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BEFORE THE ARIZONA CORPORATION COMMISSION

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

DOCKET NO. T-01051B-03-0454

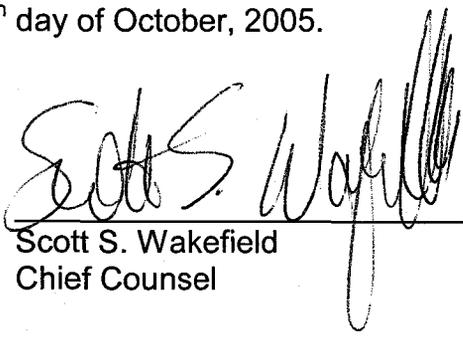
10 IN THE MATTER OF THE
INVESTIGATION OF THE COST
OF TELECOMMUNICATIONS
ACCESS.

DOCKET NO. T-00000D-00-0672

13
14 **RUCO's NOTICE OF FILING SUPPLEMENTAL TESTIMONY
IN OPPOSITION TO QWEST'S SETTLEMENT AGREEMENT**

15
16 The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the
17 Supplemental Testimony of Marylee Diaz Cortez and Dr. Ben Johnson in opposition to Qwest's
18 Settlement Agreement.

19 RESPECTFULLY SUBMITTED this 14th day of October, 2005.

20
21 
22
23 Scott S. Wakefield
Chief Counsel

1 AN ORIGINAL AND FIFTEEN COPIES
2 of the foregoing filed this 14th day
3 of October, 2005 with:

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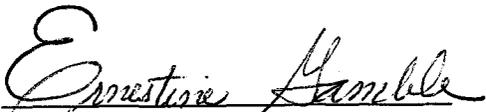
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QWEST CORPORATION

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

and

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

**SUPPLEMENTAL TESTIMONY
IN OPPOSITION TO
QWEST'S SETTLEMENT AGREEMENT**

OF

BEN JOHNSON, PH.D.

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

OCTOBER 14, 2005

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TESTIMONY
OF BEN JOHNSON, PH.D.
On Behalf of
THE STATE OF ARIZONA
RESIDENTIAL UTILITY CONSUMER OFFICE
Before the
ARIZONA CORPORATION COMMISSION

Docket No. T-01051B-03-0454
Docket No. T-00000D-00-0672

Introduction

Q. Would you please state your name and address?

A. Ben Johnson, 2252 Killearn Center Boulevard, Tallahassee, Florida 32309.

Q. What is your present occupation?

A. I am a consulting economist and president of Ben Johnson Associates, Inc., an economic research firm specializing in public utility regulation.

Q. Have you prepared an appendix that describes your qualifications in regulatory and utility economics?

A. Yes. Appendix A, attached to my testimony, will serve this purpose.

1 **Q. What is your purpose in making your appearance at this hearing?**

2 A. Our firm has been retained by the Residential Utility Consumer Office ("RUCO") to
3 assist with RUCO's participation in this proceeding, which involves a proposed
4 settlement and price cap plan between Staff, Qwest and other parties which is intended to
5 resolve issues raised in two separate Arizona Corporation Commission (Commission)
6 dockets – T-01051B-03-0454 (which examines proposed revisions to Qwest
7 Corporation's Arizona Price Regulation Plan) and T-00000D-00-0672 (which
8 investigates the pricing of Qwest's intrastate switched access service).

9 Following this introduction, my testimony has three major sections. In the first
10 section, I briefly sketch the background of this proceeding and summarize the proposed
11 settlement. In the second section, I discuss respond to specific provisions in the proposed
12 settlement and revised price cap plan. In the third section, I present my conclusions and
13 recommendations.

14

15 **Q. Would you please very briefly summarize your conclusions?**

16 A. After careful review of the revised plan proposed by the settling parties, I have concluded
17 that, from a public interest perspective, it does not represent an improvement over the
18 current Plan. To the contrary, under the proposed plan Qwest will have greater freedom
19 to exploit its remaining monopoly power, by increasing prices for services where it faces
20 relatively little competition. And, the proposed plan includes very few, if any, changes
21 which would benefit residential and other mass market customers.

22 As I explained in my direct testimony, significant barriers to entry remain in many
23 portions of the Arizona telecommunications market – and continue in residential areas

1 and rural parts of the state. While exceptions certainly exist, by and large, most local
2 competitors have not yet enjoyed much success in penetrating the local exchange market,
3 developing a market presence, gaining large numbers of customers, or building
4 substantial revenues. The high degree of pricing freedom that would be granted Qwest
5 under the proposed settlement is not consistent with the limited, inconsistent state of
6 competition in much of Qwest's Arizona service territory.

7 Equally troubling, the proposed settlement does not even attempt to resolve
8 pressing issues, such as geographic differences in cost, geographic differences in
9 competitive pressure, and the need for an improved Arizona Universal Service Fund.

10 I conclude that the public interest would not be served by replacing the current
11 price cap plan with the plan attached to the proposed settlement. The proposed settlement
12 is not an improvement over the existing plan; nor does it address some important issues
13 pending in this proceeding which are central to the future viability of competition in the
14 Arizona telecommunications market. I recommend that the Commission reject the
15 proposed settlement, and proceed to a hearing on the full record in this hearing on the full
16 record in this matter.

17
18 **Background**

19
20 **Q. Can you start your background discussion by briefly describing the purpose of price**
21 **cap regulation?**

22 **A.** The primary objective of regulation, including price cap regulation, has always been to
23 produce results in the utility sectors of the economy that parallel those obtainable under

1 conditions of effective competition. Although economists recognize that full competition
2 remains an unrealized ideal in our economy, the high levels of efficiency and equity
3 achieved under effective competition have long been a primary justification of America's
4 free enterprise or market-directed system.

5 As I explained in my direct testimony, the specific goal of price cap regulation is
6 to eliminate the linkage between cost and rates. However, under price cap regulation,
7 policy makers still view the results of effective competition as an appropriate benchmark,
8 and still are focused on preventing monopolists from charging excessive rates or earning
9 supra-normal profits. Once competition becomes strong enough to force ILECs to charge
10 the going market rate for their services, then price cap regulation can be greatly loosened,
11 particularly if the incumbent is being forced by competition to set its rates below the price
12 cap level. Stated differently, price caps are a means by which regulators can transition to a
13 competitive market, by loosening constraints as competitive pressures become strong
14 enough to prevent the exercise of monopoly power. However, if the freedom to increase
15 prices is provided prematurely, it can harm consumers and adversely impact the transition
16 to effective competition.

17
18 **Q. Would you now briefly sketching the background of this docket?**

19 **A.** Certainly. The Commission opened the Access Docket in September 2000 with the intent
20 of analyzing the relationship between the rates charged and the costs incurred in the
21 provision of access service. [Procedural Order, December 3, 2001, p. 1] On June 28,
22 2002, after several rounds of comments and testimony, Staff filed a Motion to Suspend
23 the Procedural Schedule. The Commission granted the motion on July 8, 2002. The

1 Access Investigation was subsequently combined with the rate cap review in this
2 proceeding, and thus it is feasible for the Commission to implement changes to Qwest's
3 access rate structure in this proceeding, should it decide this is appropriate.

4 The origin of the Price Cap Docket can be found in the Commission's Order No.
5 63487, which approved the Company's current Plan. On July 1, 2003 Qwest filed an
6 application for a Revised Price Regulation Plan. After several procedural delays, Qwest
7 filed supporting testimony on May 20, 2004. RUCO, Staff and other parties filed direct
8 testimony on November 18, 2004. Qwest filed rebuttal testimony on December 20, 2004.
9 The other parties filed surrebuttal testimony on January 12, 2005.

10 Shortly thereafter, Qwest, Staff, RUCO and other interested parties began a series
11 of settlement discussions. On August 23, 2005, Staff filed a Notice of Settlement
12 Agreement. The agreement included a revised price cap plan, and was entered into by
13 Staff, Qwest, the Department of Defense and other Federal Agencies, MCI, Time Warner,
14 the Arizona Utility Investors Association and DO Communications. The settling parties
15 filed supporting testimony on September 6, 2005.

16
17 **Q. Would you briefly summarize the Settlement Agreement?**

18 **A.** The Settlement Agreement has three main components. First, the parties agreed to a
19 jurisdictional revenue deficiency of \$31.8 million. Second, the parties agreed to a \$12
20 million switched access reduction. Third, the parties agreed to a Revised Price Cap Plan.
21 Key provisions of the revised plan include:

- 22
23 1. Services are grouped into four baskets.

- 1 2. Prices for services in Basket 1 (Hard Capped Retail Services) cannot increase over
2 the term of the plan.
- 3 3. Prices for individual services in Basket 2 (Limited Pricing Flexibility Retail
4 Services) cannot increase more than 25% per year. Combined revenue increases
5 for all services Basket 2 are limited by an overall revenue cap.
- 6 4. Price increases for individual services in Basket 3 (Flexibly-Priced Competitive
7 Services) are not constrained. However, combined revenue increases for all
8 services are limited by an overall revenue cap.
- 9 5. Prices for services in Basket 4 (Wholesale Services) are capped at current tariff or
10 contract levels for the duration of the plan.
- 11 6. During the term of the plan, Qwest can raise rates for basket 2 and 3 services to
12 generate up to an additional \$43.8 million in revenues. (\$31.8 million revenue
13 deficiency, plus \$12 million access charge rebalancing) However, during the first
14 year of the plan, revenues cannot increase more than \$31.8 million.
- 15 7. During the first year of the plan, only \$1.8 million of the allowed \$31.8 million
16 revenue increase can be derived from increases to Basket 2 services. During the
17 remaining years of the plan, only \$13.8 million of the allowed \$43.8 million
18 revenue increase can be derived from increases to Basket 2 services.
- 19 8. The plan has a duration of 3 years. At the end of 3 years, Qwest can propose to:
20 1) continue the plan; 2) revise the plan; or 3) terminate the plan. The plan
21 continues in effect until the Commission approves a renewal or modification of
22 the plan, or until the Commission orders the termination of the plan.
- 23

1 **Response to Settlement and Proposed Plan**

2

3 *Conceptual Framework*

4

5 **Q. Let's turn to your response to the proposed settlement and price cap plan. Can you**
6 **begin by discussing the appropriate framework within which the Commission**
7 **should review the proposal?**

8 **A.** Under the existing price cap plan, Qwest must

9

10 submit an application for continuation or modification of the Price
11 Cap Plan nine months prior to its expiration, to be reviewed by
12 Staff and RUCO. Continuation or modification of the Plan is
13 subject to Commission approval and the Plan remains in effect
14 pending a Commission decision renewing, modifying or
15 terminating it. [Decision No. 63487, March 30, 2001, p. 6]

16

17 The settling parties are requesting a modification to the current plan through approval of
18 their proposed settlement and revised price cap plan. In addition to modifying the current
19 plan by approving the settlement (or some variation of the settlement), the Commission
20 has the option of renewing the current plan, or terminating it. Presumably, if it simply
21 terminates the current plan, Qwest would thereafter be subject to traditional regulation.

22

23 When analyzing the proposed settlement, the Commission should determine
24 whether the proposal is in the public interest. In order to make such a determination, the
25 Commission needs a benchmark to evaluate the merits of the proposed settlement. That
26 benchmark should be the statu quo. In evaluating whether the settlement is an
improvement over the status quo, the Commission should focus on whether or not the

1 proposed settlement furthers important public policy objectives, such as establishing
2 robust and effective competition in the telecommunications market, preventing the
3 exploitation of monopoly power where competition is not fully effective, and preserving
4 and promoting universal service.

5 For purposes of my testimony, I will work within this conceptual framework, by
6 comparing the existing plan to the proposed settlement and by analyzing whether the
7 settlement advances or damages the aforementioned policy objectives. During such an
8 analysis, it is particularly important to consider the perspective of residential and other
9 mass market consumers, because they did not participate in the settlement negotiations,
10 they have the fewest competitive options, and they collectively have the most to gain or
11 lose from any changes in the form of regulation applied to Qwest.

12 On balance, if the proposed settlement is worse for these customers than the
13 existing plan, it fails to advance important public policy goals, or it fails to adequately
14 address important policy issues which were supposed to be dealt with in this proceeding.
15 the Commission should reject the proposed settlement, and proceed to a full hearing on
16 the merits, using the existing record that has been developed over the course of this
17 proceeding.

18

19

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23

1 *Service Baskets and Competition*

2
3 **Q. Let's turn to your discussion of service baskets and competition. Can you begin by**
4 **comparing the current basket structure to the proposed basket structure?**

5 A. Yes. Under the current plan, services are divided into 3 baskets: 1) Basic/Essential Non-
6 Competitive Services; 2) Wholesale Services; and, 3) Flexibly-Priced Competitive
7 Services. As I mentioned above, the proposed plan divides services into 4 baskets: 1)
8 Hard Capped Retail Services; 2) Limited Pricing Flexibility Retail Services; 3) Flexibly-
9 Priced Competitive Services; and, 4) Wholesale Services.

10
11 **Q. How did the settling parties determine which services to place into each basket?**

12 A. Staff witness Rowell explains that the services included in the existing Basket 1 have
13 been divided into proposed Baskets 1 and 2 under the settlement proposal.

14 Under the current plan, Basket 1 contains both basic services that are hard
15 capped and other services that have a 25% annual cap on price increases.
16 Essentially, the proposed plan gives each of these two classes of services
17 their own basket. [Rowell Direct, p. 4]

18
19 Under the current plan, Basket 3 includes those services that have been accorded pricing
20 flexibility or have been determined by the Commission to be competitive under A.A.C.
21 R14-2-1108, and new services and service packages. It appears that the intent of the
22 parties was to leave these services in Basket 3 under the proposed plan. Similarly, it
23 appears the parties intended the wholesale service basket to remain unchanged. In other
24 words, Basket 4 under the proposed plan would include the services that are currently in
25 Basket 2.

1 **Q. Did RUCO propose the addition of more retail baskets in the testimony it submitted**
2 **earlier in this proceeding?**

3 A. Yes. As I explained in my direct testimony, RUCO agrees with Qwest that competitive
4 conditions in the state have intensified since the Commission approved the current Plan.
5 Accordingly, RUCO recommended a modified basket structure that better aligned
6 services with similar competitive characteristics. More specifically, RUCO recommended
7 establishing three baskets: Moderate Pricing Flexibility Services; High Pricing Flexibility
8 Services; and Total Pricing Flexibility Services. While the settling parties have increased
9 the number of baskets, they have not adequately aligned these baskets with current
10 competitive conditions.

11
12 **Q. It sounds like the parties have simply split the current Basket 1 into two separate**
13 **baskets by separating the services that are hard-capped from those that have a 25%**
14 **cap on price increases. Is that the only effect of the proposed changes to the basket**
15 **structure?**

16 A. Unfortunately, no. Some services that are currently subject to a hard cap would be moved
17 into Basket 2, where they will be subject to prices of as much as increase by 25% per
18 year. For example, under the current plan, rates for additional local exchange lines used
19 by residential and small business customers are hard-capped. However, the parties
20 propose to move these additional lines to Basket 2, thereby allowing prices to increase by
21 as much as 25% per year. Similarly, under the current plan, exchange zone increment
22 charges on additional lines are capped. These services also have been moved to Basket 2.
23 There are other services that are capped under the current plan, but which have been

1 moved into Basket 2 to under the proposed plan. For instance, PBX trunks and caller ID
2 block are currently hard capped, but if the settlement is approved, prices for these services
3 will be allowed to increase by 25% per year.

4 Further, the settling parties propose to move some services that are currently in
5 Basket 1 to Basket 3, where Qwest would have virtually unlimited freedom to increase
6 prices. For example, Stand-by Line Service, Home Business Line Service, Uniform Call
7 Distribution and Code Billing are currently in Basket 1. All of these services are in
8 Basket 3 under the proposed settlement plan. Additionally, at the time the current plan
9 was approved, existing service packages were placed in Basket 1. Under the proposed
10 plan, these packages would be placed in Basket 3.

11
12 **Q. Are the changes you just described appropriate?**

13 **A.** No. Services should be assigned to baskets primarily on the basis of the intensity of the
14 competitive pressures currently being faced by Qwest. In determining the most
15 appropriate assignment of each service, the Commission could also consider other
16 relevant factors, including public safety or other public interest concerns, evidence that
17 competition is likely to intensify or diminish in the future, and evidence that viable
18 substitutes are available for those customers who would be unwilling or unable to use a
19 competitive offering, if the price of the service in question were to be increased
20 substantially.

21 By aligning the degree of pricing flexibility with the degree of competitive
22 intensity, the Commission can further the goals of the 1996 Telecom Act while also
23 protecting customers from Qwest's remaining market power. The 1996 Telecom Act is

1 designed to encourage greater competition, and it declared invalid all state rules that
2 restricted entry or otherwise limited competition in telephone service. Since the
3 development of competition for telephone services was one of the primary goals of the
4 1996 Telecom Act, and since competition for some services has grown considerably in
5 recent years, it is reasonable to use competitive conditions as the primary basis for
6 assigning services to baskets.

7 When assigning services to baskets, what is important is to make sure that the
8 more highly competitive services aren't commingled with much less competitive services.
9 Assigning services to baskets according to competitive intensity will advance the public
10 interest because price controls will be loosened most for services and areas with the most
11 intense competition and controls will be only moderately relaxed, or maintained, for
12 services and areas with less intensive competition.

13 Under the settlement proposal, some services that are subject to relatively weak or
14 non-existent competition would be assigned to baskets 2 or 3, where they would be the
15 subject of an excessive degree of pricing freedom. As a result, Qwest would be granted
16 an excessive degree of pricing flexibility in some of the markets where it faces relatively
17 little competitive pressure, and thus it will be able to exploit its residual market power to
18 the detriment of its customers and the public generally.

19
20 **Q. Can you elaborate on some of the specific problems that would result from the**
21 **proposed basket structure if the settlement proposal were accepted?**

22 A. Under the current plan, individual rates for additional local exchange access lines are
23 capped at the prices that were in place when the current plan was first approved. Further,

1 these services are in Basket 1, and are therefore subject to an overall basket price cap
2 equal to the change in GDP-PI minus 4.2%. To the extent inflation is less than 4.2%, at
3 least some of the prices for basket 1 services must decline.

4 In contrast, under the proposed plan, prices for additional access lines (for both
5 business and residential customers) will no longer be subject to a hard cap, and they will
6 no longer be subject to mandatory reductions in prices when inflation runs less than 4.2%.
7 In fact, under the proposed settlement, revenues from Basket 2 services can increase up to
8 \$43.8 million, so the additional line rates could immediately be increased by 25%, and
9 Qwest could thereafter increase these prices by as much as 25% per year, until they reach
10 monopoly profit-maximizing levels ("whatever the traffic will bear").

11 Similar problems apply to exchange zone increment charges applicable to
12 additional lines, as well as rates for PBX trunks and caller ID block. Even more rapid
13 movement to monopoly profit-maximizing price levels will be possible with respect to
14 services that will be moved from the current basket 1 to the proposed basket 3. These
15 include Stand-by Line Service, Home Business Line Service, Uniform Call Distribution,
16 Code Billing and certain service bundles. Price increases for these services are currently
17 constrained by the requirement that prices not increase by more than inflation minus 4.2%
18 (an allowance for cost reductions due to productivity), as part of basket 1. Under the
19 proposed plan, these services would be moved to basket 3, and Qwest would be given
20 essentially unlimited freedom to raise prices, even if competition is weak or nonexistent.

1 **Q. Can you describe the service packages that have been moved to Basket 3?**

2 A. Yes. When the current plan was approved, all existing service packages were included in
3 Basket 1. These included packages associated with basic exchange service (TIMCODE
4 E5.9.1), as well as packages not associated with basic exchange service. (TIMCODE
5 E5.9.2) Under the current plan, new service packages can be placed in Basket 3 with
6 Commission approval. However, the plan provides that the "mere repackaging of
7 existing Basket 1 services does not qualify the existing services to be "new services".
8 [Price Cap Plan, Section 4.e.ii]

9 In contrast, under the proposed settlement, all existing and future packages would
10 be placed in Basket 3, including existing packages associated with basic exchange
11 service. These existing packages include QWEST CHOICE Business and QWEST
12 CHOICE Home, which allow basic exchange customers to choose 3 enhanced features
13 (e.g., Caller ID, Call Forwarding, Call Waiting, etc..) for a single monthly rate. These
14 services will be in Basket 3 under the proposed plan. These are important offerings
15 which are widely used by mass market customers. From the perspective of many
16 residential and small business customers, these features are seen as an essential part of
17 their local exchange service. The limited degree of competition which currently exists for
18 local exchange service is not sufficient to justify giving Qwest complete freedom to
19 increase prices for these local exchange service packages. To the contrary, Qwest
20 continues to dominate most Arizona local exchange markets, and it would not be
21 appropriate for the Commission to give Qwest the freedom to rapidly increase prices for
22 these local exchange service packages. Under the existing plan, the prices for many of
23 these packages have been essentially frozen in place, because they were subject to a hard

1 cap. Clearly, the public interest would not be served by going from the current plan, with
2 its hard cap, to the proposed settlement plan, which would subject these customers to the
3 full extent of Qwest's residual monopoly power.

4
5 *Settlement Does Not Resolve Certain Problems*

6
7 **Q. You have been discussing problems with specific provisions in the proposed plan.**

8 **Can you now discuss the important issues that the proposed plan fails to address?**

9 A. There are at least three major, conceptually related, issues that are not adequately
10 addressed by the settling parties and their proposed plan. These issues are: geographic
11 cost differences; geographic competitive differences; and, the need for an improved
12 universal service fund.

13
14 **Q. Can you elaborate on what you mean by geographic cost differences?**

15 A. Qwest's service Arizona territory covers a very large geographic area which encompasses
16 a range of different market conditions. Even within the same local calling area or local
17 exchange there can be extreme differences between the operating and engineering
18 characteristics of wire centers in the downtown urban core and the characteristics of the
19 outlying wire centers. In turn, these differences can translate into substantial differences
20 in the costs and difficulties involved in serving customers in different wire centers.

21 The most obvious example of these differences concerns the unbundled UNE loop
22 rates; lower rates tend to apply to urban wire centers while higher rates apply to rural wire
23 centers. But differences in UNE loop rates are just the tip of the iceberg. There may be

1 even more dramatic percentage differences in non-loop costs when comparing the cost
2 per line of serving customers using a CLEC switch in urban and rural wire centers (e.g.,
3 due to differences in available economies of scale with respect to inter-office transport
4 facilities and collocation facilities). Further, marketing and sales costs can sometimes be
5 higher in small towns and rural areas. For instance, marketing options may be relatively
6 limited, and entrants may be forced to expend precious advertising dollars on television
7 and media coverage areas that are far wider than the intended target market.

8
9 **Q. Can you now discuss the geographic differences in competition throughout Qwest's**
10 **service territory?**

11 A. As a result of differences in the underlying characteristics of each geographic area and
12 differences in the mix of customers that are present in each area, competitive pressures
13 will vary widely within a single ILEC's service territory. In general, one can expect to
14 see lower barriers to entry and more intense competitive pressures in downtown urban
15 areas, with higher barriers to entry and weaker competitive activity in rural areas.
16 Similarly, it is reasonable to anticipate that competitive carriers will focus, at least
17 initially, on concentrations of customers that use large volumes of telecommunications
18 services (sometimes referred to as "enterprise" customers). For instance, revenues from
19 some services (e.g., custom calling) may be lower in some small towns relative to some
20 urban areas, due to differences in demand characteristics and/or income levels.

1 **Q. Have you studied the actual differences in competitive entry in Qwest's service**
2 **territory?**

3 A. Yes. In my direct testimony, filed earlier in this proceeding, I presented evidence that
4 Qwest continues to enjoy dominant positions in many local markets, which are at least
5 partially protected by substantial barriers to entry. At the time of my analysis,
6 competition had been increasing in some areas—particularly in business markets. My
7 review of the data indicated that Qwest has been experiencing substantial market share
8 losses in Phoenix and Tucson. Nevertheless, the Company continues to dominate most
9 Arizona local exchange markets. In some markets competitors have been quite successful
10 in winning customers; in other cases, relatively few competitors have been attracted into
11 the market, or they have not been very successful in winning a share of the market. The
12 data showed that successful competitive entry is not easy anywhere; but in some locations
13 entry barriers are higher than in other areas.

14 In particular, my analyses showed that CLECs tend to disproportionately focus on
15 serving enterprise customers, and that a higher proportion of enterprise lines exists in the
16 higher density wire centers. Enterprise lines tend to be most prevalent in wire centers that
17 serve the more urbanized, higher density parts of the state. In general, it is reasonable to
18 anticipate that Qwest will continue to face the greatest competitive pressures in areas with
19 the highest line density.

20
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22
23

1 **Q. Does the proposed settlement attempt to resolve problems caused by geographic**
2 **differences in costs, and the resulting effects on competition?**

3 A. No. Qwest originally included a “competitive zone” approach in its proposed price cap
4 plan. While there were problems with this specific proposal, I recommended that
5 geographic differences in the level of competition be considered when deciding which
6 services go into the various baskets.

7 While there were important differences in their specific proposals, both RUCO
8 and Qwest recognized that widely differing competitive conditions should be recognized
9 in developing revisions to Qwest’s price cap plan. Yet, Section 26 of the Settlement
10 Agreement provides:

11
12 Qwest shall withdraw its proposal for competitive zones in Arizona.
13 Qwest further agrees that it will not renew its request for competitive
14 zones during the term of the Renewed Price Cap Plan.
15

16 As explained by Qwest witness Jerrold Thompson:

17
18 Competitive zones were a controversial topic in the direct
19 testimony in this proceeding with very disparate points of view.
20 The elimination of this issue removes this controversy. Qwest will
21 continue to price its services to consumers in sparsely-populated
22 areas in the state in similar ways to consumers in the highly
23 competitive areas of Phoenix and Tucson. [Thompson Direct, p. 4]
24

25 While this part of the settlement may have been intended to reduce controversy, this has
26 the unfortunate effect of disregarding a very important feature of the current economic
27 environment in which Qwest operates, and will likely exacerbate the problems – and

1 controversy – which will arise in the future. By failing to consider differences in
2 competitive conditions, the proposed settlement leaves customers in high cost rural areas
3 vulnerable to excessive price increases – a problem that is exacerbated by other aspects of
4 the proposed settlement, including removal of the productivity offset and changes in the
5 basket structure. The proposed settlement and price cap plan does not go far enough in
6 protecting consumers who have few, if any, competitive alternatives; aside from the hard
7 cap on prices of certain services (a cap which applies to all geographic areas regardless of
8 the extent of competition) the settlement proposal offers very little protection from
9 monopoly power for customers in markets where competition is weak or non-existent.
10 Nor do the proposed changes to the existing price cap plan improve the prospects for
11 effective competition in these markets.

12
13 **Q. Are there other alternatives that could be used to improve the prospects for**
14 **competition in rural areas?**

15 A. In the absence of a state USF which adequately alleviates the high costs of serving rural
16 customers, there is relatively little potential for competition in the lower density, higher
17 cost parts of the state. As I explained in my direct testimony, if the Commission wants to
18 ensure that rural areas generate revenues which are sufficient to cover the relatively high
19 cost of serving these areas, it should revamp the Arizona universal service fund to
20 provide an appropriate mechanism for dealing with these cost disparities.

21 Historically, the high cost of serving rural areas has been recovered in part by
22 allowing carriers to charge higher for toll and access services than would otherwise be
23 allowed. In both the federal and state jurisdictions, access rates have historically been

1 regulated on a uniform average basis; the high costs incurred in rural areas is one of the
2 reasons why policy makers have historically allowed Qwest to charge so much for
3 ancillary services like switched access, custom calling and CallerID. Stated another way,
4 high rural loop costs have translated into relatively high rates for switched access, long
5 distance toll, and other ancillary services. As I explained in my direct testimony, other
6 states, such as Kansas, have used some sort of universal service funding mechanism as an
7 alternative method of providing high cost support. This proceeding provided an excellent
8 opportunity for the Commission to deal with these concerns – or at least make a start in
9 the right direction. Instead, the settlement essentially ignores the problem. It reduces the
10 amount of cost support provided by access charges, thereby making it less profitable for
11 competitive local exchange carriers to serve high cost rural areas, without making any
12 improvements to the structure of the existing USF mechanism. In this area, as in others,
13 the settlement proposal falls well short of what is needed, and cannot fairly be described
14 as an improvement over the status quo.

15
16 **Conclusions and Recommendations**

17
18 **Q. What are your conclusions regarding the proposed settlement?**

19 **A.** The proposed plan is not an improvement over the current plan, and therefore approving
20 it would not be in the public interest. If adopted, the settlement would give Qwest too
21 much freedom to exert its monopoly power. Some monopoly services, including
22 additional basic local exchange lines used by residential customers, will no longer be hard
23 capped. Instead, they will be subject to price increases of as much as 25% per year. Other

1 services that currently are subject to a 25% annual cap on rate increases, including and
2 local exchange service packages used by residential customers, will be subject to
3 unlimited price increases under the proposed plan.

4 Clearly, the existing level of competition in many parts of Qwest's Arizona
5 service territory is not strong enough to prevent Qwest from imposing substantial price
6 increases on residential customers if the settlement is approved. Under the proposed
7 settlement, Qwest would be granted far too much pricing flexibility in markets where it
8 faces very little competitive pressure, and thus it will be able to exploit its residual market
9 power to the detriment of its residential customers and the public generally.

10 As I explained in my direct testimony, significant barriers to entry remain in many
11 portions of the Arizona telecommunications market, particularly in residential areas and
12 rural parts of the state. Few local competitors have enjoyed success in penetrating the
13 local exchange market. The high degree of pricing freedom that would be granted Qwest
14 under the proposed settlement is inconsistent with the limited state of competition in most
15 rural and residential markets in Arizona. Clearly, these provisions of the settlement
16 proposal are not motivated by any need to provide Qwest with additional freedom to
17 respond to competitive market forces— since in a declining cost industry those market
18 forces almost always translate into downward pricing pressures, yet Qwest already has
19 considerable freedom to reduce prices under the current plan. As well, the changes to the
20 existing price cap plan that are called for by the settlement go almost entirely in the
21 opposite direction – providing Qwest with greater freedom to increase prices, rather than
22 providing further opportunities to reduce prices.

1 If the existing price cap plan were truly placing the company at a competitive
2 disadvantage (e.g., if the Company were prevented from cutting prices in response to
3 competitive pressures), the competitors' market share would be much larger, and the
4 Company's share of the market would be declining much more rapidly than it actually
5 has. Further, in such an environment, Qwest would not have focused its negotiating
6 efforts on trying to obtain policy changes that will result in increased rates, nor would it
7 have been so quick to abandon portions of its original proposals which would have
8 provided it with greater freedom to reduce prices in areas where it is suffering from
9 greater than average market share losses. The balance struck in the proposed settlement
10 is clearly oriented toward changes in the current plan that will enable Qwest to extract
11 additional revenues and profits from markets where the Company continues to enjoy a
12 substantial degree of monopoly power, rather than changes that would better enable the
13 Company to cut prices in markets where this is necessitated by increased competitive
14 pressures.

15 I would also note that the settlement offers very few, if any, changes which would
16 represent an improvement over the current plan from the perspective of residential and
17 other mass market customers. On balance, the proposed settlement is worse for these
18 customers than the existing plan, and therefore the Commission should reject the
19 proposed settlement.

20
21 **Q. Are there other reasons why the proposed plan should not be approved?**

22 **A.** Yes. If the Commission is going to modify or replace the current plan, it should take this
23 opportunity to make progress in resolving at least some of the looming issues which are

1 casting a shadow over the industry, and were discussed by the parties in testimony
2 submitted earlier in this proceeding. More specifically, the settlement proposal does not
3 adequately address issues related to geographic cost differences, geographic differences in
4 competitive market conditions, or the need for an improved Arizona Universal Service
5 Fund.

6 Qwest's Arizona service territory encompasses a wide range of different market
7 conditions. Even within the same metropolitan area there can be extreme differences in
8 operating and engineering characteristics. These differences translate into substantial
9 differences in the costs and difficulties involved in serving customers in different parts of
10 Qwest's service territory. As a result, competitive pressures vary widely throughout
11 Qwest's Arizona market areas. This proceeding provided an excellent opportunity for the
12 Commission to deal with these very real, and growing, concerns. Yet, the settlement
13 essentially ignores these problems. In fact, it may exacerbate the problems because it
14 reduces the amount of cost support provided by switched access charges, thereby making
15 it less profitable for competitive local exchange carriers to serve high cost rural areas,
16 without making any offsetting improvements to the structure of the existing USF
17 mechanism. The settlement proposal falls well short of what is needed, and cannot be
18 considered an improvement over the current plan.

19
20 **Q. What do you recommend the Commission do?**

21 A. I recommend that the Commission reject the proposed settlement, and move forward with
22 a full hearing on all of the issues that were raised during the earlier stages of this
23 proceeding. It is not yet time to begin thinking about providing the Company with the

1 type of extreme pricing flexibility that it seeks through this proposal. Qwest continues to
2 enjoy a dominant share of most Arizona telecommunications market, and its competitors
3 are far too small to provide an adequate substitute for continued pricing constraints, such
4 as those contained in the current plan. Further, the plan does not address important policy
5 issues that need to be resolved before the existing plan is modified.

6 I believe that parties have had ample opportunity to provide written testimony
7 concerning all of the issues that need to be dealt with in this proceeding. Since no further
8 testimony needs to be submitted, the Commission can go directly to a full hearing on the
9 merits of the parties' respective positions without further delay. If, however, the
10 Commission wants the parties to submit additional testimony concerning specific issues,
11 or to respond to specific questions that have arisen during the course of this settlement
12 hearing, it could allow the parties to file testimony that is focused on those specific issues
13 or questions with only a minimal delay.

14
15 **Q. Does this conclude your testimony concerning the proposed settlement, which was**
16 **prefiled on October 14, 2005?**

17 **A. Yes, it does.**
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Appendix A
Qualifications

Present Occupation

Q. What is your present occupation?

A. I am a consulting economist and President of Ben Johnson Associates, Inc.®, a firm of economic and analytic consultants specializing in the area of public utility regulation.

Educational Background

Q. What is your educational background?

A. I graduated with honors from the University of South Florida with a Bachelor of Arts degree in Economics in March 1974. I earned a Master of Science degree in Economics at Florida State University in September 1977. The title of my Master's Thesis is a "A Critique of Economic Theory as Applied to the Regulated Firm." Finally, I graduated from Florida State University in April 1982 with the Ph.D. degree in Economics. The title of my doctoral dissertation is "Executive Compensation, Size, Profit, and Cost in the Electric Utility Industry."

Clients

Q. What types of clients employ your firm?

A. Much of our work is performed on behalf of public agencies at every level of government involved in utility regulation. These agencies include state regulatory

1 commissions, public counsels, attorneys general, and local governments, among others.
2 We are also employed by various private organizations and firms, both regulated and
3 unregulated. The diversity of our clientele is illustrated below.

4

5 Regulatory Commissions

6

7 Alabama Public Service Commission—Public Staff for Utility Consumer Protection

8 Alaska Public Utilities Commission

9 Arizona Corporation Commission

10 Arkansas Public Service Commission

11 Connecticut Department of Public Utility Control

12 District of Columbia Public Service Commission

13 Idaho Public Utilities Commission

14 Idaho State Tax Commission

15 Iowa Department of Revenue and Finance

16 Kansas State Corporation Commission

17 Maine Public Utilities Commission

18 Minnesota Department of Public Service

19 Missouri Public Service Commission

20 National Association of State Utility Consumer Advocates

21 Nevada Public Service Commission

22 New Hampshire Public Utilities Commission

23 North Carolina Utilities Commission—Public Staff

24 Oklahoma Corporation Commission

25 Ontario Ministry of Culture and Communications

26 Staff of the Delaware Public Service Commission

27 Staff of the Georgia Public Service Commission

28 Texas Public Utilities Commission

29 Virginia State Corporation Commission

30 Washington Utilities and Transportation Commission

- 1 West Virginia Public Service Commission—Division of Consumer Advocate
- 2 Wisconsin Public Service Commission
- 3 Wyoming Public Service Commission

4

5 Public Counsels

6

- 7 Arizona Residential Utility Consumers Office
- 8 Colorado Office of Consumer Counsel
- 9 Colorado Office of Consumer Services
- 10 Connecticut Consumer Counsel
- 11 District of Columbia Office of People's Counsel
- 12 Florida Public Counsel
- 13 Georgia Consumers' Utility Counsel
- 14 Hawaii Division of Consumer Advocacy
- 15 Illinois Small Business Utility Advocate Office
- 16 Indiana Office of the Utility Consumer Counselor
- 17 Iowa Consumer Advocate
- 18 Maryland Office of People's Counsel
- 19 Minnesota Office of Consumer Services
- 20 Missouri Public Counsel
- 21 New Hampshire Consumer Counsel
- 22 Ohio Consumer Counsel
- 23 Pennsylvania Office of Consumer Advocate
- 24 Utah Department of Business Regulation—Committee of Consumer Services

25

26 Attorneys General

27

- 28 Arkansas Attorney General
- 29 Florida Attorney General—Antitrust Division
- 30 Idaho Attorney General

- 1 Kentucky Attorney General
- 2 Michigan Attorney General
- 3 Minnesota Attorney General
- 4 Nevada Attorney General's Office of Advocate for Customers of Public Utilities
- 5 South Carolina Attorney General
- 6 Utah Attorney General
- 7 Virginia Attorney General
- 8 Washington Attorney General

9

10 Local Governments

11

- 12 City of Austin, TX
- 13 City of Corpus Christi, TX
- 14 City of Dallas, TX
- 15 City of El Paso, TX
- 16 City of Galveston, TX
- 17 City of Norfolk, VA
- 18 City of Phoenix, AZ
- 19 City of Richmond, VA
- 20 City of San Antonio, TX
- 21 City of Tucson, AZ
- 22 County of Augusta, VA
- 23 County of Henrico, VA
- 24 County of York, VA
- 25 Town of Ashland, VA
- 26 Town of Blacksburg, VA
- 27 Town of Pecos City, TX

28

29 Other Government Agencies

30

- 1 Canada—Department of Communications
- 2 Hillsborough County Property Appraiser
- 3 Provincial Governments of Canada
- 4 Sarasota County Property Appraiser
- 5 State of Florida—Department of General Services
- 6 United States Department of Justice—Antitrust Division
- 7 Utah State Tax Commission

8

9 Regulated Firms

10

- 11 Alabama Power Company
- 12 Americall LDC, Inc.
- 13 BC Rail
- 14 CommuniGroup
- 15 Florida Association of Concerned Telephone Companies, Inc.
- 16 LDDS Communications, Inc.
- 17 Louisiana/Mississippi Resellers Association
- 18 Madison County Telephone Company
- 19 Montana Power Company
- 20 Mountain View Telephone Company
- 21 Nevada Power Company
- 22 Network I, Inc.
- 23 North Carolina Long Distance Association
- 24 Northern Lights Public Utility
- 25 Otter Tail Power Company
- 26 Pan-Alberta Gas, Ltd.
- 27 Resort Village Utility, Inc.
- 28 South Carolina Long Distance Association
- 29 Stanton Telephone
- 30 Teleconnect Company
- 31 Tennessee Resellers' Association

1 Westel Telecommunications
2 Yelcot Telephone Company, Inc.

3

4 Other Private Organizations

5

6 Arizona Center for Law in the Public Interest

7 Black United Fund of New Jersey

8 Casco Bank and Trust

9 Coalition of Boise Water Customers

10 Colorado Energy Advocacy Office

11 East Maine Medical Center

12 Georgia Legal Services Program

13 Harris Corporation

14 Helca Mining Company

15 Idaho Small Timber Companies

16 Independent Energy Producers of Idaho

17 Interstate Securities Corporation

18 J.R. Simplot Company

19 Merrill Trust Company

20 MICRON Semiconductor, Inc.

21 Native American Rights Fund

22 PenBay Memorial Hospital

23 Rosebud Enterprises, Inc.

24 Skokomish Indian Tribe

25 State Farm Insurance Company

26 Twin Falls Canal Company

27 World Center for Birds of Prey

28

1 ***Prior Experience***

2

3 **Q. Before becoming a consultant, what was your employment experience?**

4 A. From August 1975 to September 1977, I held the position of Senior Utility Analyst
5 with Office of Public Counsel in Florida. From September 1974 until August 1975, I
6 held the position of Economic Analyst with the same office. Prior to that time, I was
7 employed by the law firm of Holland and Knight as a corporate legal assistant.

8

9 **Q. In how many formal utility regulatory proceedings have you been involved?**

10 A. As a result of my experience with the Florida Public Counsel and my work as a
11 consulting economist, I have been actively involved in approximately 400 different
12 formal regulatory proceedings concerning electric, telephone, natural gas, railroad, and
13 water and sewer utilities.

14

15 **Q. Have you done any independent research and analysis in the field of regulatory
16 economics?**

17 A. Yes, I have undertaken extensive research and analysis of various aspects of utility
18 regulation. Many of the resulting reports were prepared for the internal use of the
19 Florida Public Counsel. Others were prepared for use by the staff of the Florida
20 Legislature and for submission to the Arizona Corporation Commission, the Florida
21 Public Service Commission, the Canadian Department of Communications, and the
22 Provincial Governments of Canada, among others. In addition, as I already mentioned,
23 my Master's thesis concerned the theory of the regulated firm.

24

1 **Q. Have you testified previously as an expert witness in the area of public utility**
2 **regulation?**

3 A. Yes. I have provided expert testimony on more than 250 occasions in proceedings
4 before state courts, federal courts, and regulatory commissions throughout the United
5 States and in Canada. I have presented or have pending expert testimony before 35
6 state commissions, the Interstate Commerce Commission, the Federal Communications
7 Commission, the District of Columbia Public Service Commission, the Alberta, Canada
8 Public Utilities Board, and the Ontario Ministry of Culture and Communication.

9
10 **Q. What types of companies have you analyzed?**

11 A. My work has involved more than 425 different telephone companies, covering the
12 entire spectrum from AT&T Communications to Stanton Telephone, and more than 55
13 different electric utilities ranging in size from Texas Utilities Company to Savannah
14 Electric and Power Company. I have also analyzed more than 30 other regulated firms,
15 including water, sewer, natural gas, and railroad companies.

16
17 *Teaching and Publications*

18
19 **Q. Have you ever lectured on the subject of regulatory economics?**

20 A. Yes, I have lectured to undergraduate classes in economics at Florida State University
21 on various subjects related to public utility regulation and economic theory. I have also
22 addressed conferences and seminars sponsored by such institutions as the National
23 Association of Regulatory Utility Commissioners (NARUC), the Marquette University
24 College of Business Administration, the Utah Division of Public Utilities and the
25 University of Utah, the Competitive Telecommunications Association (COMPTEL), the

1 International Association of Assessing Officers (IAAO), the Michigan State University
2 Institute of Public Utilities, the National Association of State Utility Consumer
3 Advocates (NASUCA), the Rural Electrification Administration (REA), North Carolina
4 State University, and the National Society of Rate of Return Analysts.

5

6 **Q. Have you published any articles concerning public utility regulation?**

7 **A.** Yes, I have authored or co-authored the following articles and comments:

8

9 "Attrition: A Problem for Public Utilities—Comment." *Public Utilities Fortnightly*,
10 March 2, 1978, pp. 32-33.

11

12 "The Attrition Problem: Underlying Causes and Regulatory Solutions." *Public Utilities*
13 *Fortnightly*, March 2, 1978, pp. 17-20.

14

15 "The Dilemma in Mixing Competition with Regulation." *Public Utilities Fortnightly*,
16 February 15, 1979, pp. 15-19.

17

18 "Cost Allocations: Limits, Problems, and Alternatives." *Public Utilities Fortnightly*,
19 December 4, 1980, pp. 33-36.

20

21 "AT&T is Wrong." *The New York Times*, February 13, 1982, p. 19.

22

23 "Deregulation and Divestiture in a Changing Telecommunications Industry," with
24 Sharon D. Thomas. *Public Utilities Fortnightly*, October 14, 1982, pp. 17-22.

25

- 1 "Is the Debt-Equity Spread Always Positive?" *Public Utilities Fortnightly*,
2 November 25, 1982, pp. 7-8.
3
4 "Working Capital: An Evaluation of Alternative Approaches." *Electric Rate-Making*,
5 December 1982/January 1983, pp. 36-39.
6
7 "The Staggers Rail Act of 1980: Deregulation Gone Awry," with Sharon D. Thomas.
8 *West Virginia Law Review*, Coal Issue 1983, pp. 725-738.
9
10 "Bypassing the FCC: An Alternative Approach to Access Charges." *Public Utilities*
11 *Fortnightly*, March 7, 1985, pp. 18-23.
12
13 "On the Results of the Telephone Network's Demise—Comment," with Sharon D.
14 Thomas. *Public Utilities Fortnightly*, May 1, 1986, pp. 6-7.
15
16 "Universal Local Access Service Tariffs: An Alternative Approach to Access
17 Charges." In *Public Utility Regulation in an Environment of Change*, edited by
18 Patrick C. Mann and Harry M. Trebing, pp. 63-75. Proceedings of the Institute of
19 Public Utilities Seventeenth Annual Conference. East Lansing, Michigan: Michigan
20 State University Public Utilities Institute, 1987.
21
22 With E. Ray Canterbery. Review of *The Economics of Telecommunications: Theory*
23 *and Policy* by John T. Wenders. *Southern Economic Journal* 54.2 (October 1987).
24

1 "The Marginal Costs of Subscriber Loops," A Paper Published in the Proceedings of
2 the Symposia on Marginal Cost Techniques for Telephone Services. The National
3 Regulatory Research Institute, July 15-19, 1990 and August 12-16, 1990.

4

5 With E. Ray Canterbery and Don Reading. "Cost Savings from Nuclear Regulatory
6 Reform: An Econometric Model." *Southern Economic Journal*, January 1996.

7

8 ***Professional Memberships***

9

10 **Q. Do you belong to any professional societies?**

11 A. Yes. I am a member of the American Economic Association.

12

QWEST CORPORATION

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

and

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

**SUPPLEMENTAL TESTIMONY
IN OPPOSITION TO
QWEST'S SETTLEMENT AGREEMENT**

OF

MARYLEE DIAZ CORTEZ, CPA

ON BEHALF OF

THE

RESIDENTIAL UTILITY CONSUMER OFFICE

OCTOBER 14, 2005

| | | |
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1 **INTRODUCTION**

2 Q. Please state your name, occupation, and business address.

3 A. My name is Marylee Diaz Cortez. I am a Certified Public Accountant. I
4 am the Chief of Accounting and Rates for the Residential Utility Consumer
5 Office (RUCO) located at 1110 W. Washington Street, Suite 220, Phoenix,
6 Arizona 85007.

7
8 Q. Please state your educational background and qualifications in the utility
9 regulation field.

10 A. Appendix I, which is attached to this testimony, describes my educational
11 background and includes a list of the rate case and regulatory matters in
12 which I have participated.

13
14 Q. Please state the purpose of your testimony.

15 A. The purpose of my testimony is to address certain aspects of the
16 settlement agreement that Qwest Corporation has reached with some of
17 the parties to this docket.

18
19 Q. Is RUCO a signatory to the Qwest settlement agreement?

20 A. No. Although RUCO participated in the settlement negotiations from the
21 beginning, it became clear as the process proceeded that a satisfactory
22 resolution of certain important issues that were important to RUCO would
23 not be possible. RUCO withdrew from the negotiations in April 2005.

1 Q. What issues does RUCO believe are unsatisfactorily addressed in the
2 proposed settlement agreement?

3 A. RUCO believes the following issues are not satisfactorily resolved by the
4 agreement:

5 1) The agreement, as a whole, does not address the current
6 status of competition in Arizona, nor will it do anything to
7 further competition in Arizona's telecom industry;

8 2) *Inappropriate* placement of certain services in certain
9 baskets;

10 3) Lack of geographic distinction in classifying competitive
11 services;

12 4) The degree to which pricing freedom is allowed in Basket 2;

13 5) The agreement results in a modified price cap plan that,
14 when compared to the existing plan, negatively impacts
15 residential ratepayers; and

16 6) The manner in which the issue of the April 1, 2005
17 productivity adjustment (required under the existing plan) is
18 resolved by the settlement.

19
20 Q. Which of these issues do you address in your testimony?

21 A. I address the issue of the April 1, 2005 productivity adjustment. All other
22 issues are addressed by RUCO witness, Dr. Ben Johnson.

23

1 **PRODUCTIVITY ADJUSTMENT**

2 **Background**

3 Q. What is the productivity adjustment?

4 A. In March of 2001 the Commission approved a three year Price Cap Plan
5 (Decision No. 63487) for Qwest. One of the terms of that Price Cap Plan
6 was a productivity adjustment that called for an annual price reduction in
7 Basket 1 services when productivity exceeded inflation. Productivity was
8 set at a fixed rate of 4.8%, and reductions were to be made on April 1 of
9 each year.

10

11 Q. Is Qwest still operating under the Price Cap Plan approved in Decision No.
12 63487?

13 A. Yes. Despite Qwest's arguments that certain terms of the existing Price
14 Cap Plan expired after three years, the Commission has determined
15 otherwise. In Decision Nos. 66772 and 67047 the Commission affirmed
16 that the productivity adjustment was to continue until the Commission
17 either modifies or terminates the Plan.

18

19 Q. Did Qwest make the required productivity adjustments?

20 A. Qwest made the required productivity adjustments for April 2002, April
21 2003, and April 2004. Qwest has not made the required productivity
22 adjustment for April 2005.

23

1 Q. Why not?

2 A. On February 3, 2005 Qwest filed a motion to suspend the Inflation Minus
3 Productivity Factor Adjustment. The Commission made the following
4 findings on that motion in Decision No. 67734:

5 We agree with RUCO that based on the terms of the current
6 Price Cap Plan, and our holdings in Decision Nos. 66772
7 and 67047 that unless we approve a new plan or terminate
8 the current Plan, Qwest is required under the Continuation
9 Clause of the Plan to make the April 1, 2005 productivity
10 adjustment. However, the Commission certainly has the
11 discretion to suspend the April 1, 2005 reduction, to
12 accommodate comprehensive settlement discussions in this
13 case. We do not believe that a mere suspension of the April
14 1, 2005 reduction would violate Scates¹, or the principle that
15 the Commission cannot modify rates absent a fair value
16 finding. We are not terminating the April 1, 2005 adjustment.
17 The liability associated with the April 1, 2005 adjustment will
18 continue to accrue. We will address the accrued liability for
19 the April 1, 2005 adjustment in the final rate order in this
20 docket.
21

22 Decision No. 67734 further states in the Findings of Fact at page 8 that:

23 Qwest has the burden of demonstrating that the terms of any
24 Renewed Plan or other form of rate regulation that may
25 ultimately be approved, whether produced by settlement or
26 through litigation, include full credit for the value of the April
27 1, 2005 productivity adjustment being given to ratepayers.
28
29

30 **The Agreement's Proposed Treatment of the April 1, 2005 Liability**

31 Q. Does the Agreement negotiated by the parties include a provision for the
32 April 1, 2005 liability?

33 A. Yes.

¹ *Scates v. Arizona Corporation Commission*, 118 Ariz. 531, 578 P.2d 612 (App.1978).

1 Q. Please describe how the settlement agreement provides for the April 1,
2 2005 productivity liability.

3 A. The settlement agreement provides the following regarding the April 1,
4 2005 productivity liability:

5 This Settlement Agreement recognizes that the
6 Commission's Decision No. 67734 suspended the
7 Productivity Adjustment to prices that Qwest would have
8 made to Basket 1 of the original Price Cap Plan on April 1,
9 2005, under the Commission's interpretation of the Plan.
10 Under Decision No. 67734, Qwest is obligated to
11 demonstrate that final rates approved in this docket result in
12 ratepayers receiving the full value of the suspended April 1,
13 2005 Productivity Adjustment as if it had been in effect April
14 1, 2005. The parties agree that Qwest's obligation under
15 Decision No. 67734 is satisfied by the \$12.0 million reduction
16 in its allowable net increased revenue from price changes for
17 the first year of the Plan as set forth in Section 10 of this
18 Agreement.

19
20
21 Q. Does RUCO agree that this provision satisfies the liability that the
22 Commission established in Decision No. 67734?

23 A. No. This Commission specifically stated in Decision No. 67734 that
24 Qwest had the burden of demonstrating that its rate plan in this docket
25 included "credit for the full value of the April 1, 2005 productivity
26 adjustment". RUCO does not believe the provisions of the settlement
27 regarding the productivity adjustment "include credit for the *full value*".

28

29 Q. Why not?

30 A. Had the Commission not temporarily suspended the productivity
31 adjustment, Qwest would have decreased the rates in its Basket 1

1 services by approximately \$12 million on April 1, 2004. Thus, by this time
2 ratepayers would have enjoyed real rate cuts equal to or better than half of
3 that amount, or \$6 million. By April 1, 2005 ratepayers would have
4 realized rate decreases of the full \$12 million. Thus, the productivity
5 adjustment would have put ratepayers in a better position than they had
6 been prior to the April 1, 2005 adjustment. The settlement agreement
7 however, does not render ratepayers in a better position than they were
8 before the settlement agreement. The agreement merely restricts the
9 amount that Qwest can *raise* prices in Basket 2². Thus, the provisions of
10 the settlement agreement do not give ratepayers full credit for the value of
11 the productivity adjustment as required by Decision No. 67734.

12
13 **RUCO's Recommendation**

14 Q. How do you recommend that ratepayers receive full credit for the value of
15 the April 1, 2005 productivity adjustment?

16 A. I recommend that all Qwest 1FR and 1FB customers receive a credit on
17 their monthly bills equal to a twelve month amortization of the value of the
18 April 1, 2005 productivity adjustment that was foregone during the
19 suspension period.

20
21
22

² The services in Basket 2 have been identified as moderately competitive to begin with.
Arguably, Qwest's ability to raise prices for these services is already restricted by competition.

1 Q. How would this specifically be calculated?

2 A. First, the total amount required to be refunded for the suspended
3 productivity adjustment would be determined as the number of months
4 that had elapsed between April 1, 2005 and the date a revised price cap
5 plan or other rate plan is adopted by the Commission. Second, the
6 number of months determined would then be multiplied \$1 million
7 (representing the \$12 million value of the productivity adjustment divided
8 by 12 months) and interest accrued at prevailing rates. The total value of
9 the productivity adjustment as determined per step 1 and 2 would then be
10 divided by 12 months to reflect the total amount to be refunded per month.
11 Finally, the monthly refund would be divided by the total number of 1FR
12 and 1FB customers and credited to their bill over the ensuing 12 months.
13 Under this methodology, ratepayers would realize real price reductions
14 just as they would have had the required productivity adjustment not been
15 temporarily suspended. RUCO believes this proposal would satisfy the
16 criteria of Decision No. 67734 requiring that ratepayers receive the full
17 value of the suspended productivity adjustment.

18

19 Q. Does this conclude your testimony?

20 A. Yes.

21

APPENDIX I

Qualifications of Marylee Diaz Cortez

- EDUCATION:** University of Michigan, Dearborn
B.S.A., Accounting 1989
- CERTIFICATION:** Certified Public Accountant - Michigan
Certified Public Accountant - Arizona
- EXPERIENCE:** Audit Manager
Residential Utility Consumer Office
Phoenix, Arizona 85007
July 1994 - Present

Responsibilities include the audit, review and analysis of public utility companies. Prepare written testimony, schedules, financial statements and spreadsheet models and analyses. Testify and stand cross-examination before Arizona Corporation Commission. Advise and work with outside consultants. Work with attorneys to achieve a coordination between technical issues and policy and legal concerns. Supervise, teach, provide guidance and review the work of subordinate accounting staff.

Senior Rate Analyst
Residential Utility Consumer Office
Phoenix, Arizona 85004
October 1992 - June 1994

Responsibilities included the audit, review and analysis of public utility companies. Prepare written testimony and exhibits. Testify and stand cross-examination before Arizona Corporation Commission. Extensive use of Lotus 123, spreadsheet modeling and financial statement analysis.

Auditor/Regulatory Analyst
Larkin & Associates - Certified Public Accountants
Livonia, Michigan
August 1989 - October 1992

Performed on-site audits and regulatory reviews of public utility companies including gas, electric, telephone, water and sewer throughout the continental United States. Prepared integrated proforma financial statements and rate models for some of the largest public utilities in the United States. Rate models consisted

of anywhere from twenty to one hundred fully integrated schedules. Analyzed financial statements, accounting detail, and identified and developed rate case issues based on this analysis. Prepared written testimony, reports, and briefs. Worked closely with outside legal counsel to achieve coordination of technical accounting issues with policy, procedural and legal concerns. Provided technical assistance to legal counsel at hearings and depositions. Served in a teaching and supervisory capacity to junior members of the firm.

RESUME OF RATE CASE AND REGULATORY PARTICIPATION

| <u>Utility Company</u> | <u>Docket No.</u> | <u>Client</u> |
|-------------------------------|-----------------------|---|
| Potomac Electric Power Co. | Formal Case No. 889 | Peoples Counsel of District of Columbia |
| Puget Sound Power & Light Co. | Cause No. U-89-2688-T | U.S. Department of Defense - Navy |
| Northwestern Bell-Minnesota | P-421/EI-89-860 | Minnesota Department of Public Service |
| Florida Power & Light Co. | 890319-EI | Florida Office of Public Counsel |
| Gulf Power Company | 890324-EI | Florida Office of Public Counsel |
| Consumers Power Company | Case No. U-9372 | Michigan Coalition Against Unfair Utility Practices |
| Equitable Gas Company | R-911966 | Pennsylvania Public Utilities Commission |
| Gulf Power Company | 891345-EI | Florida Office of Public Counsel |

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|------------------------------------|-------------------------------|---|
| Jersey Central Power & Light | ER881109RJ | New Jersey Department of Public Advocate Division of Rate Counsel |
| Green Mountain Power Corp. | 5428 | Vermont Department of Public Service |
| Systems Energy Resources | ER89-678-000 & EL90-16-000 | Mississippi Public Service Commission |
| El Paso Electric Company | 9165 | City of El Paso |
| Long Island Lighting Co. | 90-E-1185 | New York Consumer Protection Board |
| Pennsylvania Gas & Water Co. | R-911966 | Pennsylvania Office of Consumer Advocate |
| Southern States Utilities | 900329-WS | Florida Office of Public Counsel |
| Central Vermont Public Service Co. | 5491 | Vermont Department of Public Service |
| Detroit Edison Company | Case No. U-9499 | City of Novi |
| Systems Energy Resources | FA-89-28-000 | Mississippi Public Service Commission |
| Green Mountain Power Corp. | 5532 | Vermont Department of Public Service |
| United Cities Gas Company | 176-717-U | Kansas Corporation Commission |

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| General Development Utilities | 911030-WS & 911067-WS | Florida Office of Public Counsel |
| Hawaiian Electric Company | 6998 | U.S. Department of Defense - Navy |
| Indiana Gas Company | Cause No. 39353 | Indiana Office of Consumer Counselor |
| Pennsylvania American Water Co. | R-00922428 | Pennsylvania Office of Consumer Advocate |
| Wheeling Power Co. | Case No. 90-243-E-42T | West Virginia Public Service Commission Consumer Advocate Division |
| Jersey Central Power & Light Co. | EM89110888 | New Jersey Department of Public Advocate Division of Rate Counsel |
| Golden Shores Water Co. | U-1815-92-200 | Residential Utility Consumer Office |
| Consolidated Water Utilities | E-1009-92-135 | Residential Utility Consumer Office |
| Sulphur Springs Valley Electric Cooperative | U-1575-92-220 | Residential Utility Consumer Office |
| North Mohave Valley Corporation | U-2259-92-318 | Residential Utility Consumer Office |
| Graham County Electric Cooperative | U-1749-92-298 | Residential Utility Consumer Office |

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| Graham County Utilities | U-2527-92-303 | Residential Utility Consumer Office |
| Consolidated Water Utilities | E-1009-93-110 | Residential Utility Consumer Office |
| Litchfield Park Service Co. | U-1427-93-156 & U-1428-93-156 | Residential Utility Consumer Office |
| Pima Utility Company | U-2199-93-221 & U-2199-93-222 | Residential Utility Consumer Office |
| Arizona Public Service Co. | U-1345-94-306 | Residential Utility Consumer Office |
| Paradise Valley Water | U-1303-94-182 | Residential Utility Consumer Office |
| Paradise Valley Water | U-1303-94-310 & U-1303-94-401 | Residential Utility Consumer Office |
| Pima Utility Company | U-2199-94-439 | Residential Utility Consumer Office |
| SaddleBrooke Development Co. | U-2492-94-448 | Residential Utility Consumer Office |
| Boulders Carefree Sewer Corp. | U-2361-95-007 | Residential Utility Consumer Office |
| Rio Rico Utilities | U-2676-95-262 | Residential Utility Consumer Office |
| Rancho Vistoso Water | U-2342-95-334 | Residential Utility Consumer Office |
| Arizona Public Service Co. | U-1345-95-491 | Residential Utility Consumer Office |
| Citizens Utilities Co. | E-1032-95-473 | Residential Utility Consumer Office |
| Citizens Utilities Co. | E-1032-95-417 et al. | Residential Utility Consumer Office |

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| Paradise Valley Water | U-1303-96-283 & U-1303-95-493 | Residential Utility Consumer Office |
| Far West Water | U-2073-96-531 | Residential Utility Consumer Office |
| Southwest Gas Corporation | U-1551-96-596 | Residential Utility Consumer Office |
| Arizona Telephone Company | T-2063A-97-329 | Residential Utility Consumer Office |
| Far West Water Rehearing | W-0273A-96-0531 | Residential Utility Consumer Office |
| SaddleBrooke Utility Company | W-02849A-97-0383 | Residential Utility Consumer Office |
| Vail Water Company | W-01651A-97-0539 & W-01651B-97-0676 | Residential Utility Consumer Office |
| Black Mountain Gas Company Northern States Power Company | G-01970A-98-0017 G-03493A-98-0017 | Residential Utility Consumer Office |
| Paradise Valley Water Company Mummy Mountain Water Company | W-01303A-98-0678 W-01342A-98-0678 | Residential Utility Consumer Office |
| Bermuda Water Company | W-01812A-98-0390 | Residential Utility Consumer Office |
| Bella Vista Water Company Nicksville Water Company | W-02465A-98-0458 W-01602A-98-0458 | Residential Utility Consumer Office |
| Paradise Valley Water Company | W-01303A-98-0507 | Residential Utility Consumer Office |
| Pima Utility Company | SW-02199A-98-0578 | Residential Utility Consumer Office |
| Far West Water & Sewer Company | WS-03478A-99-0144 Interim Rates | Residential Utility Consumer Office |
| Vail Water Company | W-01651B-99-0355 Interim Rates | Residential Utility Consumer Office |

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| Far West Water & Sewer Company | WS-03478A-99-0144 | Residential Utility Consumer Office |
| Sun City Water and Sun City West | W-01656A-98-0577 & SW-02334A-98-0577 | Residential Utility Consumer Office |
| Southwest Gas Corporation ONEOK, Inc. | G-01551A-99-0112 G-03713A-99-0112 | Residential Utility Consumer Office |
| Table Top Telephone | T-02724A-99-0595 | Residential Utility Consumer Office |
| U S West Communications Citizens Utilities Company | T-01051B-99-0737 T-01954B-99-0737 | Residential Utility Consumer Office |
| Citizens Utilities Company | E-01032C-98-0474 | Residential Utility Consumer Office |
| Southwest Gas Corporation | G-01551A-00-0309 & G-01551A-00-0127 | Residential Utility Consumer Office |
| Southwestern Telephone Company | T-01072B-00-0379 | Residential Utility Consumer Office |
| Arizona Water Company | W-01445A-00-0962 | Residential Utility Consumer Office |
| Litchfield Park Service Company | W-01427A-01-0487 & SW-01428A-01-0487 | Residential Utility Consumer Office |
| Bella Vista Water Co., Inc. | W-02465A-01-0776 | Residential Utility Consumer Office |
| Generic Proceedings Concerning Electric Restructuring Issues | E-00000A-02-0051 | Residential Utility Consumer Office |
| Arizona Public Service Company | E-01345A-02-0707 | Residential Utility Consumer Office |
| Qwest Corporation | RT-00000F-02-0271 | Residential Utility Consumer Office |

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| Arizona Public Service Company | E-01345A-02-0403 | Residential Utility Consumer Office |
| Citizens/UniSource | G-01032A-02-0598 E-01032C-00-0751 E-01933A-02-0914 E-01302C-02-0914 G-01302C-02-0914 | Residential Utility Consumer Office |
| Arizona-American Water Company | WS-01303A-02-0867 | Residential Utility Consumer Office |
| Arizona Public Service Company | E-01345A-03-0437 | Residential Utility Consumer Office |
| UniSource | E-04230A-03-0933 | Residential Utility Consumer Office |
| Arizona Public Service Company | E-01345A-04-0407 | Residential Utility Consumer Office |
| Southwest Gas Corporation | G-01551A-04-0876 | Residential Utility Consumer Office |
| Arizona-American Water Company | W-1303A-05-0280 | Residential Utility Consumer Office |