize your Supplemental Testimony as it pertains to the Telephone
8 Assistance Plan for the Medical Needy.**

9 A. The funding level for the Telephone Assistance Plan for the Medical Needy has not been
10 increased since the inception of the program in 1991. New enrollments in the program
11 have had to be restricted due to the level of current funding. The Settlement Agreement
12 provides for an increase in funding of \$1 million annually so that additional qualified
13 applicants may be assisted and participate in the program.

14
15 **Q. Please summarize your Supplemental Testimony as it pertains to Rural Construction
16 Charges.**

17 A. In my testimony I explain how the cost to extend new facilities may preclude a rural
18 customer from being able to have basic phone service established. Consistent with Staff's
19 testimony in this matter, the Settlement Agreement provides for an increase in Qwest's
20 pro rata share of Rural Construction Charges from \$3,000 to \$5,000 to further promote
21 telephone subscribership and public safety.

22

1 **QWEST'S SERVICE QUALITY PLAN TARIFF**

2 **Q. Please summarize the recommendations regarding service quality that Staff**
3 **proposed in its Direct Testimony?**

4 A. Staff's recommendations regarding service quality were addressed in my Direct
5 Testimony, dated November 18, 2004. Staff recommended that language addressing the
6 one-time credit penalty of \$2.00 for each residence and business access line be added to
7 Qwest's Service Quality Plan Tariff. Second, Staff recommended certain nominal
8 adjustments to the penalty ranges for Residence Office Access, Business Office Access
9 and Repair Office Access. Third, Staff recommended that a total company customer
10 trouble objective be established and included in the Service Quality Plan Tariff. Finally,
11 Staff recommended that all provisions of the Service Quality Plan Tariff not modified by
12 recommendations in its Testimony be included in any renewal of the Price Cap Plan by the
13 Commission.

14
15 **Q. Does the Settlement Agreement adopt all of the service quality recommendations**
16 **proposed by Staff?**

17 A. Yes. Each of Staff's recommendations are included in Paragraph 15 of the Settlement
18 Agreement.

19
20 **Q. Does Paragraph 15 of the Settlement Agreement also provide for clarifying language**
21 **to be added to Section 2.5.1 of Qwest's Service Quality Plan Tariff?**

22 A. Yes. The Settlement Agreement allows for clarifications in the Tariff regarding Qwest's
23 obligations during conditions outside of its control. These conditions are termed "Force

1 Majeure.” The definitional language adopted for the Tariff revision is consistent with
2 language that is contained in Qwest’s SGAT¹.

3
4 **Q. Please describe the benefit that customers will derive from these service quality**
5 **provisions.**

6 A. The primary intent of Staff’s recommendations is to provide an ongoing benefit to
7 customers by continuing to incent Qwest to consistently maintain its service quality
8 performance during the term of the Renewed Price Cap Plan. The adjustments that were
9 made to penalty ranges for Residence Office, Business Office and Repair Office penalty
10 ranges provide additional incentive to the Company to maintain the performance
11 improvements it has achieved both prior to, and during, the initial term of the Price Cap
12 Plan.

13
14 **Q. Please describe how the changes to the penalty ranges provide additional incentive to**
15 **Qwest to maintain its level of service.**

16 A. The first adjustment to the penalty ranges would split the offset range into two ranges with
17 differing offset amounts. A second adjustment would decrease the width of the no penalty
18 range by five percent which would also shift the lower three ranges upward by five
19 percent. These changes are illustrated in the following table from page 8 of my Direct
20 Testimony.

¹ *Statement of Generally Available Terms and Conditions for Interconnection, Unbundled Network Elements, Ancillary Services and Resale of Telecommunications Services provided by Qwest Corporation in the State of Arizona (“SGAT”), Fourteenth Revision, August 29, 2003.*

Current Range	Current Penalty/Offset	Recommended Range	Recommended Penalty/Offset
85.01% - 100.00%	\$4,000/day offset	90.01% - 100.00%	\$4,000/day offset
		85.01% - 90.00%	\$2,000/day offset
70.01% - 85.00%	No penalty	75.01% - 85.00%	No penalty
56.01% - 70.00%	\$1,000/day penalty	61.01% - 75.00%	\$1,000/day penalty
32.01% - 56.00%	\$2,000/day penalty	37.01% - 61.00%	\$2,000/day penalty
0% - 32.00%	\$4,000/day penalty	0% - 37.00%	\$4,000/day penalty

The current range for no penalty is asymmetrical around the objective with 2/3 of the no penalty range being below objective. The range adopted in the Settlement Agreement is a narrower, as well as symmetrical range, thus encouraging Qwest to maintain a higher performance level that more closely meets the objective in order to not incur a penalty.

Second, shifting the lower ranges upward appropriately penalizes Qwest over a broader range for poor performance and has the potential for increased penalties should low levels of performance occur. This risk can be avoided by the Company by maintaining high levels of service which, in turn, benefits customers.

Finally, splitting the 85.01 percent to 100.0 percent offset range into two components minimizes the potential for one good month offsetting as many as four months of poorer performance. For example, currently one month with performance between 85.01 percent and 90.00 percent would offset four months with performance in a range of 56.01 percent to 70.00 percent. Adoption of Staff's recommendation in the Settlement Agreement would reduce this example to two months of 61.01 percent to 75.00 percent performance. While the Company could still receive the highest offset amount, it could only do so for results over 90.01 percent. Thus the Company should be incented to maintain performance at a high level and customers would benefit.

1 **TELEPHONE ASSISTANCE PLAN FOR THE MEDICAL NEEDY**

2 **Q. Please describe Qwest's Telephone Assistance Plan for the Medical Needy ("TAP")?**

3 A. The Telephone Assistance Program for the Medically Needy is available to low income
4 households that meet specific financial eligibility criteria and demonstrate a special
5 medical need requiring a telephone in the home. Customers are financially eligible if their
6 annual income is at or below 150 percent of current federal poverty guidelines.
7 Certification of medical need is obtained by use of a simple, standardized form that is
8 completed by a physician and attached to the application. The expected duration of the
9 medical condition must also be stated on the form. The Arizona Department of Economic
10 Security ("DES") administers the program for Qwest.

11
12 TAP provides a credit to cover the monthly charge for basic local residential phone
13 service including any applicable monthly exchange zone increments. The program also
14 covers the Universal Service Fund surcharge. In addition, the program covers 50 percent
15 of the nonrecurring charge to install the primary residential line as well as the
16 nonrecurring charge for the exchange zone increment if applicable. The FCC Lifeline
17 program provides funding for the subscriber line charge of \$6.30 and contributes an
18 additional \$3.50 credit toward the monthly charge for basic local residential service. In
19 addition, normal deposit requirements are waived for program participants.

20
21 The funding for TAP was established by the Arizona Corporation Commission in
22 Decision No. 57462, dated July 15, 1991. In the Decision, Qwest was ordered to set aside
23 \$1,000,000 annually for the program. TAP benefits are available to new program
24 participants as long as there is sufficient money in the fund (which includes the

1 \$1,000,000 annual set-aside, matching federal Lifeline funds and all existing surplus
2 funds) to cover them.²
3

4 **Q. Over time, has there been an increase in the number of customers each year who**
5 **have benefited from the TAP program?**

6 A. Yes. The number of participants in the TAP program has increased each year and reached
7 a peak in 2002. However, the number of participants in the program declined in 2003 and
8 2004.
9

10 **Q. Does Staff attribute the decrease in the number of TAP participants the last two**
11 **years to the current level of funding available to the TAP program?**

12 A. Yes, Staff believes there is a correlation. The population of Arizona in the early 1990's
13 was certainly less than it is today. There was also a period of time where DES and the
14 Community Action Agencies were "ramping up" to enroll eligible customers in the
15 program. As a result all of the funding was not used and a surplus built up. By the mid
16 1990s the TAP program was utilizing its entire \$1 million dollar funding level and was
17 beginning to draw down the surplus funds that had developed in prior years. By year-end
18 2003 the surplus had been fully used and the number of customers who could benefit from
19 TAP was limited to the current \$1 million level of funding.
20

21 **Q. Is it Staff's understanding that DES has had to restrict TAP eligibility criteria to**
22 **keep expenditures within the program's current level of funding?**

23 A. Yes. It is Staff's understanding that DES is now restricting new enrollments in TAP to
24 eligible participants who have not had phone service from Qwest for at least ninety days
25 prior to the date of application. As a result, there are medically needy customers who

² *Exchange and Network Services Price Cap Tariff*, Section 5.2.6.B.2.

1 meet the income and medical-needs criteria but who either currently have phone service or
2 had phone service within the last ninety days that are precluded from benefiting from the
3 TAP program.

4
5 **Q. Does the Settlement Agreement provide for an increase in annual funding for the**
6 **TAP program?**

7 A. Yes. Paragraph 13, Subpart C, provides for an increase in the funding level of the TAP
8 program from its current \$1 million level to a level of \$2 million annually.

9
10 **Q. Will there be a consumer benefit from increasing the funding level of the TAP**
11 **program from \$1 million annually to \$2 million annually?**

12 A. Yes. As mentioned previously there are qualified applicants for the TAP program who are
13 precluded from participating today due to funding level constraints. It appears these
14 constraints have reduced the average monthly number of customers receiving TAP
15 benefits approximately twenty percent since 2002. Once DES and the Community Action
16 Centers “ramp up” for the increased funding level Staff anticipates that the average
17 monthly number of customers on the program will resume an upward trend. DES has
18 indicated that targeted promotion to raise awareness of the program will also have a
19 positive effect on the number of participants in the program. In addition, Arizona’s
20 population continues to rise which should also tend to increase the quantity of eligible
21 participants.

22

1 **Q. Currently, what is the approximate average monthly number of customers on the**
2 **TAP program and how might the increase in funding change the number of**
3 **participants?**

4 A. In 2002, near the end of the time frame TAP expenditures were allowed to exceed TAP's
5 funding level due to there being a surplus from prior years, the average number of
6 customers each month who benefited from the TAP program was approximately 10,400.
7 During 2004, where expenditures were equal to the \$1 Million funding level, the average
8 number of customers each month who benefited from the TAP was program was in excess
9 of 8,100. Staff would expect that there is a linear relationship between funding level and
10 the number of potential customers who might benefit from a doubling of the TAP funding
11 level. Accordingly, an increase in TAP funding from \$1 Million to \$2 Million should
12 increase the upper limit for the number of customers who might benefit to approximately
13 16,000.

14
15 **Q. Does the Settlement Agreement provide for increase public awareness of the TAP**
16 **program?**

17 A. Yes. The Settlement Agreement calls for Qwest to work with DES on the mutual
18 development of a public awareness plan. Staff anticipates that the plan will consider the
19 number of new applicants the DES and the Community Action Centers can process each
20 month and promote TAP in a manner most likely to reach eligible participants. The public
21 awareness plan described above, which is to be executed during the first six months of the
22 plan, provides at a minimum for: 1) public information which addresses the availability,
23 benefits and qualifying criteria for the Medically Needy program; 2) information to be
24 provided in both English and Spanish; 3) targeted promotion to effectively reach those
25 consumers who may meet the eligibility criteria of the program; and 4) further efforts to
26 reach out and contact other community agencies to increase TAP participation.

1 **Q. Does the current TAP program provide any funding to the Community Agencies that**
2 **assist DES in enrolling qualified customers in TAP and does the Settlement**
3 **Agreement make any changes in this regard?**

4 A. The current TAP program does not provide any funding to the Community Agencies.
5 However, the Settlement Agreement provides for funding of \$100,000 annually, which
6 shall be deducted from the \$2.0 Million in TAP funding, to offset the reasonable
7 administrative costs incurred by community agencies that assist DES in enrolling qualified
8 applicants in the TAP program. An increase in funding to the TAP program will have an
9 impact on the Community Agencies as they will have to process more applications.
10 Therefore, it is appropriate to provide some level of compensation to the Agencies to
11 mitigate the impact of the additional TAP funding level. The Agreement provides that on
12 a quarterly basis, DES shall determine, and invoice Qwest for each community agency's
13 pro rata share of the \$100,000 annual funding based upon the number of TAP applications
14 each agency has processed in the quarter. Qwest shall consult with DES and submit to the
15 Commission a plan which determines how each community agency's pro rata share is to
16 be determined.

17
18 **Q. Is there an offset to the \$1 million of additional funding for TAP included in the**
19 **determination of Qwest's \$31.8 million jurisdictional revenue deficiency?**

20 A. No. Qwest has agreed to not request recovery of the cost of the additional TAP funding.
21

1 **SPECIAL RURAL CONSTRUCTION CHARGES**

2 **Q. Please briefly describe Special Rural Construction Charges³?**

3 A. Special Rural Construction Charges generally apply to new establishments of service
4 outside the base rate area of a Qwest Exchange when a rural customer's pro rata share of
5 the cost of constructing facilities exceeds \$3,000.

6
7 **Q. Please summarize the recommendation regarding Special Rural Construction**
8 **Charges that Staff proposed in its Direct Testimony?**

9 A. Staff's recommendation regarding Special Rural Construction Charges was addressed in
10 the Direct Testimony of Elijah Abinah, dated November 18, 2004. Staff recommended
11 that, where Special Rural Construction Charges were applicable, Qwest's pro rata share of
12 the cost for constructing facilities be increased from \$3,000 to \$5,000.

13
14 **Q. Does the Settlement Agreement adopt the Special Rural Construction Charge**
15 **recommendation of Staff?**

16 A. Yes. Staff's recommendation is included in Paragraph 16 of the Settlement Agreement.

17
18 **Q. Please describe the benefit that customers will derive from the Special Rural**
19 **Construction Charge provision of the Settlement Agreement?**

20 A. For those affected customers, the increase in Qwest's pro rata share will make the
21 establishment of new service more affordable. Qwest has estimated that there are about
22 115 customers per year where the estimate for Rural Construction Charges would be
23 between \$3,000 and \$5,000. To the extent that potential customers could not afford their
24 pro rata share with a \$3,000 allowance, a \$5,000 allowance may allow them to initiate
25 service. Encouraging establishment of new service connections in rural areas promotes

³ Also referred to as line extension charges.

1 national goals of increased subscribership to basic telephone service and may reduce
2 health and safety risks associated with a lack of communication ability.

3
4 **CONCLUSION**

5 **Q. Do you believe that overall, the Service Quality Plan Tariff, Telephone Assistance**
6 **Plan for the Medical Needy and the Special Rural Construction Charge provisions of**
7 **the Settlement Agreement are reasonable and provide a benefit to consumers?**

8 A. Yes. I believe these provisions strike a reasonable public interest balance between Qwest
9 and its general body of rate payers. The Service Quality Plan Tariff revisions incent
10 Qwest to not allow certain performance indicators to degrade and negatively impact
11 customers. As discussed earlier, there is a need to increase the funding level to the TAP
12 program so that eligible participants may be assisted. Finally, making new service
13 establishment in rural areas more affordable may reduce public health and safety risk due
14 to lack of basic communications services.

15
16 **Q. Does this conclude your Supplemental Testimony?**

17 A. Yes, it does.

BROSCH

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S) DOCKET NO. T-01051B-03-0454
FILING AMENDED RENEWED PRICE)
REGULATION PLAN)

IN THE MATTER OF THE INVESTIGATION OF THE) DOCKET NO. T-00000D-00-0672
COST OF TELECOMMUNICATIONS ACCESS)

SUPPLEMENTAL TESTIMONY

OF

MICHAEL L. BROSCH

**ON BEHALF OF THE STAFF OF THE
ARIZONA CORPORATION COMMISSION**

SEPTEMBER 6, 2005

1 Q. Please state your name and business address.

2 A. My name is Michael L. Brosch. My business address is 740 North Blue Parkway,
3 Suite 204, Lee's Summit, Missouri 64086.

4

5 Q. On whose behalf are you appearing in this proceeding?

6 A. I am appearing on behalf of the Arizona Corporation Commission Utilities Division
7 Staff ("Staff").

8

9 Q. Are you the same Michael L. Brosch who previously submitted Direct and
10 Surrebuttal Testimony in this Docket?

11 A. Yes.

12

13 Q. What is the purpose of your Supplemental Testimony?

14 A. My Supplemental Testimony explains how price cap regulation differs from
15 traditional regulation and why price cap regulation has been adopted by many state
16 regulatory agencies for the large incumbent local exchange carriers ("ILECs"). I
17 describe why the Settlement Agreement and the Renewed Price Cap Plan ("Plan")
18 represent an appropriate balancing of the interests of ratepayers and shareholders, in
19 place of a return to traditional cost-based rate of return regulation for Qwest's
20 Arizona intrastate regulated business. I will explain certain aspects of the Qwest
21 Renewed Price Cap Plan agreed to by the Parties,¹ and will clarify how Sections 10,
22 11 and 12 of the Settlement Agreement resolve issues associated with Arizona
23 intrastate revenue levels in a manner that is consistent with the public interest.

24

1 Qwest Corporation ("Qwest"), the Arizona Corporation Commission ("Commission") Utilities
Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies
("DOD-FEA"), the regulated subsidiaries of MCI, Inc. ("MCI"), Time Warner Telecom of
Arizona, LLC ("Time Warner"), the Arizona Utility Investors Association ("AUIA"), Cox Arizona
Telcom, LLC ("Cox"), and XO Communications Services, Inc. ("XO").

PRICE CAP REGULATION

1
2 Q. How does price cap regulation differ from traditional cost-based rate of return
3 regulation for incumbent ILECs such as Qwest?

4 A. Price cap regulation involves a moratorium on periodic formal traditional rate case
5 proceedings for a specified period of time, during which overall revenues and price
6 levels are constrained by certain formula designed to limit price increases. Revenue
7 and price changes for specific services or baskets of services are “capped” within
8 explicit revenue constraints during the term of the price cap plan. Rather than
9 requiring periodic rate cases to measure and litigate issues associated with test year
10 expense levels, the appropriate rate of return, the valuation of rate base and various
11 cost studies supportive of specific service prices, the price cap regulatory approach
12 serves to more directly protect customers from unreasonable increases in the pricing
13 of basic services while recognizing that other specific telephone services that are
14 more competitive require pricing flexibility within certain overall revenue
15 constraints. Price cap regulation may also formalize other regulatory commitments
16 addressing service quality, service availability, financial reporting and other matters
17 of concern to customers in a more comprehensive manner than periodic rate case
18 proceedings.

19
20 Q. What are the intended benefits of a price cap form of alternative regulation, in place
21 of traditional cost-based rate of return regulation?

22 A. Price cap regulation provides pricing stability to consumers for the services that are
23 least competitive and must remain subject to firm regulation, while recognizing the
24 need for limited pricing flexibility for other telecommunications services that are
25 more competitive. This is accomplished by classifying services within “baskets” and
26 designing tighter pricing and revenue constraints for application to the less
27 competitive service baskets.

28 Price cap regulation provides an alternative to frequent rate cases that are
29 often complicated, time-consuming, expensive and contentious. Thus, a price cap
30 form of regulation can serve to improve regulatory efficiency for the benefit of the

1 ILEC, its customers and constituents of the regulatory agency. However, well
2 designed plans provide for continued financial reporting and monitoring by the
3 regulator, as well as a defined term and/or re-opener opportunities in the event
4 unforeseen changes in performance of the plan or financial outcomes require future
5 plan revisions.

6 Price cap regulation should also serve to promote operational efficiency
7 within the ILEC by decoupling costs from prices. Traditional cost-based regulation
8 rate cases can provide an opportunity for an inefficient ILEC to translate its higher
9 costs into higher authorized revenues and prices. The absence of traditional rate
10 cases during the term of a price cap plan serves to amplify the regulatory lag
11 incentive to management to maximize productivity in the operation of the business,
12 while also limiting opportunities to subsidize competitive services or corporate
13 affiliates.

14 Finally, price cap regulation offers pricing flexibility to the ILEC that enables
15 it to be more responsive to market conditions, by allowing for rapid implementation
16 of price changes or service bundling strategies that reduce competitive losses. In
17 return for granting such flexibility, the regulator is often able to secure valuable
18 regulatory commitments regarding the continued availability of certain services at
19 specific prices, comprehensive service quality guarantees, as well as specific
20 financial reporting provisions and possibly lower absolute revenue levels than would
21 be required under less flexible traditional regulation.

22
23 Q. Because of these benefits, has price cap regulation become the most prevalent form
24 of regulation used by state regulatory agencies to regulate their largest ILECs?

25 A. Yes. The Executive Summary of a November 2004 report by The National
26 Regulatory Research Institute ("NRRI") titled State Retail Regulation of Local
27 Exchange Providers as of September 2004 states:

28 Following the trend of previous years, local exchange carriers are still
29 transitioning from traditional forms of rate regulation – i.e. rate-of-
30 return regulation (ROR) – towards alternative forms of regulation,
31 including rate freeze, price caps, flexible regulation and deregulation.
32 Among these regulatory regimes, price cap regulation is the most

1 commonly adopted by states to regulate the rates of their incumbent
2 local exchange carriers, particularly of larger incumbents.
3

4 Despite the prevalence of price caps, traditional rate of return
5 regulation (ROR) is still in use in 36 states, mostly to regulate smaller
6 incumbents, as illustrated in Figure 2. The number of states that use
7 ROR for all their ILECs has decreased over time; as of September
8 2004, only Alaska, Hawaii, Montana, New Hampshire and
9 Washington did so. Arizona and Idaho are special cases; both states
10 use ROR for all their ILECs, but Qwest is under hybrid plans that
11 combine ROR with price caps in Arizona and with deregulation in
12 Idaho.
13

14 I have attached excerpts of this report to my testimony, designated as Attachment
15 MLB-S1.²
16

17 Q. Does the Renewed Price Cap Plan that has been agreed to by the Parties to the
18 Settlement Agreement in this Docket contain provisions that capture these general
19 benefits attributable to the price cap regulatory framework?

20 A. Yes. While I am not responsible for the detailed design of the individual elements of
21 the Qwest Renewed Price Cap Plan, it is my opinion the Settlement Agreement and
22 Renewed Price Cap Plan incorporate the desirable attributes of the price cap
23 regulatory approach I have described. Mr. Carver's Supplemental Testimony
24 explains how the \$31.8 million revenue deficiency in the Settlement Agreement was
25 determined to be reasonable by Staff. My testimony that follows will explain how
26 this agreed upon revenue deficiency, as well as other specific provisions within the
27 Settlement Agreement, work together to ensure that the prices charged to customers
28 are reasonable and consistent with the public interest.
29

30 REVENUE INCREASES UNDER THE PLAN

31 Q. How is the \$31.8 million revenue deficiency that is provided for in the Settlement
32 Agreement allowed to be implemented by Qwest?

2 A full copy of the report is available online at: <http://www.nrri.ohio-state.edu/phps113/search.php?focus=04-13&select=Publications>

1 A. The implementation of any revenue increases by Qwest is governed by Sections 10,
2 11 and 12 of the Settlement Agreement and corresponding paragraphs 1 through 6 of
3 the Renewed Price Cap Plan document. The most basic and essential services
4 offered by Qwest, such as residential and business single-line access (1FR and 1 FB),
5 are placed within "Basket 1" of the Plan and the existing service prices are hard-
6 capped and cannot be increased during the term of the Plan. Therefore, none of the
7 revenue increase approved in the Settlement Agreement will be recovered from basic
8 recurring monthly service charges.

9 Instead, the revenue increase of \$31.8 million will provide only an
10 "Opportunity For Price Changes Permitted Under the Plan" within Basket 2: Limited
11 Pricing flexibility Retail Services and Basket 3: Flexibly-Priced Competitive
12 Services, as more fully described in Settlement Agreement paragraphs 10 and 11. In
13 Year 1 of the Plan, up to \$1.8 million of increased revenues from net price changes
14 for services within "Basket 2" are permitted, with the balance of the \$31.8 million (at
15 least \$30 million) assigned to "Basket 3" potential price increases. Thus, Qwest is
16 afforded the opportunity to change prices for its more competitive Basket 3 retail
17 services to achieve the majority of the additional revenues allowed in the Settlement
18 Agreement, with no guarantee that market conditions will actually permit Qwest to
19 charge such higher prices.

20

21 Q. In discussing how the Renewed Price Cap Plan provides Qwest with limited pricing
22 flexibility, you indicated that the Plan allowed for "increased revenues from net price
23 changes." Could you briefly explain the meaning of that phrase?

24 A. The net revenue impact of price increases and price decreases within the Basket is to
25 be quantified by multiplying each price change (increases as well as decreases) by
26 corresponding current annual sales volumes for the service. The "opportunity for
27 price changes" is limited by the Settlement Agreement as noted above. There is no
28 opportunity for Qwest to increase revenues to make up for overall volume and
29 revenue declines that may continue to occur because the revenue opportunity relates
30 solely to net pricing changes in the future.

1

2 Q. Please explain how the “Switched Access Charge Reductions” and the “April 1, 2005
3 Productivity Adjustment” described in Sections 8 and 7 of the Settlement Agreement,
4 respectively, impact the implementation of the \$31.8 million revenue deficiency.

5 A. The access charge rate reductions and the productivity adjustment provisions directly
6 impact price and revenue changes allowed for other intrastate services. First, it
7 should be noted that the Parties agreed to a permanent reduction in Qwest’s Switched
8 Access Charge prices and revenues in the amount of \$12 million annually, as stated
9 in paragraph 8, with further agreement that, “...the \$12 million reduction shall be
10 revenue neutral. This revenue “neutrality” provision would normally have the effect
11 of requiring offsetting increased pricing and revenues from other intrastate services to
12 “make up” for the reduced access charge revenues. Indeed, in Year 2 of the Plan, this
13 is precisely what happens, the \$1.8 million limitation in Basket 2 price change
14 revenue impacts is increased to \$13.8 million to achieve revenue neutrality for the
15 permanent Switched Access rate reduction.³

16 However, this does not occur in Year 1 of the Plan, because an additional \$12
17 million revenue reduction is required under Section 7, to recognize that, “Under
18 Decision No. 67734, Qwest is obligated to demonstrate that the final rates approved
19 in this docket result in ratepayers receiving the full value of the suspended April 1,
20 2005 productivity Adjustment as if it had been effective April 1, 2005”. The Parties
21 agreed in Section 7 that, “Qwest’s obligation under Decision No. 67734 is satisfied
22 by the \$12 Million reduction in its allowable net increased revenue from price
23 changes for the first year of the Plan as set forth in Section 10.” It is this first-year
24 \$12 million reduction in revenues pursuant to paragraph 7 that causes the Basket 2
25 revenue opportunity to be reduced from \$13.8 million to \$1.8 million in Plan year 1.

26
27 Q. How was the \$12 million reduction in revenues for Plan year 1 determined?

28 A. The amount of the Section 7 revenue reduction in connection with this issue is
29 addressed by Staff witness Mr. Rowell. The point I wish to emphasize is that the

3 See Settlement Agreement paragraphs Sections 10 and 11 and Plan paragraph 6.

1 ongoing annual revenue opportunity stated at \$43.8 million in Year 2 and subsequent
2 years in Sections 10, 11 and 12 is actually equivalent to the agreed-upon revenue
3 deficiency of \$31.8 million, increased by \$12 million because of the permanent
4 revenue neutral Switched Access Service pricing reductions that are required under
5 paragraph 8.

6
7 Q. Under the Renewed Price Cap Plan, will Qwest be able to increase its prices for
8 services in Baskets 1, 2 or 3 to make up for any competitive losses it may experience
9 in Arizona?

10 A. No. As noted previously, Basket 1 prices are hard-capped and cannot be increased at
11 all. In Baskets 2 and 3, Qwest's ability to increase prices is limited to the specified
12 dollar amounts of new revenues set forth in the Settlement Agreement and the Plan.

13 Qwest's overall intrastate revenues have been declining for the past several
14 years due to reductions in the number of access lines demanded by customers and to
15 competitive losses of toll and feature revenues.⁴ If this trend in Qwest's overall
16 intrastate revenues continues, there is no opportunity under the Plan to make up for
17 such losses. At best, Qwest can exercise the granted pricing flexibility to respond to
18 market conditions, adjusting prices as required to meet competitive pressures while
19 increasing net overall prices only up to the limits permitted for Baskets 2 and 3
20 services.

21
22 Q. What is the significance of the last sentence in Plan Section 11 that states, "The
23 Additional Consumer Benefits identified in Section 13 shall not be accounted for in
24 determining price and revenue changes pursuant to Sections 10 and 11 of this
25 Settlement Agreement"?

26 A. Section 13 specifies certain rate reductions for zone charges, non-published numbers
27 and non-listed numbers and provides for increased funding for the Telephone
28 Assistance Plan. The last sentence in Section 11 makes it clear that Qwest cannot
29 count the foregone revenues from these specified price reductions in calculating the

4 See Direct and Rebuttal Testimony of Philip Grate and Brosch Surrebuttal testimony at pages 2-4.

1 net pricing and revenue changes otherwise permitted for Basket 2 and 3 services. In
2 other words, the Additional Consumer Benefits to consumers in Section 13 will not
3 simply be paid for by increasing prices to customers taking other Qwest services.
4

5 **REGULATORY OVERSIGHT UNDER THE RENEWED PLAN**

6 Q. Does the Settlement Agreement require Qwest to submit improved financial
7 reporting to the Commission during the term of the Renewed Price Cap Plan?

8 A. Yes. In Paragraph 3 Qwest is obligated to provide on an annual basis more detailed
9 reporting of its jurisdictionally separated financial results in the form of its existing
10 "1990s" reports. This represents an improvement over existing reporting that is
11 provided by Qwest on an un-separated basis, combining FCC-jurisdictional interstate
12 financial data with the intrastate information that is relevant to Qwest's financial
13 performance under Arizona Commission jurisdiction. Mr. Carver's Supplemental
14 Testimony provides an example of the confidential 1990s report Qwest is to provide.
15

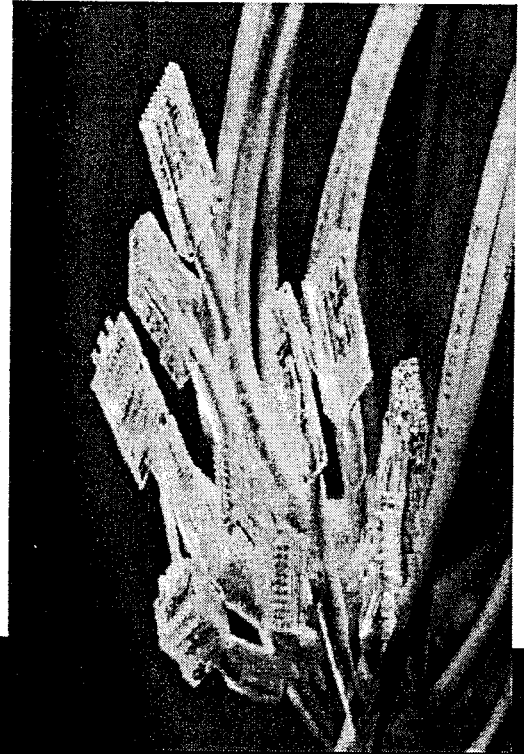
16 Q. What filings are required as part of a next review of the Renewed Price Cap Plan?

17 A. Section 17 of the Settlement Agreement sets a three year term for the Renewed Price
18 Cap Plan, starting from the effective date on which the Commission approves the
19 Settlement Agreement and Plan. Then, at least 9 months prior to expiration of the
20 term of the Renewed Plan, Section 18 requires Qwest to submit a list of financial and
21 operational data. If any significant (more than "de minimis") revenue increase is
22 sought by Qwest when it applies for review of the Renewed Plan, a rate case filing
23 under A.A.C. R-14-103 is required of Qwest.
24

25 Q. Does this conclude your testimony at this time?

26 A. Yes.

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LEGAL DIV.

State Retail Rate
Regulation of Local
Exchange Providers
as of September 2004

Prepared by
Lilia Pérez-Chavolla

November 2004

**STATE RETAIL RATE REGULATION OF LOCAL EXCHANGE PROVIDERS
AS OF SEPTEMBER 2004**

by Lilia Pérez-Chavolla, Ph.D.
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November 2004

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EXECUTIVE SUMMARY

Following the trend of previous years, local exchange carriers are still transitioning from traditional forms of rate regulation—i.e. rate-of-return regulation (ROR)—towards alternative forms of regulation, including rate freeze, price caps, flexible regulation and deregulation. Among these regulatory regimes, price cap regulation is the most commonly adopted by states to regulate the rates of their incumbent local exchange carriers, particularly of larger incumbents.

The enclosed tables and figures show the status of retail rate regulation of local exchange carriers in the United States as of September 2004. The information included in this report was obtained from the Supplemental White Papers on Retail Rate Regulation of Local Exchange Providers, published each year by *State Telephone Regulation Report*. Staff members from 32 states and the District of Columbia reviewed this information and provided revisions, improving the accuracy of the report.

A total of 37 states use some form of price cap regulation (see Table 1 and Figure 1). Of them, only six states (AL, DE, DC, LA, RI and TX) apply it to all their ILECs, including Regional Bell Operating Companies (RBOCs) and other competitors. The most common trend is for the states to regulate the rates of their large incumbents under a price cap plan while maintaining their smaller incumbents under ROR regulation (18 states); other states have granted smaller incumbents flexible regulation or rate deregulation, either partial or complete, while regulating large ILECs under price caps (7 states). As it is explained in Table 4, many small incumbents can opt to change to price caps or some other form of alternative regulation, but many have decided to remain under traditional forms of regulation. Finally, the remaining six states (AR, KY, MN, NY, ND, and OR) use a mix of regimes, including price caps, to regulate both their large and small incumbents.

Despite the prevalence of price caps, traditional rate of return regulation (ROR) is still in use in 36 states, mostly to regulate smaller incumbents, as illustrated in Figure 2. The number of states that use ROR for all their ILECs has decreased over time; as of September 2004, only Alaska, Hawaii, Montana, New Hampshire and Washington did so. Arizona and Idaho are special cases; both states use ROR for all their ILECs, but Qwest is under hybrid plans that combine ROR with price caps in Arizona and with deregulation in Idaho.

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3 Map of Retail Rate Regulation of CLECs as of September 2004	4

**Table 1. Distribution of States by Type of Retail Rate Regulatory Regime
(as of September 2004)**



Regulatory Regime	Price caps (All incumbents)	ROR (All incumbents)	Deregulation (All incumbents)	Price caps for large incumbents & ROR (Other incumbents)	Price caps for large incumbents & mix of regimes for other incumbents	Mix of regimes for large and other incumbents	Rate flexibility	Some rates regulated	Rates not reviewed	
States	AL (BLS and others), DE (VZ), DC (VZ), LA (BLS and others), PA (Alternative Regulation: VZ), VA, VZ North, Commonwealth Telephone, and others), RI (VZ), TX (SBC, VZ, FON, Valor Telecom, and others), WY (Cost-based pricing flexibility: Q and others)	AK (large and small incumbents), HI (VZ HI), MT (Q and others), NH (VZ and others), WA (Q, VZ, and others)	NE (Q and others), SD (Q and others)	CA (Caps: SBC, VZ, Surewest Telecom, CZN/Frontier), CO (Caps: Q), CT (Caps: BS, VZ, FON and 6 other incumbents, ROR: only one small incumbent), GA (Caps: BS and 25 other incumbents; ROR: Only 9 small incumbents), IL (Caps: SBC), KS (Caps: SBC, FON), ME (Caps: VZ), MD (Caps: VZ), MS (Caps: BS), MO (Caps: SBC, CTL, FON, Spectra/CTL), NV (Caps: Sprint NV, SBC), NJ (Caps: VZ), OK (Caps: SBC), SC (Caps: BS, FON, VZ), TN (Caps: BS, FON, CZN), UT (Caps: Q), VT (Caps: VZ)	IA (Caps: Q, Iowa Telecom Services, Frontier Communications of Iowa), NM (Caps: Q, Valor Telecom; deregulation: other incumbents with fewer than 50,000 lines), VA (Caps: VZ VA, VZ South, Sprint Telcos)	IN (Caps: SBC, FON, VZ; flexibility: investor-owned incumbents with fewer than 30,000 lines; deregulation: telephone cooperatives), MI (Caps: SBC, VZ; local rate freeze & deregulation of intrastate switched access rates: other incumbents), NC (Caps: BS, FON [Centel, Carolina Tel & Telegraph], VZ, Alltel, Mebtel, Concord Tel and North State Communications; ROR: remaining 8 smaller incumbents), WI (Caps: SBC, VZ; flexible price-based regulation: 29 small incumbents; streamlined ROR with some pricing flexibility: 42 incumbents; traditional ROR: 2 incumbents; rate deregulated: 12 telephone cooperatives)	AR (Caps: SBC, Alltel, AZ (ROR with price caps: Q & ROR; others), ID (ROR & deregulation: Q South, & ROR: others), KY (Caps: BS, Alltel KY; Rate freeze: CBT & ROR: KY Alltel, others), MA (Alternative reg: VZ; ROR: others), MN (Caps: Q, FON, CZN; ROR: CZN [formerly GTE], & flexibility: others), NY (Tariff regulation: VZ; Price caps: Frontier Telephone of Rochester; ROR: others), ND (Caps: Q; ROR: ND Telephone, & deregulation: retail rates of investor-owned companies with less than 8,000 lines and of all coop.), OH (Alternative Reg: SBC, FON, CTL, CBT, Chillicothe Horizon; ROR: others), OR (Caps: Q; ROR: VZ, FON, CTL, & deregulation: others), WV (Flexibility: VZ; Frontier/CZN, & ROR: others)	AL, AK, AZ, CA, CO, FL, GA, HI, IL, IN, IA, KY, LA, MD, MI, MN, MS, MO, NM, NY, OH, OK, PA, UT, VT, WA, WV	DE (cost-based rate floor), NJ (basic exchange, vertical services and switched access cannot exceed VZ's rates without cost justification), VA (rates capped at incumbent's rate unless regulatory waiver is obtained; subsequent increases require notice to customers and Corp. Commit)	AR, CT, DC, ID, KS, ME, MA, MT, NC, NV, NH, NJ, ND, OR, RI, SC, SD, TN, TX, WI, WY
TOTAL	8	5	2	3	4	11	27	3	21	

Sources: State Telephone Regulation Report, July-August, 2004, Vol. 22 (15, 16 & 17) & State Regulatory Commissions.

BLS= BellSouth
CBT= Cincinnati Bell
CTL= Century Telecom
CZN= Citizens Communications/Frontier
FON= Sprint
Q= Qwest
SBC= Southwestern Bell
VZ= Verizon

CARVER

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST CORPORATION'S) DOCKET NO. T-01051B-03-0454
FILING AMENDED RENEWED PRICE)
REGULATION PLAN)

IN THE MATTER OF THE INVESTIGATION OF) DOCKET NO. T-00000D-00-0672
THE COST OF TELECOMMUNICATIONS ACCESS)

SUPPLEMENTAL TESTIMONY

OF

STEVEN C. CARVER

**ON BEHALF OF THE STAFF OF THE
ARIZONA CORPORATION COMMISSION**

SEPTEMBER 6, 2005

**BEFORE THE
ARIZONA CORPORATION COMMISSION
SUPPLEMENTAL TESTIMONY OF
STEVEN C. CARVER**

**QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

1 Q. Please state your name and business address.

2 A. My name is Steven C. Carver. My business address is 740 NW Blue Parkway, Suite 204,
3 Lee's Summit, Missouri 64086.

4
5 Q. Are you the same Steven C. Carver that filed Direct and Surrebuttal testimony in this
6 proceeding?

7 A. Yes.

8
9 Q. What is the purpose of your testimony?

10 A. My Supplemental testimony discusses the overall revenue deficiency agreed to by the
11 Parties¹ and explains why the amount set forth in the Settlement Agreement is reasonable
12 and in the public interest. My testimony will also address why the Commission should
13 find as reasonable the fair value rate base, rate of return and adjusted operating income
14 underlying the Settlement Agreement revenue deficiency.

15
16 Q. What is the amount of the overall revenue deficiency specified in the Settlement
17 Agreement?

18 A. Section 2 of the Settlement Agreement sets forth the agreement of the Parties that
19 Qwest's jurisdictional revenue deficiency is \$31.8 million. Under the terms of the
20 Settlement Agreement, Qwest may only recover this revenue deficiency by increasing the
21 prices for competitive services (i.e., services in Basket 2 and Basket 3), within defined
22 parameters specified in the Settlement Agreement.

¹ Qwest Corporation ("Qwest"), the Arizona Corporation Commission ("Commission") Utilities Division Staff ("Staff"), the Department of Defense and All Other Federal Executive Agencies ("DOD-FEA"), the regulated subsidiaries of MCI, Inc. ("MCI"), Time Warner Telecom of Arizona, LLC ("Time Warner"), the Arizona Utility Investors Association ("AUIA"), Cox Arizona Telcom, LLC ("Cox"), and XO Communications Services, Inc. ("XO").

ACC Staff witness Mr. Rowell will discuss the design of the Renewed Price Cap Plan ("Plan") as specified in the Settlement Agreement, including Qwest's limited ability to change the price of individual services in each Basket during the term of the Plan.

Q. Does the \$31.8 million revenue deficiency represent the result of issue-by-issue negotiation and resolution among the Parties?

A. No. The \$31.8 million revenue deficiency in the Settlement Agreement is a packaged resolution of all revenue requirement issues, without specific findings to resolve each issue. Settlement discussions that occurred are confidential and did involve consideration of the merits of individual rate case issues, but the only revenue requirement issues specifically resolved by the Parties are identified in Section 3 through Section 6 of the Settlement Agreement.² On the remaining revenue requirement issues between Staff and Qwest, Mr. Brosch and I provided advice and assistance to the Staff regarding the litigation risk and overall merits of the various ratemaking adjustments presented by Staff, Qwest and the other parties that submitted prefiled evidence.

Q. Why is the \$31.8 million revenue deficiency reasonable and in the public interest?

A. In June 2004, the Company filed revised R14-2-103³ schedules supporting an overall intrastate revenue deficiency of \$318.5 million (original cost) and \$458.8 million (fair value).⁴ This revised Company filing served as the starting point for Staff's Direct testimony, which supported a revenue deficiency of approximately \$3.5 million.⁵ In rebuttal testimony,⁶ Qwest reduced its overall revenue deficiency from \$318.5 million to \$271.258 million – a decrease of about \$47.3 million.⁷

² Statement of Financial Accounting Standards 106 ("FAS106"), American Institute of Certified Public Accountants' Statement of Position 98-1 ("SOP 98-1"), depreciation rates and amortizations, BSI Construction Related Charges and DSL Allocation.

³ Qwest Corporation filing pursuant to A.A.C. R14-2-103(B)(7) or "R14-2-103" filing.

⁴ See Qwest Schedule A-1, filed June 21, 2004.

⁵ See Schedule A, Staff Joint Accounting Schedules.

⁶ Qwest Exhibit PEG-R1.

⁷ Qwest's rebuttal filing revised virtually every Company proposed adjustment, including ten (10) new or revised adjustments that incrementally changed revenue requirement in excess of \$1 million. These 10 adjustments represent a cumulative \$47.4 million change in overall revenue requirement, including a revised depreciation adjustment (PFA-01) which decreased revenue requirement by \$45.6 million.

In comparison to Qwest's evidence, Staff's Direct testimony supported a \$3.5 million revenue deficiency, while RUCO presented evidence supporting a revenue deficiency of \$160 million.⁸

Schedule E of the Staff Joint Accounting Schedules, included in Staff's prefiled direct evidence, summarizes and reconciles the revenue requirement value of the various Staff ratemaking adjustments, depreciation changes and the rate of return difference comprising the many items initially at issue between Staff's direct filing (\$3.5 million) and Qwest's June 2004 filing (\$318.5 million). Referring to Schedule E from Staff's original filing, the following table summarizes the approximate revenue requirement effect of the major issues comprising the \$315 million difference between these Staff and Company filings, prior to Qwest's rebuttal revisions:

<u>Adjustment</u>	<u>Description</u>	<u>Revenue Requirement (millions)</u>
	Rate of Return	\$ (46.8)
B-3, C-6	DSL (Remove)	(13.1)
C-4, C-7	BSI (Construction)	(6.2)
B-6, C-11	SOP 98-1 (Software)	(30.7)
B-8, C-18	FAS106 (OPEB Costs)	(27.0)
B-7, C-22, C-23	Depreciation	(151.0)
C-9	Marketing, Advertising	(5.6)
C-16	YE Wage & Salary	(12.8)
C-17	Incentive Compensation	(5.8)
		<u>\$ (299.0)</u>

These major issues, along with many other revenue requirement issues, were vigorously contested by Qwest in Rebuttal testimony to which Staff responded in Surrebuttal testimony. While many of these issues have been previously raised by Staff, there are several disputed issues where there is no guiding policy or precedent in prior ACC rate orders. Moreover, as shown in the table above, a significant portion of the revenue requirement difference involves disputes about rate of return and depreciation accrual

represent a cumulative \$47.4 million change in overall revenue requirement, including a revised depreciation adjustment (PFA-01) which decreased revenue requirement by \$45.6 million.

⁸ Direct testimony of RUCO witness Marylee Diaz Cortez, pp. 2-3.

rates, which are issue areas involving significant analytical judgment. Consequently, an adverse decision on only a few of these contested issues could result in an authorized revenue deficiency significantly larger than the \$31.8 million specified in the Settlement Agreement.

Q. In evaluating the reasonableness of the Settlement Agreement, please identify the “contested” revenue requirement issues that have no guiding ACC precedent.

A. Most of the major issues have no clear ACC guiding precedent:

- The DSL (Adjustments B-3 & C-6) and BSI (Adjustments C-4 & C-7) issues have not been raised in prior Qwest proceedings.
- In Qwest’s last rate case, Staff raised SOP 98-1 (Adjustments B-6 & C-11) as an issue, involving the capitalization of certain software costs previously expensed. Qwest contested this issue in both the last rate case and this proceeding. The Settlement Agreement in the last rate case was silent on this issue.
- Adjustments B-8 and C-18 also relate to when accrual accounting for FAS106 (OPEB costs) was or should be adopted for ratemaking purposes. In the last rate case, Staff did not contest Qwest’s proposed rate case adjustment adopting FAS106 accrual accounting. However, the Settlement Agreement in the last rate case did not specifically address this issue, leading to a valuation dispute between Staff and Qwest in the current proceeding.
- Qwest’s rebuttal testimony does propose a revised depreciation adjustment, reducing the Company’s June 2004 revenue requirement by \$45.6 million. However, significant depreciation valuation issues remain between Staff and Qwest. While the Commission has addressed depreciation issues in prior proceedings, there is no clear precedent on certain depreciation issues unique to the pending proceeding.
- Staff also proposed Adjustment C-16, recognizing lower test year-end employee levels, year-end wage/ salary rates and related benefit costs. While the Commission has addressed similar issues in prior rate proceedings, Qwest’s rebuttal argues that Staff employed a “piecemeal” approach to annualizing labor-related costs that was inconsistent with other adjustments proposed by Staff.
- The incentive compensation (Adjustment C-17) issue has not been explicitly addressed by the Commission.

While Staff believes that its Direct and Surrebuttal evidence fully supports each of these adjustments, we also recognize the risk that litigation of these issues could result in a

significantly higher overall revenue requirement than has been agreed to in the Settlement Agreement, if Qwest were to prevail.

Q. You previously testified that the Settlement Agreement was a “packaged resolution” of all revenue requirement issues. Does the Settlement Agreement explicitly resolve the disagreements over the accounting issues regarding Qwest’s SOP 98-1 and FAS106 adoption dates?

A. Yes. At the risk of oversimplifying two complex accounting issues, the resolution of these issues in the Settlement Agreement can best be understood by first briefly summarizing the nature of the differences between Qwest and Staff. Qwest’s testimony⁹ initially proposed the prospective or “pro forma” adoption of both SOP 98-1 and FAS106 during the 2003 test year, under the premise that neither accounting change had been previously adopted or approved for Arizona accounting or ratemaking purposes. Subsequently, Qwest revised its SOP 98-1 position, contending that the software accounting change was adopted in Arizona by the Company in 1999.¹⁰

Staff’s Direct and Surrebuttal testimony discussed the fact that Staff had proposed adoption of SOP 98-1 in the Company’s last rate case test year (i.e., calendar year 1999),¹¹ which was contested by Qwest, and did not oppose Qwest’s proposed adoption of FAS106 in the last rate case.¹² The basic premise of Staff’s testimony in the current proceeding was that SOP 98-1 should be adopted prospectively in the 2003 test year and that it was the regulatory intent that FAS106 was adopted in the last rate case.

Extensive testimony has been filed by both Qwest and Staff on both of these issues. Because they are complex, the purpose of the foregoing summary was not to reopen or reargue the issues, but rather to provide context for the resolution negotiated by the Parties. Section 3 of the Settlement Agreement sets forth a negotiated resolution of the accounting adoption dates for both of these accounting issues. For Arizona regulatory

⁹ Grate direct testimony, pp. 57-62 (SOP 98-1) & pp. 54-56 (FAS106) & Grate rebuttal, pp. 15-23 (FAS106).

¹⁰ Grate rebuttal testimony, pp. 23-32(SOP 98-1).

¹¹ SOP 98-1 addressed in Staff testimony: Carver direct, pp. 45-56 & Carver surrebuttal, pp. 13-19.

¹² FAS106 addressed in Staff testimony: Carver direct, pp. 56-71 & Carver surrebuttal, pp. 19-22.

accounting, reporting and revenue requirement purposes, Section 3 of the Settlement Agreement sets forth the agreement of the Parties to recognize Qwest's adoption of SOP 98-1 effective January 1, 2001, and FAS106 effective April 1, 2001.¹³

Q. For Arizona reporting purposes, does the Settlement Agreement specify that SOP 98-1 and FAS106 expenses will be reported to the Commission on a basis of accounting consistent with these adoption dates?

A. Yes. Section 3 of the Settlement Agreement reflects Qwest's agreement to provide its year-to-date December "1990s report" for Arizona, or any substantively identical replacement, at the same time the Company files its Annual Report with the Commission. Qwest also agreed to maintain adequate off-book or side records consistent with the agreements on FAS106 and SOP 98-1 and with Commission-ordered depreciation rates and amortizations. Attachment SCC-SA1 represents a redacted specimen copy of the 1990s report that will be provided by Qwest, which will include financial results on both a total Arizona and Arizona intrastate basis and will incorporate the intrastate impact of these issue-specific agreements.

Q. How did Staff determine that the \$31.8 million revenue deficiency was reasonable?

A. Staff reviewed Qwest's rebuttal filing and discussed the revenue requirement issues during settlement negotiations. As a result of these efforts, Staff evaluated and modified certain of the adjustments contained in its Direct testimony to reflect various revisions and corrections. Although there are many different ways one may support a revenue requirement settlement that is not based on specific outcomes for particular issues, Staff revised or corrected only the following prefiled accounting adjustments in determining that the \$31.8 million revenue deficiency was reasonable:

<u>Adjustment</u>	<u>Description</u>
B-6 & C-11	SOP 98-1 (Software)
B-8 & C-18	FAS106 (OPEB Costs)
B-10, C-19, C-20 & C-24	FCC Deregulated Services
C-1	Qwest Update – Corrections & Revisions
C-23	Depreciation – Staff Proposed Rates

¹³ The FAS106 resolution also provides for a ten year amortization of Qwest's December 31, 2000 Accumulated Post-Retirement Benefit Obligation ("APBO") starting April 1, 2001.

As noted previously, the SOP 98-1 and FAS106 adjustments were modified to reflect the adoption dates specified in Section 3 of the Settlement Agreement. The modifications to the FCC Deregulated Services adjustments and the Qwest Update reflect corrections and modifications identified in the Company's Rebuttal testimony and discussed during the settlement process. The change to Staff's depreciation adjustment recognizes the depreciation rates and amortizations addressed in Section 4 of the Settlement Agreement. Overall, these changes and revisions caused the \$3.5 million revenue deficiency recommendation presented in Staff's Direct testimony to increase to \$31.8 million, which is still significantly below the filed revenue deficiency recommendation of any other Party to this proceeding.

Q. Has Staff attempted to reconcile the Settlement Agreement revenue deficiency to the prefiled evidence of RUCO?

A. No. At the present time, I am not aware of any revisions to the positive \$160 million revenue deficiency sponsored by RUCO that would reduce that recommendation to a level consistent with the Settlement Agreement. RUCO's prefiled evidence supported an overall revenue deficiency that is about \$128 million greater than Staff's revised settlement position.¹⁴

Q. What fair value rate base is specified in the Settlement Agreement?

A. Section 1 of the Settlement Agreement indicates that the Parties have agreed that the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 2003, is \$1,507.7 million. This amount agrees with Staff's proposed rate base, after revising Adjustments B-6, B-8 and B-10 as noted above.

Q. What fair rate of return underlies the Settlement?

¹⁴ Direct testimony of RUCO witness Marylee Diaz Cortez, pp. 2-3.

- A. Section 1 specifies that, for ratemaking purposes and for purposes of the Settlement Agreement, the Parties have agreed to a 9.5% fair rate of return, which is equal to the weighted cost of capital originally proposed by Staff.¹⁵

When applied to the Settlement Agreement fair value rate base, this return produces a Required Operating Income of \$143.2 million. Recognizing the uncertainty associated with litigating the various operating income issues, the Parties concluded through negotiation that Qwest's Adjusted Net Operating Income of \$124.4 million at present rate levels was reasonable. Using these values, the \$31.8 million revenue deficiency set forth in the Settlement Agreement is summarized below:

[millions]	Settlement Values
Proposed Rate Base	\$ 1507.7
Rate of Return	9.50%
Required Operating Income	\$ 143.2
Adjusted Net Operating Income	124.4
Operating Income Deficiency	18.8
Revenue Conversion Factor	1.6910
 Settlement Revenue Deficiency	 \$ 31.8

- Q. In your opinion, will the overall revenue deficiency and the explicit resolution of SOP 98-1 and FAS106 ratemaking issues specified in the Settlement Agreement produce just and reasonable rates that are in the public interest?

A. Yes.

- Q. Does this conclude your Supplemental testimony?

A. Yes.

¹⁵ See Schedule D of the Staff Joint Accounting Schedules, as filed with Staff's direct testimony.

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1204
VERSION 505

ACCOUNT DESCRIPTION	MR YTD BOOKED OPERATIONS (A)	JD YTD OFFBOOK OPERATIONS (B)	JR YTD BOOKED OPERATIONS (C=A+B)	YTD DEREG (D)	YTD PART X (E)	YTD BILLING & COLLECTION OPERATIONS (F)	MR YTD INTERSTATE OPERATIONS (G=A-D-E)	MR YTD INTRASTATE OPERATIONS (H=F+G)	JR YTD INTRASTATE OPERATIONS (I=H+G)	JR YTD INTRASTATE PERCENT (J=I/G)
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REVENUES

- 1 LOCAL SERVICE
- 2 ACCESS SERVICE
- 3 LONG DISTANCE SERVICE
- 4 MISCELLANEOUS
- 5 TOTAL REVENUE

EXPENSES

COSTS OF SERVICES AND PRODUCTS

- 6 MAINTENANCE
- 7 ENGINEERING
- 8 NETWORK OPERATIONS
- 9 NETWORK ADMINISTRATION
- 10 ACCESS
- 11 OTHER
- 12 TOTAL COST OF SERV AND PRODS
SELLING, GENERAL & ADMINISTRATIVE
- 13 CUSTOMER OPERATIONS
- 14 CORPORATE OPERATIONS
- 15 PROPERTY AND OTH OPERAT TAXES
- 16 UNCOLLECTIBLES
- 17 TOTAL SEL, GEN AND ADMINIST
- 18 OTHER OPR INCOME & EXPENSE
- 19 DEPRECIATION AND AMORTIZATION
- 20 UNIVERSAL SERVICE FUND
- 21 LINK UP AMERICA
- 22 TOTAL OPERATING EXPENSES
(L12+L17+L18+L19+L20+L21)
- 23 INCOME FROM OPERS BEFORE TAXES
(L5-L22)

REDACTED

INCOME TAXES

- 24 FEDERAL
- 25 STATE AND LOCAL

26 NET OPERATING INCOME
(L23-L24-L25)

27 INTEREST EXPENSE

28 NONOPER INC & EXP

29 NONOPERATING INCOME TAX

30 JURIS DIFF & NONREG NET INCOME

31 EXTRAORDINARY ITEMS

32 NET INCOME
(L26-L27-L28-L29-L30-L31)

33 NET INCOME AVAILABLE FOR TOTAL
CAPITAL OBLIGATIONS

QWEST
SEPARATED RESULTS OF OPERATIONS
STATE: Arizona
VIEW: FINL1204
VERSION 505

ACCOUNT DESCRIPTION	MR YTD BOOKED OPERATIONS (A)	JD YTD OFFBOOK OPERATIONS (B)	JR YTD BOOKED OPERATIONS (C=A+B)	YTD DEREG (D)	YTD PART X (E)	YTD BILLING & COLLECTION (F)	MR YTD INTERSTATE OPERATIONS (G=A-D-E)	MR YTD INTRASTATE OPERATIONS (H=A-D-E)	JR YTD INTRASTATE OPERATIONS (I=F+H)	JR YTD INTRASTATE PERCENT (J=G/C)
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RETURNS

34 RETURN TO EQUITY
35 RETURN ON AVG TOTAL CAPITAL
36 RETURN ON AVG NET INVESTMENT

CAPITAL

37 AVERAGE EQUITY
38 AVERAGE DEBT
39 AVERAGE TOTAL CAPITAL
40 AVERAGE UNAMORTIZED JDIC
41 AVERAGE TOTAL CAPITAL INC JDIC

AVERAGE INVESTMENT

42 PLANT IN SVC
43 PLT UND CONST SHORT
44 PLT UND CONST LONG
45 PLANT UNDER CONSTRUCTION
46 PROP HELD FOR FUT USE
47 PLT ADJ
48 MATERIALS & SUPPLIES
49 ACCUM DEP
50 ACCUM AMORT
51 ACCUMULATED DEP & AMORT
52 ACCUM DEFERRED TAX RESERVE
53 AVERAGE NET INVESTMENT
(L42+L45+L46+L47+L48-L51-L52)

REDACTED

OTHER INVESTMENT DETAIL

54 CUSTOMER DEPOSITS
55 AVG LAND DEVEL AGREE DEPOSITS
56 AVG OTHER SPC CONSTR DEPOSITS

DUNKEL

BEFORE THE
ARIZONA CORPORATION COMMISSION

IN THE MATTER OF QWEST)
CORPORATION'S FILING OF) 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)

SUPPLEMENTAL TESTIMONY
OF
WILLIAM DUNKEL
PERTAINING TO DEPRECIATION, BSI AND DSL
IN THE SETTLEMENT AGREEMENT

ON BEHALF OF
THE STAFF OF THE ARIZONA CORPORATION COMMISSION

SEPTEMBER 6, 2005

1 A. Yes. The resolution of these issues as contained in the Settlement Agreement are
2 reasonable and in the public interest, as more fully described herein.

3

4 **Q. Could you address depreciation and amortization in the Settlement Agreement?**

5 A. Yes. In its Direct Testimony, Qwest had recommended depreciation rates that would
6 result in reducing intrastate annual depreciation expense by \$109 million. In my Direct
7 Testimony on behalf of the ACC Staff, I recommended depreciation rates that would
8 result in reducing intrastate annual depreciation expense by \$250 million. In its Rebuttal
9 Testimony Qwest accepted one of my adjustments², which brought the Qwest
10 recommendation in testimony to a \$160 million annual intrastate reduction.³

11

12 Depreciation and amortization are discussed in Section 4 of the Settlement Agreement,
13 and the depreciation rates and amortization agreed upon by the Parties are shown on
14 Attachment B to that Agreement. The depreciation rates and amortization agreed to in the
15 Settlement Agreement result in a reduction of approximately a \$255 million in the
16 annual intrastate depreciation expense for each of the first five years, and result in
17 approximately a \$225 million per year reduction below the test year level in intrastate
18 depreciation expense thereafter.⁴ The reduction in the amount of expense savings after
19 five years is because the reduction resulting from the amortization expires after five
20 years.

21

² In Rebuttal Testimony, Qwest accepted my position that the depreciation rates should be calculated using the depreciation reserve levels as of the end of the test year, instead of using the levels as of the start of the test year. See pages 16-17 of the Rebuttal Testimony of Dennis Wu.

³ Executive Overview, Rebuttal Testimony of Dennis Wu.

⁴ Section 4 of the Settlement Agreement.

1 **Q. How does the agreed upon depreciation and amortization compare to Staff's**
2 **prefiled testimony position?**

3 A. The amount of intrastate depreciation and amortization expense reduction that results
4 from the Settlement Agreement is very close to the reduction that would result from the
5 Staff testimony position on this issue. The Staff Direct Testimony recommendations
6 would have resulted in a \$250 million annual reduction. The Settlement Agreement
7 results in a \$255 million annual reduction for each of the first five years, and a \$225
8 million annual reduction thereafter. The Settlement Agreement annual expense reduction
9 exceeds the original Qwest proposed reduction⁵ by approximately \$145 million for each
10 of the first five years, and exceeds the original Qwest proposed reduction by
11 approximately \$115 million annually thereafter.

12
13 The depreciation and amortization as set forth in the Settlement Agreement are
14 reasonable and in the public interest.

15
16 **Q. Could you address the BSI construction related charges in the Settlement**
17 **Agreement?**

18 A. Yes. This issue is discussed in Section 5 of the Settlement Agreement. Qwest Broadband
19 Services, Inc. (BSI) is an affiliate that uses some Qwest facilities when providing services
20 similar to cable TV services. The Staff testimony demonstrated that Qwest had not
21 charged BSI for installation of pedestals and cabinets used by BSI. In the Settlement

⁵ The original Qwest recommendation would have resulted in a reduction in intrastate annual depreciation expense of approximately \$109 million. The Qwest recommendation moved to approximately \$160 million annual reduction after Qwest accepted one of the Staff recommendations. (Executive Overview, Rebuttal Testimony of Dennis Wu).

1 Agreement, Qwest agrees that it should have charged BSI for the cost of installing the
2 cabinets and pedestals used by BSI. The calculation of the revenue deficiency takes into
3 account Qwest's failure to bill for pedestals and cabinets used by BSI. Qwest also agreed
4 on a going forward basis to bill BSI for the cost of installing the cabinets and pedestals in
5 accordance with the FCC's affiliate billing rules.

6
7 The calculation of the revenue deficiency in the Settlement Agreement does adjust for
8 Qwest's failure to bill for installation of pedestals and cabinets used by BSI. On a going
9 forward basis Qwest will bill BSI for the cost of installing the cabinets and pedestals in
10 accordance with the FCC's affiliate billing rules. Therefore, this issue is reasonably
11 resolved in the Settlement Agreement and the treatment of this issue in the Settlement
12 Agreement is reasonable and in the public interest.

13
14 **Q. Please address the DSL allocation issue in the Settlement Agreement.**

15 A. The DSL allocation issue is addressed in Section 5 of the Settlement Agreement. DSL
16 revenues are not considered intrastate jurisdictional revenues. However, Qwest was
17 separating a significant portion of the DSL costs into the intrastate jurisdiction, as
18 discussed in Staff testimony.⁶ In the Settlement Agreement, Staff and Qwest have agreed
19 that, to the extent permissible under the FCC Part 36 separations rules, the DSL costs
20 should not be considered intrastate jurisdictional costs. The resolution of this issue in the
21 Settlement Agreement is reasonable and is in the public interest.

22
23 **Q. Please summarize your testimony.**

⁶ Pages 6-13, Direct Testimony and Schedules of William Dunkel.

- 1 A. In my opinion, the resolutions set forth in the Settlement Agreement are reasonable and
- 2 in the public interest on the issues addressed in this testimony.