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BEFORE THE ARIZONA CORPORATION COM

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Commissioner

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AZ CORP COMMISSION
DOCUMENT CONTROL

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

Docket No. T-01051B-03-0454

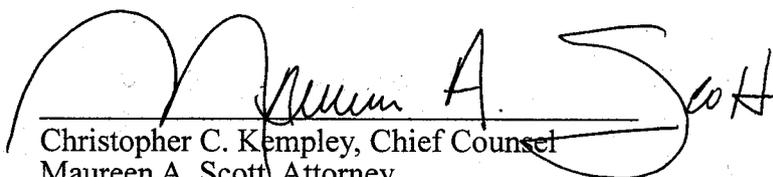
11 IN THE MATTER OF THE INVESTIGATION OF
12 THE COST OF TELECOMMUNICATIONS
13 ACCESS

Docket No. T-00000D-00-0672

**NOTICE OF FILING TESTIMONY
SUMMARIES**

14 The Arizona Corporation Commission Staff ("Staff") hereby files the Summaries of
15 Testimony in Support of the Settlement Agreement filed by Mike Brosch (Utilitech), Steve Carver
16 (Utilitech) and Bill Dunkel (Dunkel & Associates).

17 RESPECTFULLY submitted this 1st day of November, 2005.

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**SUMMARY OF
SUPPLEMENTAL TESTIMONY OF MICHAEL L. BROSCHE
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

My Supplemental Testimony explains the conceptual framework of price cap regulation, as an alternative to traditional rate case proceedings. I describe several intended benefits associated with price cap regulation, relative to traditional cost-based rate of return regulation. These benefits include pricing stability for consumers, improved regulatory efficiency, the promotion of operational efficiency by decoupling costs from prices and the ability of price cap carriers to better respond to changing market conditions. I sponsor excerpts from a National Regulatory Research Institute study that illustrates how price cap regulation has become the most commonly applied regulatory regime among state regulator agencies for the larger incumbent local exchange carriers like Qwest.

I also explain how the agreed upon \$31.8 million revenue deficiency is distributed among baskets in my Supplemental Testimony. No revenue pricing increases are permitted for hard-capped retail services within Basket 1, while Basket 2 price increases cannot exceed \$1.8 million in year one and \$13.8 million thereafter. Access charge revenues are reduced by \$12 million annually in each year of the Plan on a revenue neutral basis. The most competitive services that are contained in Basket 3 will receive the remaining unused portion of the aggregate overall revenue deficiency, after accounting for the access revenue reductions and any implemented Basket 2 price increases.

The final topic addressed in my Supplemental Testimony is the improved financial reporting to the Commission that Qwest is obligated to provide under the Renewed Price Cap Plan.

**SUMMARY OF
SUPPLEMENTAL TESTIMONY OF STEVEN C. CARVER
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

In conjunction with other Staff witnesses, I filed supplemental testimony discussing the overall revenue deficiency of \$31.8 million agreed to by the Parties¹ and explaining why that amount is reasonable. My supplemental testimony also recommends that the Commission find as reasonable the fair value rate base, rate of return and adjusted operating income underlying the negotiated revenue deficiency.

The terms of the Settlement Agreement allow Qwest to recover the \$31.8 million revenue deficiency by only increasing the prices for competitive services (i.e., services in Basket 2 and Basket 3). The \$31.8 million revenue deficiency is significantly less than the original cost amounts asserted in the Company's direct (\$318.5 million) and rebuttal (\$271.2 million) testimony filings. This amount is also significantly less than the \$160 million supported by RUCO in direct testimony.

In arriving at the \$31.8 million revenue deficiency, the confidential negotiations did involve discussions of individual rate case issues, but the Settlement Agreement represents a packaged resolution of all revenue requirement issues without specific findings to resolve each issue. However, Sections 3 through 6 of the Settlement Agreement do identify certain revenue requirement issues specifically resolved by the Parties.²

During the course of this proceeding, extensive testimony was filed by both Qwest and Staff on the adoption and ratemaking recognition of SOP 98-1 and FAS106. For Arizona regulatory accounting, reporting and revenue requirement purposes, Section 3 of the Settlement Agreement sets forth a negotiated resolution of both accounting issues.³

Although there are many different ways to support a revenue requirement settlement that is not based on specific outcomes for particular issues, Staff revised or corrected its prefiled accounting adjustments in five areas⁴ in determining that the \$31.8 million revenue deficiency was reasonable. Overall, these changes and revisions caused

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").

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 The Parties agreed to recognize the adoption of SOP 98-1 effective January 1, 2001, and FAS106 effective April 1, 2001. 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.

⁴ SOP 98-1 (Software), FAS106 (OPEB Costs), FCC Deregulated Services (corrections), Qwest Update (corrections) and Depreciation (negotiated accrual rates).

SUMMARY OF SUPPLEMENTAL TESTIMONY OF STEVEN C. CARVER

PAGE 2

the \$3.5 million revenue deficiency recommendation presented in Staff's Direct testimony to increase to \$31.8 million, which remains significantly below the filed revenue deficiency recommendation of any other Party to this proceeding.

Section 1 of the Settlement Agreement sets forth the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 2003, at \$1,507.7 million. This amount agrees with Staff's proposed rate base, after revision and correction. The Parties agreed to a 9.5% fair rate of return, which is equal to the weighted cost of capital originally proposed by Staff. Recognizing the uncertainty associated with litigating the various operating income issues, the Parties agreed that Qwest's Adjusted Net Operating Income of \$124.4 million at present rate levels was reasonable. These values result in the \$31.8 million revenue deficiency, which should be adopted by the Commission.

**SUMMARY OF
SUPPLEMENTAL TESTIMONY OF WILLIAM DUNKEL
QWEST CORPORATION
DOCKET NOS. T-01051B-03-0454 & T-00000D-00-0672**

In my opinion, the resolutions set forth in the Settlement Agreement are reasonable and in the public interest on the issues I address in my testimony.

Depreciation Issues in the Settlement Agreement

The depreciation and amortization as set forth in the Settlement Agreement are reasonable and in the public interest. Depreciation and amortization are discussed in Section 4 of the Settlement Agreement, and the depreciation rates and amortization agreed upon by the Parties are shown on Attachment B to that Agreement. The amount of intrastate depreciation and amortization expense reduction that results from the Settlement Agreement is very close to the reduction that would result from the Staff testimony position on this issue. The Staff Direct Testimony recommendations would have resulted in a \$250 million annual reduction. The Settlement Agreement results in a \$255 million annual reduction for each of the first five years, and a \$225 million annual reduction thereafter. The Settlement Agreement annual expense reduction exceeds the original Qwest proposed reduction by approximately \$145 million for each of the first five years, and exceeds the original Qwest proposed reduction by approximately \$115 million annually thereafter.

BSI construction related charges in the Settlement Agreement

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

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

DSL allocation issue in the Settlement Agreement.

The DSL allocation issue is addressed in Section 5 of the Settlement Agreement. DSL revenues are not considered intrastate jurisdictional revenues. However, Qwest was been separating a significant portion of the DSL costs into the intrastate jurisdiction, as discussed in Staff testimony. In the Settlement Agreement, Staff and Qwest have agreed

SUMMARY OF SUPPLEMENTAL TESTIMONY OF WILLIAM DUNKEL

PAGE 2

the \$3.5 million revenue deficiency recommendation presented in Staff's Direct testimony to increase to \$31.8 million, which remains significantly below the filed revenue deficiency recommendation of any other Party to this proceeding.

Section 1 of the Settlement Agreement sets forth the "fair value" of Qwest's Arizona rate base for the test year ending December 31, 2003, at \$1,507.7 million. This amount agrees with Staff's proposed rate base, after revision and correction. The Parties agreed to a 9.5% fair rate of return, which is equal to the weighted cost of capital originally proposed by Staff. Recognizing the uncertainty associated with litigating the various operating income issues, the Parties agreed that Qwest's Adjusted Net Operating Income of \$124.4 million at present rate levels was reasonable. These values result in the \$31.8 million revenue deficiency, which should be adopted by the Commission.